Paragon Bank PLC
Registered No: 05390593

Paragon Bank PLC

Annual Report & Accounts

For the year ended 30 September 2023

CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report, the Strategic Report and the Directors' Remuneration Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Paragon Banking Group Plc ('PBG'). 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 also a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, and the extent of their impact on overall demand for the 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; social unrest; acts of terrorism and other acts of hostility or war and responses to, and consequences of those acts; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the 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 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	
	2023 £m	2022 £m	2023 £m	2022 £m
Mortgages	1,875.6	1,900.9	10,968.2	8,884.1
Commercial Lending	152.7	226.1	466.4	439.5
	2,028.3	2,127.0	11,434.6	9,323.6

The Bank's total loan book increased by 22.6% in the year following a 14.8% increase in the preceding year. The Bank continued to pursue its strategy objective of managed, targeted growth in challenging market conditions. Total advances decreased 6.4% year-on-year, although the pattern of movements was not consistent between the Group's specialist markets, with the complex economic situation seen in the year impacting different business lines to varying degrees.

MORTGAGES

The Bank offers buy-to-let first charge 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.

	2023 £m	2022 £m
First charge buy-to-let	1,875.6	1,899.9
First charge owner-occupied	-	1.0
	1,875.6	1,900.9

Total mortgage originations in the Bank decreased by only 1.3%, despite the constriction seen in the housing and mortgage markets more generally resulting in an increased market share of new lending. This is partly due to the Bank's pipeline hedging policy, which enabled mortgage offers in process at the start of the year to be satisfied, where many lenders had to withdraw offers as a result of rising market interest rates. 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's first charge mortgage lending has been carefully managed to ensure that owner occupied lending only with appropriate risks and returns is undertaken, as a consequence no advances were seen during the year.

STRATEGIC REPORT (Continued)

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 2023 £m	30 September 2022 £m
Originated assets		
First charge buy-to-let	10,829.0	8,697.8
First charge owner-occupied	22.5	28.0
Second charge	75.8	104.4
	10,927.3	8,830.2
Acquired assets		
Second charge	40.9	53.9
	10,968.2	8,884.1

At 30 September 2023 the balance on the Bank's mortgage portfolio was 23.5% higher than a year earlier, with the buy-to-let book having grown by 24.5%.

The annualised redemption rate on all mortgage assets is at 8.5% (2022: 8.4%), has continued at a relatively low level. This is despite the potential impact of rising rates on customers whose interest charges are linked to reference rates, and the increasing numbers of five-year products now reaching the end of their fixed rate periods.

Arrears on the buy-to-let book increased in the year to 0.34% (2022: 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 0.06% (2022: 0.09%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.69% across the buy-to-let sector at 30 September 2023 (2022: 0.41%), though still less than the arrears seen in the wider mortgage market.

Arrears on originated second charge mortgages increased to 2.41% from 1.88% 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 increased to 13.5% (2022: 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)

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

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

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.

	2023	**2022**
	£m	**£m**
Motor finance	162.2	166.2
Structured lending	(9.5)	59.9
	152.7	226.1

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

These facilities generally fund non-bank lenders of various kinds, providing the Bank with increased product diversification and are constructed to provide a credit buffer in the event of default in the ultimate customer population. The Group's experienced account managers receive regular reporting on the performance of the security assets, and maintain a high level of contact with clients to safeguard its position. To date the Bank has recorded no losses on any of its structured lending facilities.

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

STRATEGIC REPORT (Continued)

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, including static caravans.

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

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

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

	30 September 2023 £m	**30 September 2022 £m**
Motor finance	297.4	260.8
Structured lending	169.0	178.7
	466.4	439.5

Margins on commercial lending have remained strong. Arrears on the commercial lending business remain low with arrears in the motor finance business at 1.08% (2022: 1.58%).

GROUP ENTITIES

During the period the amounts loaned to other Group entities decreased to £1,404.6 million (2022: £1,610.9 million). The decrease principally resulted from the repayment of loans provided to subsidiaries of the Bank following the repayment of issued debt held by these entities.

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 2023 and 30 September 2022 is summarised as follows:

	2023 £m	2022 £m
Retail deposit balances	13,265.3	10,669.2
Central bank facilities	2,750.0	2,750.0
Sale and repurchase agreements	50.1	-
Total on balance sheet funding	16,065.4	13,419.2
Off balance sheet central bank facilities	-	-
	16,065.4	13,419.2

RETAIL FUNDING

The Bank's retail deposit balance grew by 24.3% in the year to £13,265.3 million (2022: £10,669.2 million). The Bank considers the retail deposit market to be a reliable, scalable and cost-effective source of funding, with the Bank's strategy centred on offering sterling deposits products to UK households through a streamlined online presence, supported by an outsourced administration function, with additional routes to market provided by third party platforms.

Products include cash ISAs, where the Bank has a significant market presence, term and notice deposits and easy access accounts. The proposition is based on competitive rates and value for money, combined with the Bank's strong customer service ethic and the protection provided to depositors by the Financial Services Compensation Scheme ('FSCS'). The protection provided to depositors by the FSCS both incentivises larger savers to divide their deposits between several institutions and reduces the perceived risk for customers in using less familiar institutions, providing market opportunities for the Bank's offering. At 30 September 2023, this FSCS protection covered around 95% of the Bank's deposit balances

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

Savings accounts at the year end are analysed below.

	Average interest rate		Proportion of deposits	
	2023 %	2022 %	2023 %	2022 %
Fixed rate deposits	4.07%	1.74%	65.5%	58.1%
Variable rate deposits	3.74%	1.55%	34.5%	41.9%
All balances	3.95%	1.66%	100.0%	100.0%

STRATEGIC REPORT (Continued)

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

This rise in market savings rates was, however, not as large as that seen for market benchmark rates. During the year the SONIA benchmark increased from 2.19% at 30 September 2022 to 5.18% at 30 September 2023, meaning that the average variable rate paid by the Bank represented a 123 basis point discount to SONIA (2022: 53 basis points) continuing the widening trend seen in the previous financial year. This represented a general realignment of borrowing and lending rates across the sector and increased the attractiveness of deposit funding compared to wholesale funds, which are generally priced at a margin above SONIA.

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

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

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

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

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

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

STRATEGIC REPORT (Continued)

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

CENTRAL BANK FACILITIES

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

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

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

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 increased in the year from £356.0 million at 30 September 2022 to £389.1 million at 30 September 2023.

DIVIDENDS AND DISTRIBUTIONS

During the year the Bank paid an interim dividend of £118.3 million (2022: £150.3 million). With a growing balance sheet and with a view to future growth opportunities the Bank did not declare a final dividend in respect of its earnings for the year ended Sept 2023 (2022: £139.8 million). The Bank anticipates making a dividend payment in respect of its 2023 profit during the year ended 30 September 2024, subject to its anticipated capital requirements and its trading performance.

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.

STRATEGIC REPORT (Continued)

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

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the 'fully loaded' basis. The 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.

		2023 £m	2022 £m
CET1 capital	Basic	1,105.7	1,086.3
	Fully loaded	1,092.4	1,060.9
TRC	Basic	1,255.7	1,236.3
	Fully loaded	1,242.4	1,210.9

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

The Financial Policy Committee of the Bank of England has stated that it expects 2.0% to be the long-term standard level of the UK CCyB. Further buffers may be set by the PRA on a firm-by-firm basis but cannot be disclosed

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

		2023	2022
CET1 ratio	Basic	14.5%	14.5%
	Fully loaded	14.3%	14.2%
TCR	Basic	16.4%	16.5%
	Fully loaded	16.3%	16.2%
UK leverage ratio	Basic	7.1%	7.1%
	Fully loaded	7.0%	6.9%

STRATEGIC REPORT (Continued)

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.

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

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

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

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 193.7% compared to 146.2% during the 2022 financial year. This increase, which was particularly marked towards the end of the year, represents a build-up of retail funding in advance of settlement of wholesale borrowings just before the year-end, and in anticipation of payment of TFSME indebtedness in the early part of the new financial year described above. It also includes the impact of £383.4 million of swap collateral held in cash, (2022: £388.6 million)

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

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 decreased to £232.6 million in 2023 (2022: £480.2 million).

	£m	£m
Interest receivable	852.4	368.0
Interest payable and similar charges	(536.8)	(147.0)
Net interest income	315.6	221.0
Other operating income	108.7	174.4
Total operating income	424.3	395.4
Operating expenses	(117.4)	(99.8)
Provisions for losses	(10.5)	(6.6)
	296.4	289.0
Fair value net (loss) / gain	(63.8)	191.2
Operating profit being profit on ordinary activities before taxation	232.6	480.2
Tax charge on profit on ordinary activities	(36.4)	(85.8)
Profit on ordinary activities after taxation	196.2	394.4

The Bank's total operating income in the year increased by 7.3% to £424.3 million (2022: 395.4 million).

Net interest income increased by 42.8% to £315.6 million from the £221.0 million recorded in the year ended 30 September 2022. The increase principally reflects growth in the size of the loan book, which rose by 22.6% to £11,434.6 million over the year (2022: £9,323.6 million) and from an improvement in net interest margin ('NIM').

Other operating income in 2023 included £96.50 million of dividends from subsidiary companies (2022: £156.0 million) and £8.5 million of deferred sale consideration (2022: £14.9 million). Aside from this, fee income increased slightly to £3.7 million (2022: £3.5 million).

Operating expenses increased to £117.4 million from £99.8 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 £10.5 million (2022: £6.6 million). This results partly from experience in the year, where a number of portfolios have seen some increased evidence of delinquency, but also from management's view of the potential impact of the current high interest rate environment on its customers. The increases in the cost of living and of doing business, both those experienced over the last twelve months, and the further increases expected in the near term, being the main drivers for this behaviour.

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

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.

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

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

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

The Bank has constructed the scenarios required for its ECL modelling based on a number of forecasts from public and private bodies, synthesised to produce internally coherent sets of data. The central scenario is that used for the Bank's planning process, while upside and downside scenarios have been derived from this.

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

Overall, the forecasts represent an environment of interest rate expectations continuing at historically high levels, a decline in property values, especially in the short term, minimal growth and inflation generally falling, although remaining at high levels compared to recent history.

Given the potential range of longer term outcomes, the Group has maintained the weightings attributable to each scenario in its modelling at the levels used at the previous year end. The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 17.

STRATEGIC REPORT (Continued)

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

During the 2022 financial year, particularly during the second half, there was a significant level of volatility in UK benchmark interest rate expectations, resulting in a fair value gain of £191.2 million being recorded in the year. This impact having been amplified by the Bank's approach to pipeline hedging and the retention strategy applied to maturing five-year fixed loans, which meant that the pipeline was larger and of longer duration (and hence more exposed to movements in rates) than in earlier periods.

In the year ended 30 September 2023 the levels of volatility in market rates reduced, with longer term market rate expectations moderating, which, coupled with the conversion of loans which had been part of the hedged pipeline at the start of the year, and the consequent commencement of the run-off of hedging gains related to those loans, resulted in much of the previous period's gain being unwound and a fair value loss of £63.8 million being reported

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.

Corporation tax has been charged at the rate of 15.7%, decreasing from 17.9% 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 26.7% (2022: 26.5%).

Profit after taxation of £196.2 million (2022: £394.4 million) have been transferred to equity, which totalled £1,001.5 million at the year end (2022: £1,063.4 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 112 to 122 and in notes 38 to 42. A discussion of critical accounting estimates is set out in note 45.

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.

STRATEGIC REPORT (Continued)

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

14 December 2023

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="2">Capital Risk</th></tr>
<tr><th>Description</th><th>Mitigation</th></tr>
<tr><td>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.

The Bank of England have yet to publish their final policy for the implementation of the Basel 3.1 standards in the UK, which is currently intended to be effective from 1 July 2025.</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.

The Bank continues to engage with the PRA in respect of its application for the accreditation of its IRB approach to buy-to-let credit risk for capital adequacy purposes, responding to feedback as the regulator proceeds with its internal assessment process.

The Bank of England Basel 3.1 proposals largely follow the core Basel proposals and, as such, are materially in line with expectations. The Consultation Paper also highlighted enhancements to the IRB accreditation process, which would have a favourable impact on the Group if retained in the ultimate rules.</td></tr>
<tr><td>Year on year change</td><td>While there has been little impact on the overall capital risk framework in the financial year, the global and UK economic outlook has continued to be subject to the pressures which arose following Russia’s intervention in Ukraine, although these have not worsened significantly over the period.

Although downside risks will present headwinds, the Bank’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 both retail and wholesale funding sources to cover current and future business requirements. Comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due, even under stressed conditions. The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding. The Board, through the delegated authority provided to the ALCO, sets limits for the level, composition and maturity of funding and liquidity resources. The Bank's holdings of its own mortgage backed securities, together with assets pre-positioned with the Bank of England, mean that it has ready access to wholesale funding or liquidity if required.
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, resulting in increased levels of liquid assets being held, and higher LCR and OLAR levels year-on-year. Despite a number of market disruptions during the year, including a number of bank failures in March and April 2023, liquidity risk is considered to have reduced from its level at the start of the year, when it was elevated by the fallout from the September 2022 'mini-budget'.

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.	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 mismatches.
Year on year change	While the rise in the Bank of England base rate to its highest level in over a decade has increased volatility in pricing levels on both the asset and liability sides of the balance sheet, requiring particular focus on risk management in this area, markets were generally more stable at 30 September 2023 than a year earlier. The Bank's overall market risk profile, relative to its balance sheet, has remained broadly similar to that at the previous year end, and therefore associated risk levels remain generally stable compared to the previous period end.

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">Higher interest rates, rising costs, and resource shortages have been a key feature of the lending environment within the last twelve months. However, the Bank's prudent credit policies combined with consistently high lending standards, have ensured that the impact on customer loan repayments has been modest so far. Arrears remain favourable compared with historical levels, with impacts being generally confined to early arrears states as borrowers adjust their cashflows to accommodate the higher costs. Tracking of customer risk profiles across lending areas shows little indication of stress, and asset equity coverage continues to provide significant credit risk mitigation.

Whilst current loan performance remains robust, the Bank continues to monitor the potential future impacts of the increased interest rate environment, house price movements and higher costs of living and doing business, and has reviewed and adjusted credit policy and affordability models accordingly. As a result of these broader economic movements, in particular the rapid increase in market interest rates, the credit risk profile is considered to have increased compared to 30 September 2022.</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Model Risk</th></tr>
<tr><th colspan="2">Description</th><th>Mitigation</th></tr>
<tr><td colspan="2">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.</td><td>A robust framework of management and governance is in place to manage the risks associated with the use of internally developed models. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Group.

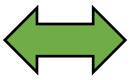
The Model Risk Management Framework provides a structured and disciplined approach to the management of model risk. It includes clear development, implementation and ongoing oversight principles, together with requirements for independent validation based on model materiality criteria.

PRA Supervisory Statement SS 1/23, which addresses model risk management principles for banks and applies to firms with permission to use internal models to calculate regulatory capital, was published in the year. Firms have twelve months from the grant of such permissions to comply with the expectations of the SS. The Bank has begun a programme of work to ensure compliance with the principles in advance of the Bank receiving IRB accreditation, and is well-placed to meet the requirements within the timeframes required.</td></tr>
<tr><td>Year on year change</td><td colspan="2">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 and the Group's continuing investment in this area, model risk remains within appetite and the outlook remains stable.</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

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 internal actions and external events, as a consequence of the crystallisation of other principal risks, or through failure to safeguard the integrity of the Bank's brand or meet external expectations in its business practices.	The reputational risk policy supports reputational risk management across the Bank. Reputational issues are considered at Board and ExCo level and, where relevant, will be identified, reviewed and escalated through risk committee governance. The reputational impacts of changes to strategy, pricing, people, processes or third-party relationships are explicitly considered in the decision-making process and are reviewed by the Director of External Relations. The Bank will not undertake any activity it considers might be damaging to its reputation. Employees adhere to defined standards of conduct, encompassing policies, procedures and ways of working. These are defined in the Group's Code of Conduct. The Group has an experienced External Relations function which manages all Bank communications and ensures that the reputational profile of the Bank is protected. Reputational risk is monitored through tracking traditional and social media coverage, net promoter scores, review platforms and regular customer surveys. Any 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

Strategic Risk	
Description	**Mitigation**
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.	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.
Year on year change 	Whilst the political and economic landscape has stabilised somewhat over the year, there remains some uncertainty around the performance of the UK economy in both the near and longer term. Material increases in the cost of living, interest rates and businesses input costs, continue to put pressure on household and corporate disposable income. The full impacts of this uncertainty, coupled with implications of the UK's new trading relationships post-Brexit, are still to be fully determined, as are those of any potential change of political direction, with a UK general election due before January 2025. Despite the wider economic challenges, the Bank has remained resilient throughout the year, and has made strong progress in meeting the strategic targets in its corporate plan. In particular it has continued to make significant progress in its digitalisation programme which remains a key priority. Notwithstanding the apparently more benign economic situation and its continuing strong activity levels, the Bank recognises that the full impact of interest rate rises is unlikely to be immediate, with the potential for further economic and property market disruption into the new financial year presenting a further risk to the execution of the Bank's strategy.

PRINCIPAL RISKS AND MITIGATIONS

Climate Risk	
Description	**Mitigation**
The Group considers the impact of climate change either directly on the Group or indirectly through its third-party relationships or its lending activities. This includes 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.	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. The Group continues to actively engage with public forums such as Bankers for Net Zero ('B4NZ'), the Mission Zero Coalition and UK Finance to support the development of future policy and regulation. Ongoing and enhanced climate change analysis, supported by scenario testing, continues to be further embedded throughout the business to inform longer term strategic planning. 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.
Year on year change	The Group has continued to make progress on its climate change agenda, with activity focused on enhancing its financed emissions balance sheet, continued public policy advocacy through B4NZ, and enhancing its approach to climate change scenario analysis. The levels of regulatory scrutiny and public interest in this area continue to be high. However, the Group's approach has matured in the year, and a proportionate approach to managing the risks and opportunities associated with climate change has been maintained. Although there is significant uncertainty in respect of the direction of government policy and regulation in this area, the Group's scenario analysis assessment indicates that its exposure to climate change impacts is being managed appropriately and does not pose it a significant or increasing risk

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 and strategy. Conduct risk arises where the culture and behaviours fail to promote the customer's best interests resulting in unfair outcomes for the customer.	The management of conduct risk within the Group is tailored to the specific product and customer type and includes dedicated quality and control teams which validate process adherence, the delivery of good customer outcomes, and the appropriate management of those customers showing signs of vulnerability, including those in financial difficulties. During the year work was undertaken to review and enhance the Group's management of conduct risk in preparation for the introduction of the FCA Consumer Duty in the year. All employees are required to undertake conduct risk related training. The Group's approach to employee remuneration means that very few employees are included in financial incentive schemes. The incentive scheme framework is reviewed by the Remuneration Committee and the CCC annually and individual schemes require approval from the Chief People Officer, CFO and Conduct and Compliance Director before implementation.
Year on year change	Whilst the Bank is well-placed to provide appropriate support, the current economic environment, including the cost of living crisis, increasing input costs for businesses, and rising interest rates and mortgage payments, is likely to place strain on some of the Group's customers. This will potentially increase the risk of customer vulnerabilities, particularly in relation to financial resilience. The introduction of the FCA's Consumer Duty also raises the expectations of firms to proactively seek to prevent causes of foreseeable harm, and to identify harm when it occurs.

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. Operational risk is managed through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Information Technology, Data Protection, Change Management, Procurement, Financial Crime and People. The Group is committed to ensuring it remains resilient, particularly in respect of IT capability. Significant investment has been undertaken to ensure that the Bank is well-protected in the face of the evolution of cyber threats particularly as it increasingly moves to cloud-based infrastructure and looks to harness digital capability as part of its IT roadmap. Whilst the Group continues to drive through strategic transformation across all its lending lines, there remains a continuing focus on ensuring that these changes do not compromise overall resilience. A well-embedded change framework ensures that changes are managed in a controlled way. Operational resilience remains a key driver and consideration at all stages of the project lifecycle. The Group relies on third party providers for a number of key services including in support of its savings offering, and in respect of material IT services. The robust oversight of third parties is also seen as critical to overall resilience. The Group continues to focus on building an engaged and highly skilled workforce through the delivery of effective reward, succession planning, recruitment, development and retention strategies. In addition, the Group remains committed to the well-being of its employees, and its employee networks play a crucial role in ensuring leadership understand and can act on employee feedback.

PRINCIPAL RISKS AND MITIGATIONS

Year on year change 	The Bank does not consider itself to have a higher than average likelihood of being subject to a cyber threat, however the general threat level has significantly increased following the impacts of the conflict in Ukraine. Given the pace at which the external cyber threat level continues to evolve, the Group remains committed to investment in this area on a long-term basis, focussing on key areas such as data loss prevention and vulnerability management. Ongoing assessment of, and response to, the Group's cyber profile remains integral to successful execution of its overall strategy. Recruitment and retention in some specialisms remain challenging given wider skill shortages across the industry. Changing working patterns and economic uncertainty continue to influence the recruitment market. More generally, impacts of the war in Ukraine and the wider cost of living challenges have further increased potential risk exposures across key operational risk categories such as financial crime. Regulatory compliance expectations continue to rise, and the Group is committed to ensuring that it remains compliant in its operational activities. There is potential that as expectations increase, gaps may be identified which will need addressing to reduce inherent operational risk exposures. The Bank continues to make strong progress on its strategic transformation programme, which it anticipates will benefit operational risk management in the longer term. However, it is recognised that significant change can exacerbate operational strains in the short term. Potential for such issues is being carefully managed through robust governance and oversight. Whilst the Bank continues to maintain a robust control environment and operational risk related losses remain at historically low levels, the present operating environment poses considerable challenges which increase inherent operational risks.

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 2023.

DIRECTORS

The directors who served during the year were:

Robert D East

Nigel S Terrington

Richard J Woodman

Barbara A Ridpath

Hugo R Tudor

Graeme H Yorston

Alison C M Morris

Peter A Hill

Tanvi P Davda

Zoe L Howorth (appointed 1 June 2023)

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 2023, 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 2023 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 2023. Given the application of similar corporate governance practices to PBG and the Bank, PBG's corporate governance statement as contained in its 2023 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 2023 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 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 should be able to raise any matters of concern	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
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

DIRECTORS' REPORT (Continued)

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.	B5
L. The annual board evaluation provides an opportunity for the directors to consider their collective and individual effectiveness and decide where there are areas for improvement.	B4.4
Section 4: Audit, Risk and Internal Control	
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

In addition to good corporate governance, maintaining a reputation for high standards of business conduct in all of the Banks operations is a key priority for the board, and management of conduct risk is a key part of the risk management framework. PBG's 2023 Annual Report sets out information on corporate responsibility and sustainability, including the Group's people policies and engagement with employees, involvement in industry initiatives, support for the community and environmental, social and conduct impacts. 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 long term sustainable 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 2023, it has acted in good faith to promote the long-term sustainable 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 Company'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 2023 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

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.

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 Bank has an Investor Relations Programme, under which forty-six meetings were held with shareholders and analysts. In addition, the CEO and CFO hold regular analyst briefing meetings
- A comprehensive update on Investor Relations is included in the CEO's report presented at each Board meeting
- After commencing a wide-ranging consultation process in 2022, covering remuneration policy and other governance issues, the SID/Chair of the Remuneration Committee continued to engage with major shareholders and shareholder advisory groups before and after the PBG 2023 AGM
- 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 shareholder feedback provided helps the Board to understand the interests of the Group's shareholders and align the Group's strategy with the interests of shareholders
- Increasing shareholder interaction is helping to frame the Group's response to reporting and targeting in relation to sustainability matters, in particular climate change risk

Capital management

Growth

Diversification

Digitalisation

DIRECTORS' REPORT (Continued)

Further information on the Group's investor relations activities is given in section B4.3 of PBG's 2023 Annual Report and Accounts. Discussions with investors on remuneration matters are discussed in the Remuneration Report (Section B7) of PBG's 2023 Annual Report and Accounts.

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 2023 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.

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 took part in an insights day with the Mortgage Lending business, which included visiting the team and taking part in a question and answer session with a panel of brokers
- The Board receives Customer Insight updates bi-annually
- The Board received periodic updates on the Group's progress towards implementing the new FCA Consumer Duty principles throughout the year
- Graeme Yorston, an independent non-executive director has been designated as the Board's Consumer Duty Champion since October 2022
- Customer metrics are a key element of the Performance Share Plan ('PSP')

Outcome

- Rollout of the Think Customer initiative to all group employees
- Greater understanding of customers and their priorities is used to refine product offerings, documentation and processes
- All group 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 2023 Annual Report and Accounts.

Digitalisation

Sustainability

Diversification

Growth

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 we need a wide range of employee skills and expertise. To succeed our shared values and focus on employee engagement provide the foundation for this success and help us attract, develop and retain talent.

Sustainability

How we engage and / or monitor

- Regular group-wide anonymous employee engagement surveys are conducted, most recently in the current year
- The Chief People Officer updates the Board and ExCo on group employee feedback from surveys and from the People Forum, as well as other metrics
- The Chair and non-executive directors attend the Group's employee-led People Forum on a regular basis
- Designated ExCo members with responsibility for gender diversity and wider diversity regularly report progress on these matters
- The Group's EDI network is sponsored by a member of ExCo and, throughout the year, members of the Board and ExCo have attended employee listening circles
- The Nomination Committee receives six-monthly updates on succession planning and feedback from the EDI network from the Chief People Officer
- People metrics are a key element of the PSP

Outcome

- 88% of employees took part in the engagement survey and the Group achieved an overall score of 90%, the Group's highest score in eight years
- The Group is accredited as an Investor in People with Platinum IIP status
- Feedback from the People Forum and regular updates from the Chief People Officer enable the Board to support and understand employees and their engagement
- Tailored career development programmes embedded across the Group for apprentices through to high potential senior leaders
- The launch of the Paragon Moments Rewards apps which allows employees to recognise the performance of colleagues who demonstrate one or more of the Group's values.

Further information on the involvement of the Group's people and the impact of policies on them can be found in section A6.3 of PBG's 2023 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

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 standards.

How we engage and / or monitor

- Regular engagement with the PRA throughout the year on key regulatory matters, including the IRB implementation
- Direct contact between the Chair and non-executive directors and regulators
- ExCo and the Board are kept updated on all interaction with the FCA and PRA
- Senior Managers and Certification Regime ('SMCR') is embedded across the Group, with conduct measures monitored monthly, overseen by the Executive Risk Committee
- 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 continues to identify instances of potential risk adjustment for MRTs and others on a structured and formal basis

Further information on the Group's tax policies is set out in Section A6.5 of PBG's 2023 Annual Report and Accounts.

Capital management

Sustainability

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. Our commitment includes active involvement in a range of community volunteering and charity partnerships.

Sustainability

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
- Group employees support a nominated charity each year via payroll donations and fund-raising efforts
- All group employees are given one day per year to volunteer for specific initiatives

Outcome

- In the twelve months ended 30 September 2023 employees had raised over £45,000 for Newlife, a disabled children's charity
- The Group's Charity Committee is sponsored by a member of ExCo
- Group employees were supported to take part in a range of volunteering activities
- 469 employee volunteering days across the Group were used to support specific initiatives in local communities

Further information on the Group's community involvement is set out in Section A6.5 of PBG's 2023 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.

Sustainability

How we engage and / or monitor

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

Outcome

- The Group offers a range of green mortgages which encourage landlords to invest in energy efficient properties
- Loans to finance battery electric vehicles, including light commercial vehicles, are offered by the Group's motor finance business
- The Board has objectives in place against current energy performance to further reduce consumption
- Operational emissions for the year have been offset with purchased carbon credits certified 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
- All employees undertook training focussed on sustainability issues during the financial year

DIRECTORS' REPORT (Continued)

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 2023 Annual Report and Accounts.

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
- The Board met with a selection of mortgage intermediaries as part of its Mortgage Lending insight day
- 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 its overall approach to supplier engagement and its expectations of its suppliers
- A comprehensive questionnaire covering broad sustainability topics was issued to critical suppliers

Digitalisation

Sustainability

Outcome

- Intermediary feedback key to updating and streamlining operational systems
- Our suppliers understand the minimum standards we expect from them and our commitments and expectations around bribery and corruption, data protection and modern slavery
- Ongoing engagement with our key suppliers ensuring operational resilience and reduced risk
- Results of the Group's 2022 supplier survey were used to inform the ongoing development of its supplier management and procurement process
- The Group is a signatory to the UK's Prompt Payment Code, and ensuring that suppliers are paid promptly is a priority

The Group's management of business partner relationships is discussed further in Section A6.7 of PBG's 2023 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

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. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

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.

POLITICAL CONTRIBUTIONS

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

DIVIDENDS

An interim dividend of 21.4 pence per share was paid in the year (2022: 27.2 pence per share), a final dividend of nil is proposed (2022: 25.3 pence).

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

14 December 2023

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 2023, the directors have elected to prepare the financial statements in accordance with UK-adopted international accounting standards in conformity with the requirements of the Companies Act.

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)

Confirmation by the Board of Directors

The Board of Directors currently comprises:

R D East (Chair of the Board)

N S Terrington (CEO)

R J Woodman (CFO)

H R Tudor (Non-executive director)

B A Ridpath (Non-executive director)

G H Yorston (Non-executive director)

A C M Morris (Senior independent director)

P A Hill (Non-executive director)

T P Davda (Non-executive director)

Z L Howorth (Non-executive director)

Each of the current directors confirm that, to the best of their knowledge, the financial statements, prepared in accordance with applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank.

Approved by the Board of Directors as the persons responsible within the Bank and signed on behalf of the Board.

RICHARD WOODMAN

Director

14 December 2023

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 2023 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 2023 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 eight financial years ended 30 September 2023. 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 2022), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter	Our response
Impairment allowances on loans to customers Risk vs 2022: ◄► (£44.8 million; 2021: £28.1 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 remains heightened in the current year due to the increased judgement and estimation uncertainty as a result of the ongoing economic uncertainties. The key areas where we identified greater levels of management judgement and	We performed the tests below 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. Our procedures included: **Our economics expertise:** We involved our own economic specialists, who assisted us in: – assessing the reasonableness of the Company's methodology for determining the economic scenarios used and the probability weightings applied to them; and – assessing the overall reasonableness of the economic forecasts by comparing the Company's forecasts to our own modelled forecasts.

therefore increased 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. **Judgemental adjustments** – Management makes adjustments to the model-driven ECL results to address issues relating to model responsiveness or emerging trends relating to the current economic environment as well as risks not captured by the models. Such adjustments are inherently subjective and significant management judgement is involved in estimating these amounts. **Significant Increase in Credit Risk ('SICR')** – The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Company's ECL calculation as these criteria determine whether a 12 month or lifetime provision is recorded. The Buy-to-Let mortgage loan portfolio is the most significant in this regard. **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 and assumptions used in the portfolios are the key drivers of the Company's ECL results and are therefore the most significant judgemental 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 allowances on loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the 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 credit risk modelling expertise:** We involved our own credit risk modelling specialists, who assisted us in: – Evaluating the Company's impairment methodologies for compliance with IFRS 9; – for models which were changed or updated during the year, evaluating whether the changes or updates were appropriate by assessing the updated model methodology against the applicable accounting standard; – for a selection of models, assessing the reasonableness of the model predictions by reperforming the model monitoring to compare the predictions against actual results and evaluating the resulting differences; – evaluating the model output for a selection of models by rebuilding the model code in line with the corresponding model functionality and comparing our output with management's output; and – independently applying management's staging methodology and inspecting model code for the calculation of the ECL model to assess its consistency with the Company's approved staging criteria and the output of the model. **Test of details:** Key aspects of our testing in addition to those set out above involved: – assessing the reasonableness of each judgemental adjustment by comparing these against our independent assessment calculated by applying alternative calculations and assumptions and performing sensitivity analysis; – testing the key LGD assumptions impacting the Company's overall ECL model calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions and assessing the key assumptions against the Company's historical experience; – for a selection of portfolios, reperforming the calculation of the loan staging applied and comparing to management's staging outputs; and – for a selection of portfolios, reperforming the calculation of the ECL measured on each of the Company's loan portfolios. **Benchmarking assumptions:** Key aspects of our testing involved: – assessing the completeness of judgemental adjustments to the model-driven ECL by performing benchmarking to comparable peer group organisations and using our knowledge of the Company and its industry to challenge the completeness of risks addressed in the adjustments; and – testing the key LGD assumptions impacting the Company's overall ECL model calculation by comparing the Company's assumptions to those of comparable peer group organisations. **Sensitivity analysis:** We performed sensitivity analysis over the key assumptions including the economic scenarios and weightings as well as certain PD and LGD assumptions, by applying alternative assumptions. **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's overall ECL, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made, was sufficiently clear.

	Our results As a result of our work, we found the impairment provision recognised and the related disclosures to be acceptable (2022: acceptable).
Interest receivable on originated loan accounts Risk vs 2022: ▲ (£430.8 million; 2022: £287.5 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 and the expectations regarding future reversionary interest rates. 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 and reversionary interest rate assumptions based on its forecasting process which incorporates historical experience. Ongoing developments in the UK economy result in a greater degree of subjectivity in this assessment for the current year. 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.	We performed the tests below 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. Our procedures included: • **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. We also applied alternative repayment profiles based on our recalculations. The historical comparison included considering the potential impact of uncertainties arising from the current economic environment on the behavioural life forecasts. • **Our sector experience:** We critically assessed key assumptions behind the Company's expected behavioural lives and reversionary interest rates against our own knowledge of industry experience and trends, including market rates. We also challenged the appropriateness of the level of segmentation applied to the loan portfolios by management. • **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles incorporating the results from the above procedures. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's EIR adjustments and interest receivable. We assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the critical estimates and assumptions made, was sufficiently clear. **Our results** As a result of our work, we found the interest receivable on originated loan accounts and related disclosures to be acceptable. (2022: acceptable).
Recoverability of Company's investment in subsidiaries Risk vs 2022: ◄► (£664.4 million; 2022: £667.1 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	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 cash flow forecasts with actual results to assess forecasting accuracy;

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.	• **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 in 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 considering the discount rates and sensitising the forecast future cash flows. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the estimated recoverable amount. In addition, we challenged whether the disclosure of the key judgements and assumptions made, was sufficiently clear. **Our results** The result of our testing were satisfactory, and we found the resulting carrying amount of the investments in subsidiaries and associated disclosures to be acceptable (2022: acceptable).

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 £10.0 million, determined with reference to a benchmark of Company profit before tax, normalised to exclude fair value movements in 2023 as disclosed in note 10, of £296.4m (2022: £289.0 million determined with reference to a benchmark of profit before tax normalised to exclude fair value movements). This materiality level represents 3.4% (2022: 3.0%%) 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 £7.5 million (2022: £6.6 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 £0.50 million (2022: £0.44 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. We assessed the completeness of the going concern disclosure.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period and
- we have nothing material to add or draw attention to in relation to the directors' statement in note 47 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for the going concern period, and 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.
- Using analytical procedures to identify any unusual or unexpected relationships.
- Involving our forensics specialists in assessing the completeness and appropriateness of the identified fraud risk factors and associated fraud risks.

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

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, and the risk of fraudulent revenue recognition, in particular the risk that the EIR adjustment on interest income may be misstated, the risk that 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.

We did not identify any additional fraud risks.

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. This included searching for those posted and approved by the same user, journals posted to seldom-used accounts, unbalanced journal postings and those including specific descriptors, and testing any journal entries identified where applicable
- Assessing whether the judgements made in making accounting estimates are indicative of a potential bias

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

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

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 39, 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.

Michael McGarry (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square

London

E14 5GL

14 December 2023

The Accounts

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

STATEMENT OF PROFIT OR LOSS
For the year ended 30 September 2023

	Note	2023 £m	2022 £m
Interest receivable	4	852.4	368.0
Interest payable and similar charges	5	(536.8)	(147.0)
Net interest income		315.6	221.0
Other income	6	108.7	174.4
Total operating income		424.3	395.4
Operating expenses	7	(117.4)	(99.8)
Provisions for losses	9	(10.5)	(6.6)
Operating profit before fair value items		296.4	289.0
Fair value net (loss) / gain	10	(63.8)	191.2
Operating profit being profit on ordinary activities before taxation		232.6	480.2
Tax charge on profit on ordinary activities	11	(36.4)	(85.8)
Profit on ordinary activities after taxation for the financial year		196.2	394.4

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.

BALANCE SHEET
For the year ended 30 September 2023

	Note	2023 £m	2022 £m
Assets			
Cash – central banks	12	2,783.3	1,612.5
Cash – retail banks	12	76.7	33.6
Loans to customers	13	11,161.2	8,952.8
Investment in structured entities	17	1,427.9	1,791.2
Derivative financial assets	18	518.2	605.9
Sundry assets	19	88.6	115.0
Property, plant and equipment	20	-	-
Investment in subsidiary undertakings	21	2,069.0	2,278.0
Total assets		18,124.9	15,389.0
Liabilities			
Retail deposits	22	13,234.4	10,569.5
Derivative financial liabilities	18	39.7	118.1
Central bank facilities	23	2,750.0	2,750.0
Sale and repurchase agreements	24	50.1	-
Corporate bond	25	146.3	150.0
Sundry liabilities	26	811.0	648.5
Current tax liabilities	28	53.0	34.5
Deferred tax liability	29	38.9	55.0
Total liabilities		17,123.4	14,325.6
Called up share capital	30	552.6	552.6
Reserves	31	448.9	510.8
Total equity		1,001.5	1,063.4
Total liabilities and equity		18,124.9	15,389.0

Approved by the Board of Directors on 14 December 2023.
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 2023

	Note	2023 £m	2022 £m
Net cash generated by operating activities	32	1,215.6	883.4
Net cash generated / (utilised) by investing activities	33	206.3	(212.1)
Net cash (utilised) by financing activities	34	(208.0)	(219.3)
Net increase in cash and cash equivalents		1,213.9	452.0
Opening cash and cash equivalents		1,646.1	1,194.1
Closing cash and cash equivalents		2,860.0	1,646.1
Represented by balances within:			
Cash	12	2,860.0	1,646.1
Short term bank borrowings		-	-
		2,860.0	1,646.1

STATEMENT OF MOVEMENTS IN EQUITY
For the year ended 30 September 2023

Year ended 30 September 2023	**Share capital £m**	**Profit and loss account £m**	**Total equity £m**
Transactions arising from			
Profit for the year	-	196.2	196.2
Other comprehensive income	-	-	-
Total comprehensive income	-	196.2	196.2
Transactions with owners			
Shares issued	-	-	-
Dividends paid	-	(258.1)	(258.1)
Net movement in equity in the year	-	(61.9)	(61.9)
Opening equity	552.6	510.8	1,063.4
Closing equity	552.6	448.9	1,001.5

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

NOTES TO THE ACCOUNTS
For the year ended 30 September 2023

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 2023

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the 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	2023	2022
		£m	£m
Interest receivable	4	852.4	368.0
Other operating income	6	108.7	174.4
Total revenue		961.1	542.4

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

4. INTEREST RECEIVABLE

Interest receivable is analysed as follows.

	2023	2022
	£m	£m
Interest receivable in respect of		
First mortgages	385.2	253.9
Secured consumer loans	8.2	8.8
Development finance	-	0.1
Finance leases	19.3	13.3
Other loans	18.1	11.4
Interest on loans to customers	430.8	287.5
Effect of fair value hedging of loan assets	159.5	(6.6)
Interest on loans to customers after hedging	590.3	280.9
Other interest receivable	88.4	26.3
Interest on group loan	80.7	23.4
Interest on investments	93.0	37.4
Total interest on financial assets	852.4	368.0

The above interest arises from:

	2023	2022
	£m	£m
Financial assets held at amortised cost	673.6	361.3
Finance leases	19.3	13.3
Derivative financial instruments held at fair value	159.5	(6.6)
	852.4	368.0

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

5. INTEREST PAYABLE AND SIMILAR CHARGES

	2023	2022
	£m	£m
On financial liabilities		
On retail deposits	334.1	108.8
Effect of fair value hedging of deposit	55.4	4.2
Interest on retail deposits after hedging	389.5	113.0
On bank loans and overdrafts	13.9	2.2
On corporate bonds	6.6	6.6
On central bank facilities	112.6	22.2
On intercompany loans	14.1	2.6
Total interest on financial liabilities	536.7	146.6
Discounting on lease liabilities	-	-
Other finance costs	0.1	0.4
Total interest payable and similar charges	536.8	147.0

The above amounts relate to:

	2023	2022
	£m	£m
Financial liabilities held at amortised cost	536.7	146.6
Other items	0.1	0.4
	536.8	147.0

6. OTHER INCOME

	2023	2022
	£m	£m
Loan account fee income	3.7	3.5
Deferred sale consideration	8.5	14.9
Dividend income	96.5	156.0
	108.7	174.4

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

7. OPERATING EXPENSES

	Note	2023 £m	2022 £m
Auditor remuneration	8	0.8	0.6
Financial Services Compensation Scheme levy		1.2	1.1
Depreciation of operational assets	20	-	0.3
Other administrative costs		115.4	97.8
		117.4	99.8

Other administrative costs relate to management and administrative services provided by fellow group companies as disclosed in note 34.

The Bank incurred no costs in respect of short-term operating leases in the year (2022: 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.

	2023 £m	2022 £m
Audit fee of the company	0.8	0.6
Total fees	0.8	0.6
Irrecoverable VAT	-	-
Total cost to the Bank	0.8	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.

9. PROVISION FOR LOSSES

	Note	2023 £m	2022 £m
Impairment of provision of financial assets:			
Loan accounts	16	6.4	5.1
Finance leases	16	1.4	1.8
Balances with group companies		2.7	(0.3)
		10.5	6.6

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

10. FAIR VALUE NET (LOSS) / GAIN

	2023 £m	2022 £m
Ineffectiveness of fair value hedges (note 18)		
Portfolio hedges of interest rate risk		
Deposit hedge	7.8	11.6
Loan hedge	(2.9)	20.7
	4.9	32.3
Individual hedges of interest rate risk	-	-
	4.9	32.3
Other hedging movements	(44.8)	5.4
Net (loss) / gain on other derivatives	(23.9)	153.5
	(63.8)	191.2

The fair value net (loss) / 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.

The impact of hedging arrangements on the Bank's balance sheet is summarised in note 18 which also provides a full description of the Bank's use of derivative financial instruments for hedging purposes.

11. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

(a) Analysis of charge in the year

	2023 £m	2022 £m
Current tax		
UK Corporation Tax on profits of the period	52.4	34.0
Adjustment in respect of prior periods	0.1	(0.2)
Total current tax	52.5	33.8
Deferred tax (credit) / charge	(16.1)	52.0
Tax charge on profit on ordinary activities	36.4	85.8

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

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 22.0% (2022: 19.0%), based on legislation enacted at the year end. During the year ended 30 September 2021, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK from 19.0% to 25.0% from April 2023. Consequently, the current year falls partly in the period during which the 19.0% rate applies and partly in that where the rate is 25.0%. These measures will increase the standard rate of corporation tax applicable to the Bank 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 financial year ended 30 September 2022 the UK Government enacted legislation reducing the rate of the Banking Surcharge from 8.0% to 3.0%, from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. This has resulted in the surcharge applying in the current year reducing to 5.5%, with a threshold of £62.5m, while in future years a surcharge of 3.0% on earnings over £100.0m will apply. The impact of this change on deferred tax balances was accounted for in the year ended 30 September 2022. The combination of the standard rate of tax and the surcharge results in taxable profits in excess of the annual threshold arising is being taxed at 27.5% in the current year (2022: 27.0%). This will rise to 28.0% in subsequent financial years.

(b) Deferred tax charge for the year

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

	2023 £m	**2022 £m**
Impact of surcharge and changes in tax rate	(2.7)	15.8
Loans and derivatives	(13.4)	36.2
Deferred tax charge for the year	(16.1)	52.0
Prior period adjustment	-	-
Deferred tax (credit) / charge (note 29)	(16.1)	52.0

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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

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 22.0% (2022: 19.0%).

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

	2023 £m	2022 £m
Profit on ordinary activities before taxation	232.6	480.2
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	51.2	91.2
Effects of:		
Non-taxable income	(20.6)	(29.7)
Mismatch in timing differences	0.6	-
Bank Corporation Tax Surcharge – impact on current tax	7.7	8.7
Impact of surcharge and changes in tax rates – deferred tax	(2.6)	15.8
Prior year (credit) / charge	0.1	(0.2)
Tax charge for the year	36.4	85.8

Change in rate of taxation includes the effect of providing for deferred tax balances at rates other than the comparator rate. This includes deferred tax provision on fair value movements in the year, which form the largest part of this balance.

(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 2023

12. CASH AND CASH EQUIVALENTS

	2023 £m	2022 £m
Deposits with the Bank of England	2,783.3	1,612.5
Balances with central banks	2,783.3	1,612.5
Deposits with other banks	76.7	33.6
Cash and cash equivalents	2,860.0	1,646.1

'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. LOANS TO CUSTOMERS

	Note	2023 £m	2022 £m
Loan accounts	14	11,137.2	9,062.8
Finance lease receivables	15	297.4	260.8
Loans to customers		11,434.6	9,323.6
Fair value adjustments from portfolio hedging		(273.4)	(370.8)
		11,161.2	8,952.8

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

14. LOAN ACCOUNTS

Loan accounts at 30 September 2023 and 30 September 2022, which are all denominated and payable in sterling, were:

	2023 £m	2022 £m
First mortgage loans	10,851.5	8,725.8
Second charge mortgage loans	116.7	158.3
Development finance loans	-	-
Other secured commercial lending	169.0	178.7
	11,137.2	9,062.8

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 23 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 2023				
In respect of:				
Central bank facilities	4,109.0	-	-	4,109.0
Total pledged as collateral	4,109.0	-	-	4,109.0
Prepositioned with Bank of England	2,568.7	-	-	2,568.7
Other assets not pledged as collateral	4,173.8	116.7	169.0	4,459.5
	10,851.5	116.7	169.0	11,137.2
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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

15. FINANCE LEASE RECEIVABLES

The minimum lease payments due under these loan agreements are:

	2023 £m	2022 £m
Amounts receivable		
Within one year	82.0	74.8
Within one to two years	75.4	65.2
Within two to three years	79.0	57.5
Within three to four years	61.8	56.2
Within four to five years	28.2	24.2
After five years	44.9	36.2
	371.3	314.1
Less: future finance income	(69.3)	(49.4)
Present value	302.0	264.7

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

	2023 £m	2022 £m
Amounts receivable		
Within one year	66.7	63.0
Within two to five years	198.8	171.3
After five years	36.5	30.4
Present value	302.0	264.7
Allowance for uncollectible amounts	(4.6)	(3.9)
Carrying value	297.4	260.8

None of the Bank’s finance lease receivables were pledged as collateral for liabilities at 30 September 2023 or 30 September 2022.

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For the year ended 30 September 2023

16. 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 13, 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 2023

16. 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, net of likely 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 (including cases where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

Notwithstanding the mechanical procedures discussed above, the 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 conditions at the balance sheet date. This may be the case where economic indicators at the reporting date and future expectations for those indicators lie outside the range of the observations used to construct the models. In such circumstances, management carefully review all outputs to ensure provision is adequate.

During the current financial year interest rates have risen to their highest levels in some time, and with unusual speed. Rates of inflation in the UK have been subject to significant fluctuations in the year, reaching 9.6% in October 2022, which the ONS suggested was a forty-year high point. This type of economic environment is not significantly represented in the historic data sets used by the Group to construct its IFRS 9 impairment models. It was also noted that the rate of change in the economic situation over the year might lead to a lagging impact on the credit bureau data which forms an input to models of customer behaviour, which may delay the recognition of an account potentially at risk.

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

16. 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, either from operational experience or its regular credit risk monitoring activities. No such evidence was noted at 30 September 2023 or 30 September 2022, and hence no additional accounts were identified as having an SICR.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. 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 used for internal monitoring 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.

16. 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.

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

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

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 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

In the year ended 30 September 2023 the most significant factors in these considerations were the extent to which uncertainties in the UK economy arising from rapidly rising interest rates, increases in the cost of living and doing business in the UK and the impacts of the continuing conflict in Ukraine were reflected in current customer performance at the period end and were being fully addressed by the Group's provision modelling, particularly in view of the lack of recent observations relating to similar conditions.

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

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

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

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 £3.8m (2022: £5.0m). The movements in the year represent principally the extent to which the anticipated economic and customer behaviours which gave rise to judgemental adjustments at 30 September 2022 are now observable and thus are reflected by the Group's models. There has also been a reduction in the levels of economic and political uncertainty in the UK, compared to the position at 30 September 2022, which also impacts on the level of adjustments required. The movements in the 2022 financial year represented a transition from Covid related overlays to ones which relate more to the responsiveness of the Group's provision models to economic conditions at the end of that year.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The adjustment at 30 September 2022 in the Mortgage Lending book was principally a result of a disconnect between the credit metrics which drive the models and the economic expectations of management, brokers and customers at the year end date. While some of the anticipated impacts have begun to manifest themselves in arrears performance, neither the Group nor the mortgage industry more generally has seen a significant reaction to higher levels of interest rates and inflation in credit performance as yet. Combined with potential model limitations in responding to significant rapid changes in interest and inflation rates, management determined it was appropriate to reduce, but not remove the judgmental adjustment.

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.

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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 2023					
Gross loan book	10,801.8	554.7	122.9	-	11,479.4
Impairment provision	(7.8)	(6.5)	(30.5)	-	(44.8)
Net loan book	10,794.0	548.2	92.4	-	11,434.6
Coverage ratio	0.10%	1.20%	24.80%	-	0.39%
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%

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

Finance leases included above, analysed by staging, were:

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2023					
Gross loan book	281.0	18.5	2.5	-	302.0
Impairment provision	(2.6)	(0.8)	(1.2)	-	(4.6)
Net loan book	278.4	17.7	1.3	-	297.4
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

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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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 reduced significantly in the Mortgage Lending segment over the year. This is driven principally by a lower number of accounts identified through model based criteria which are driven by the economic scenarios input into the models. The economic forecasts at 30 September 2022 included significant short term shifts in interest rates and house prices. These have been reflected in actual economic performance, to some extent, and the initial part of the September 2023 scenarios have lower rate movements.

The number of arrears cases being recorded has increased, as a result of increasing economic pressure on customers, to some extent representing a proportion of the SICR cases identified at the previous year end. However, the scale of this increase is less than indicated by the Group’s modelling at 30 September 2022, with accounts not, so far, as severely impacted by rate rises and cost-of-living issues as predicted. Together these factors have led to a reduction in the overall Stage 2 pool.

Overall Stage 2 provisions have increased with the Stage 2 balance, but coverage levels, on average, also increasing. Provision coverage levels in the Mortgage Lending segment have generally increased, partly as a result of downward pressure on property prices impacting on security values.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2023				
Gross loan book	457.7	13.5	83.5	554.7
Impairment provision	(2.7)	(0.1)	(3.7)	(6.5)
Net loan book	455.0	13.4	79.8	548.2
Coverage ratio	0.59%	0.70%	4.40%	1.20%
30 September 2022				
Gross loan book	1,275.5	8.9	18.1	1,302.5
Impairment provision	(4.9)	(0.1)	(0.7)	(5.7)
Net loan book	1,270.6	8.8	17.4	1,296.8
Coverage ratio	0.38%	1.12%	3.87%	0.44%

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.

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For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The number and value of Stage 3 accounts has increased in the year across all books. This has mostly been driven by increases in the number of accounts in serious arrears. Realisations cases, particularly in Mortgage Lending have increased, as the increase in arrears cases reported at the half year works its way through the system. RoR cases in the Mortgage Lending division have remained broadly stable, however there has been a level of churn in the book with old cases settled and new appointments made.

Coverage levels in the Mortgage Lending segment on Stage 3 cases have remained broadly similar, despite the falls in house prices and thus security cover in the year.

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2023					
Gross loan book	7.5	27.6	47.1	40.7	122.9
Impairment provision	(0.2)	(1.5)	(15.4)	(13.4)	(30.5)
Net loan book	7.3	26.1	31.7	27.3	92.4
Coverage ratio	2.67%	5.44%	32.70%	32.92%	24.80%
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%

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.

	2023	2022
	£m	£m
First mortgages	80.6	41.9
Second mortgages	4.7	6.2
Motor finance	1.2	0.7
	86.5	48.8

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16. 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 have largely reached a long-term, stable position, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Bank's RoR arrangements are described in more detail below.

Mortgage loan accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

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

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the 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 2023		**30 September 2022**	
	No.	**£m**	**No.**	**£m**
Managed accounts				
Appointment date				
2010 and earlier	131	20.0	112	18.5
2011 to 2015	28	4.1	34	5.1
2016 to 2020	15	2.0	13	1.8
2021 and later	144	22.0	46	5.9
Total managed accounts	318	48.1	205	31.3
Accounts in the process of realisation	207	38.5	95	14.6
	525	86.6	300	45.9

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 2023 and 30 September 2022 is set out below.

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

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

16. 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 2022	7.8	5.7	14.6	-	28.1
New assets originated or purchased	15.1	-	-	-	15.1
Changes in loss allowance					
Transfer to stage 1	2.0	(2.0)	-	-	-
Transfer to stage 2	(1.1)	1.2	(0.1)	-	-
Transfer to stage 3	(12.6)	(0.7)	13.3	-	-
Changes on stage transfer	(1.8)	1.3	5.7	-	5.2
Changes due to credit risk	(1.6)	1.0	(0.3)	-	(0.9)
Write offs	-	-	(2.7)		(2.7)
Assets derecognised	-	-	-	-	-
Loss allowance at 30 September 2023	7.8	6.5	30.5	-	44.8
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

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16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

During the year ended 30 September 2023 the impairment allowance increased, driven mostly by the increase in Stage 3 cases, a result of the level of actual defaults in the period, and by reduced levels of available security through declining house prices in the mortgage segment.

The net reduction in Stage 1 provisions includes the effect of changes in judgemental adjustments in the period, with items formerly addressed by these provisions beginning to move through Stage 2 and Stage 3. These movements were driven by both account performance, and by the impact of more severe actual and forecast economic conditions.

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

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

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16. 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 2022	7,979.50	1,302.5	69.7	-	9,351.7
New assets originated or purchased	3,261.7	-	-	-	3,261.7
Changes in staging					
Transfer to stage 1	833.4	(831.5)	(1.9)	-	-
Transfer to stage 2	(259.6)	263.6	(4.0)	-	-
Transfer to stage 3	(51.8)	(28.2)	80.0	-	-
Redemptions and repayments	(914.2)	(140.7)	(18.7)	-	(1,073.6)
Assets derecognised	-	-	-	-	-
Write offs			(2.7)		(2.7)
Other changes	(47.2)	(11.0)	0.5	-	(57.7)
Balance at 30 September 2023	10,801.8	554.7	122.9	-	11,479.4
Loss allowance	(7.8)	(6.5)	(30.5)	-	(44.8)
Carrying value	10,794.0	548.2	92.4	-	11,434.6
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	7,979.50	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

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 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

At 30 September 2023 enforceable contractual balances of £6.5m (2022: £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 to income

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

	2023	2022
	£m	£m
Provided in period	5.1	3.3
Written off amounts	2.7	3.6
	7.8	6.9
Of which		
Loan accounts	6.4	5.1
Finance leases	1.4	1.8
	7.8	6.9

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 2023

16. 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 2023 forecasting cycle (the 'October reforecast'), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2022, with the starting point of the scenario updated to reflect the actual movements of economic variables in the year.

The general trend of the Group's central forecasts follows that published by the Bank of England in August 2023, however the Group has taken a more pessimistic position than the Bank. Monetary policy is forecast to remain tight, with pressure on real incomes, leading to minimal growth, rising unemployment and a slow decline in inflation. As a result interest rates are forecast to remain, with a short-term decline in property values.

Compared to the central scenario adopted at 30 September 2022, the new central forecast is generally more pessimistic across most variables, with a much more severe decline in house prices than in the earlier scenario and a more prolonged period of elevated interest rates. The scenario also begins from the actual September 2023 economic position, so the interest rate rises, increased inflation and house price falls observed in the period are included in the starting position.

The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. The shapes of these three scenarios are broadly similar across the forecast period, with the upside scenario having a more rapid reduction in inflation, leading to a faster reduction in base rates and a stronger recovery. The downside includes traditional recessionary factors with additional pressure on house prices and rising unemployment, with interest rates being reduced more rapidly in response.

The severe scenario has been derived from stress testing scenarios published by the Bank of England, as in previous periods, with the 2022 Annual Cyclical Scenario ('ACS') being used at 30 September 2023. This scenario is based on a pronounced recession with interest rates remaining high, rising unemployment and a slump in house prices.

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to maintain the scenario weightings used at 30 September 2022. While the economic outlook is more settled than it was twelve months earlier there remains a significant divergence in opinions on the likely outlook for the UK economy, with a potential for serious downside outcomes. This supports the maintenance of the September 2022 weightings.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The weightings attached to each scenario are set out below

	2023	2022
Central scenario	40%	40%
Upside scenario	10%	10%
Downside scenario	30%	30%
Severe scenario	20%	20%
	100%	100%

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 2023

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.2	0.3	2.3	0.9	1.2	(0.8)	1.2	(5.0)
HPI	4.4	(8.2)	7.4	(3.1)	4.1	(13.4)	7.2	(16.4)
BBR	5.5	4.0	5.3	3.5	5.8	2.0	6.0	3.3
CPI	5.0	1.5	4.3	1.8	6.0	0.4	17.0	2.0
Unemployment	6.0	4.5	4.8	3.8	7.0	5.0	8.5	5.2
Secured lending	3.0	-	3.8	0.8	3.0	(0.8)	3.0	(2.0)
Consumer credit	5.0	2.0	5.8	2.8	5.0	1.3	5.0	-

30 September 2022

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

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

	2023 £m	2022 £m
Calculated provision	40.4	28.1
100% weighted central scenario	36.7	21.2
Effect of multiple economic scenarios	3.7	6.9

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 are shown below:

Scenario	2023 Provision £m	2023 Difference £m	2022 Provision £m	2022 Difference £m
Central	36.7	(3.7)	21.2	(6.9)
Upside	30.8	(9.6)	17.5	(10.6)
Downside	40.5	0.1	27.3	(0.8)
Severe	54.3	13.9	53.4	25.3

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.

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 £55.9m (2022: £94.7m) would transfer from stage 1 to stage 2, and the total provision would increase by £0.8m (2022: 0.7m) 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 £0.5m (2022: £1.8m).

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

16. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.1m (2022: £0.2m).

17. 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. During the year the floating rate notes issued by PM25 and debt issued by PSF was repaid, the Bank received cash for the investment held at that time.

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.

	2023 £m	2022 £m
AAA	1,199.9	1,391.4
AA	81.5	251.9
A	44.5	44.5
BBB	40.8	40.8
Not rated	61.2	62.6
At 30 September 2023	1,427.9	1,791.2

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

17. INVESTMENT IN STRUCTURED ENTITIES (CONTINUED)

The movements in the Bank's investment in structured entities in the year ended 30 September 2023 and the year ended 30 September 2022 were:

	2023 £m	2022 £m
Cost		
At 1 October 2022	1,791.2	1,944.1
Additions	-	15.8
Effective Interest Rate ('EIR') income	8.8	3.1
Payments received	(372.1)	(171.8)
At 30 September 2023	1,427.9	1,791.2

£11.8m (2022: £7.2m) is included in Sundry Assets (note 19) in respect of accrued interest on these Notes at the year end.

18. 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 38 to 41) 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. These are not treated as hedges for accounting purposes due to the low level of exposure.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

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 2023 or the preceding year.

	2023 Assets £m	2023 Liabilities £m	2022 Assets £m	2022 Liabilities £m
Derivatives in accounting hedge relationships				
Fair value hedges				
Interest rate swaps				
Fixed to floating	419.8	(4.9)	466.3	-
Floating to fixed	76.2	(27.0)	0.3	(98.5)
	496.0	(31.9)	466.6	(98.5)
Total derivatives in accounting hedge relationships	496.0	(31.9)	466.6	(98.5)
Individual fair value hedges				
Interest rate swaps				
Floating to fixed	-	(3.7)	-	-
Total derivatives in hedge accounting relationships	496.0	(35.6)		
Other derivatives				
Interest rate swaps	22.2	(4.1)	138.8	(19.6)
Currency futures			0.5	-
Total recognised derivative assets/(liabilities)	518.2	(39.7)	605.9	(118.1)

The credit risk inherent in the derivative financial assets shown above is discussed in note 38.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. 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 ended 30 September 2022 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 and the two sections of each hedge were combined in the second half of the financial year.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

During the year the Group has continued to hedge interest rate risk on fixed rate CBILS and BBLS exposures using SONIA-linked basis guarantee swaps, which are included in the loan hedge.

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

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships. These will generally be swaps taken out to pre-hedge the pipeline of fixed rate mortgage offers, which will match with the related loans when they complete.

At the end of each designation period the 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, bank profit will also be affected by the fair value movements of interest rate swap agreements which were entered into as part of the Bank's interest rate risk hedging strategy but failed to find a match in the hedging portfolio, particularly those relating to the pre-hedging of the lending pipeline.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Hedging Instruments

The hedging portfolios at 30 September 2023 and 30 September 2022 consist of a large number of sterling denominated swaps In addition, at 30 September 2023 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.

	2023		2022	
	Deposit Hedge	**Loan hedge**	**Deposit Hedge**	**Loan hedge**
Average fixed notional interest rate	4.22%	1.99%	1.45%	1.10%
Average notional margin over SONIA	-		-	-
	£m	**£m**	**£m**	**£m**
Notional principal value				
SONIA BGS	-	31.6	-	47.0
SONIA swaps	6,257.0	6,321.5	4,286.0	4,847.5
	6,257.0	6,353.1	4,286.0	4,894.5
Maturing				
Within one year	5,253.5	1357.0	3,097.0	1,092.0
Between one and two years	857.5	385.5	987.5	1,230.5
Between two and five years	146.0	4,610.6	201.5	2,569.5
More than 5 years	-	-	-	2.5
	6,257.0	6,353.1	4,286.0	4,894.5
Fair value	(49.2)	414.9	(98.2)	466.3

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 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Accounting impacts

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

	2023		2022	
	Deposit Hedge £m	Loan Hedge £m	Deposit Hedge £m	Loan Hedge £m
Hedging items				
Interest rate swaps				
Included in derivative financial assets	76.2	419.8	0.3	466.3
Included in derivative financial liabilities	(27.0)	(4.9)	(98.5)	-
	49.2	414.9	(98.2)	466.3
Notional principal value	6,257.0	6,353.1	4,286.0	4,894.5
Change in fair value used in calculating hedge ineffectiveness	77.7	(161.4)	(94.8)	436.0

	2023		2022	
	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	5,758.1	-	3,986.4	-
Fixed rate loans				
Monetary amount of risk relating to Loans to Customers	-	6,389.4	-	4,973.5
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 23 and 14) *	30.9	(273.4)	99.7	(370.7)
Of which: amounts related to discontinued hedging relationships being amortised	(4.3)	111.3	(7.9)	72.5
Change in fair value used in recognising hedge ineffectiveness	(69.9)	158.5	106.4	(415.3)
Hedge ineffectiveness recognised				
Included in fair value gains/losses in the profit and loss account	7.8	(2.9)	11.6	20.7

* 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 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

b) Fair value micro hedges

Background and hedging objectives

The Bank's individual fair value hedges of interest rate risk ('micro hedges') relate to its long-term fixed interest rate liabilities. The structure of these borrowings exposes the Bank to interest rate risk, in the event of an adverse movement in market interest rates and during the year the decision was taken to hedge against any future interest rate movements.

The hedge takes the form of a single interest rate swap which is intended to be in place for the expected fixed rate period of the related borrowing. The terms of the fixed rate leg of the derivative match the terms of the borrowing as far as possible and the hedging relationship was designated at the point at which the swap contract was entered into.

The hedging relationship is tested for effectiveness on a monthly basis by comparing the movements in the calculated fair value of the hedged item to the fair value movement in the derivative hedge.

Potential sources of ineffectiveness

In its interest rate hedging for individual items the Bank seeks to minimise hedge ineffectiveness by aligning the terms of the hedging instrument as closely as possible with those of the hedged item. The notional amount of the derivative matches that of the hedged item and settlements are due on the same days and at the same intervals.

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

- The use of derivatives as a hedge of interest rate risk additionally exposes the 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
- The small difference between the fixed rate of interest charged on the hedged item and the fixed rate leg of the derivative, where the impact of discounting will mean that movements in present values of the two flows are not exactly parallel
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Hedging Instrument

The financial derivatives used in the Bank's individual fair value hedge comprise a single sterling denominated interest rate swap with a notional value of £150.0m.

Settlement on the swap is twice-yearly, on the same days as those when interest payments on the hedged item fall due. On settlement:

- The payment received by the Bank is calculated based on a fixed rate of interest of 3.989% and the notional value of the swap
- The opposite payment made by the Bank is calculated based on the same notional value but using a floating interest rate set at the compound SONIA reference rate

The swap matures on 25 September 2026 (between two and five years after the balance sheet date).

Accounting impacts

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

	2023	2022
	£m	£m
Hedging instruments		
Interest rate swaps		
Included in derivative financial assets	-	-
Included in derivative financial liabilities	(3.7)	-
	(3.7)	-
Notional principal value	150.0	-
Change in fair value used in calculating hedge ineffectiveness	(3.7)	-

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

	2023	2022
	£m	£m
Hedged items		
Fixed rate borrowings		
Corporate bond	150.0	-
Accumulated amount of fair value hedge adjustments included in carrying value	3.7	-
Of which: amounts related to discontinued hedging relationships being amortised	-	-
Change in fair value used in recognising hedge ineffectiveness	3.7	-
Hedge ineffectiveness recognised		
Included in fair value (loss) / gains in the profit and loss account (note 10)	-	-

c) 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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Interest rate swaps

	2023		2022	
	Pay fixed	Pay floating	Pay Fixed	Pay floating
Average fixed notional interest rate	3.78%	5.52%	1.71%	4.31%
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps			-	-
SONIA swaps	728.5	722.6	1,858.6	377.1
	728.5	722.6	1,858.6	377.1
Maturing				
Within one year	9.5	583.5	474.1	288.0
Between one and two years	23.5	126.0	61.5	86.0
Between two and five years	475.5	13.1	488.0	3.1
More than 5 years	220.0	-	835.0	-
	728.5	722.6	1,858.6	377.1
Fair value	17.2	0.9	122.1	(2.9)

Currency futures

	2023	2022
US Dollar futures		
Average future exchange rate	1.22	1.07
	£m	£m
Notional principal value	7.6	13.4
Maturing		
Within one year	7.6	13.4
Between one and two years	-	-
Between two and five years	-	-
	7.6	13.4
Fair value	-	0.5

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

19. SUNDRY ASSETS

	Note	2023 £m	2022 £m
Current assets			
Amounts owed by Group companies		34.4	58.0
Accrued interest income		16.0	7.2
CSA assets		-	19.5
CRDs		38.0	30.2
Other receivables		0.2	0.1
Sundry financial assets	48	88.6	115.0

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

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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

20. 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 2021	5.4
Additions	-
Disposals	(5.4)
At 30 September 2022	-
Additions	-
Disposals	-
At 30 September 2023	-
Accumulated depreciation	
At 30 September 2021	(0.3)
Charge for the year	(0.3)
On disposals	0.6
At 30 September 2022	-
Charge for the year	-
On disposals	-
At 30 September 2023	-
Net book value	
At 30 September 2023	-
At 30 September 2022	-

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

21. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Shares in Group companies £m	Loans to Group companies £m	Total £m
At 1 October 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	-	-	-
Loans advanced	-	9,543.8	9,543.8
Loans repaid	-	(9,750.1)	(9,750.1)
Provision movements	(2.7)	-	(2.7)
At 30 September 2023	664.4	1,404.6	2,069.0

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

During the year ended 30 September 2023 the Company received £96.5m in dividend income from its subsidiaries (2022: £156.0m) and £80.7m of interest on loans to Group companies (2022: £23.4m).

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

22. 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:

	2023 £m	2022 £m
Fixed rate	8,690.2	6,201.3
Variable rates	4,575.1	4,467.9
	13,265.3	10,669.2

The weighted average interest rate on retail deposits at 30 September 2023 and 30 September 2022, analysed by charging method, was:

	2023 %	2022 %
Fixed rate	4.07	1.74
Variable rates	3.74	1.55
All deposits	3.95	1.66

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

22. RETAIL DEPOSITS (CONTINUED)

The contractual maturity of these deposits is analysed below.

	2023 £m	2022 £m
Amounts repayable		
In less than three months	1,589.4	929.0
In more than three months, but not more than one year	5,193.7	3,732.1
In more than one year, but not more than two years	1,643.0	1,627.3
In more than two years, but not more than five years	631.8	421.4
Total term deposits	9,057.9	6,709.8
Repayable on demand	4,207.4	3,959.4
	13,265.3	10,669.2
Fair value adjustments for portfolio hedging	(30.9)	(99.7)
	13,234.4	10,569.5

23. 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 14, 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 25 months (2022: 37 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 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 2023

23. CENTRAL BANK FACILITIES (CONTINUED)

The amounts drawn under these facilities are set out below.

	2023 £m	2022 £m
TFSME	2,750.0	2,750.0
ILTR	-	-
Total central bank facilities	2,750.0	2,750.0

All TFSME borrowings fall due after more than one year.

During the year ended 30 September 2022 all TFSME borrowings were repaid and redrawn, extending the maturity date to 21 October 2025 for the majority of drawings, with £5.2m falling due on 31 March 2027.

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes and eligible retained Notes can also be used to support this funding. The mortgage assets pledged in support of these drawings are set out in note 14.

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

	2023 £m	2022 £m
TFSME at IAS 20 carrying value	2,716.3	2,700.2
Deferred government assistance	33.7	49.8
	2,750.0	2,750.0

24. SALE AND REPURCHASE AGREEMENTS

From time to time the Group enters into short-term sale and repurchase agreements with highly-rate UK banks as part of its liquidity management operations.

At 30 September 2023 £50.1m was outstanding under such arrangements (2022: £nil). The average term of the agreements was 3 months and the average remaining term 2.8 months. The average interest rate payable was 0.80% above compounded SONIA.

The securities subject to the sale and repurchase agreement were certain of the Bank's purchased asset backed loan notes, described in note 17.

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. These notes are callable at the option of the Company between 25 June 2026 and 25 September 2026 and may be called at any time in the event of certain tax or regulatory changes.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

25. CORPORATE BOND (CONTINUED)

The carrying value of Tier 2 Notes in the accounts of the Bank at 30 September 2023 was £146.3m (2022: £150.0m), with the difference arising as a result of the hedging treatment described in note 18.

26. SUNDRY LIABILITIES

	2023 £m	2022 £m
Current liabilities		
Accrued interest	187.4	53.0
Amounts owed to group companies	239.1	206.0
CSA liabilities	383.4	388.3
Other accruals	1.1	1.2
Sundry financial liabilities	811.0	648.5
Lease payables (note 27)	-	-
	811.0	648.5
Non-current liabilities		
Lease payables (note 27)	-	-
Total sundry liabilities	811.0	648.5

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.

	2023 £m	2022 £m
Leasing liabilities falling due:		
In more than five years	-	-
In more than two but less than five years	-	-
In more than one year but less than two years	-	-
In more than one year (note 26)	-	-
In less than one year (note 26)	-	-
	-	-

28. CURRENT TAX LIABILITIES

Current tax represents UK corporation tax owed.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

29. DEFERRED TAX LIABILITY

The movements in the net deferred tax liability are as follows:

	2023 £m	2022 £m
Net liability at 1 October 2022	55.0	3.0
Income statement (credit) / charge	(16.1)	52.0
Net liability at 30 September 2023	38.9	55.0

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

	2023 £m	2022 £m
Loans and derivatives	38.9	55.0
Net deferred tax liability	38.9	55.0

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:

	2023 Number	2022 Number
Ordinary shares		
At 1 October 2022 and 30 September 2023	552,625,034	552,625,034

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

31. RESERVES

Profit and loss account

	2023 £m	2022 £m
At 1 October 2022	510.8	266.7
Profit for the year	196.2	394.4
Dividends paid	(258.1)	(150.3)
At 30 September 2023	448.9	510.8

An interim dividend of £0.21 per share was paid during the year (2022: £0.27 per share). A final dividend of £nil per share is proposed (2022: £0.25).

32. NET CASH FLOW FROM OPERATING ACTIVITIES

	2023 £m	2022 £m
Profit before tax	232.6	480.2
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	-	0.3
Impairment losses on loans to customers	10.5	6.6
Net (increase) / decrease in operating assets:		
Loans to customers	(1,755.5)	(1,056.2)
Derivative financial instruments	87.7	(577.4)
Fair value of portfolio hedges	(97.4)	394.9
Other receivables	26.4	12.5
Net increase / (decrease) in operating liabilities:		
Retail deposits	2,596.0	1,368.9
Derivative financial instruments	(78.4)	76.1
Fair value of portfolio hedges	68.9	(96.8)
Other liabilities	158.8	309.3
Cash generated by operations	1,249.6	918.4
Income taxes (paid)	(34.0)	(35.0)
	1,215.6	883.4

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

33. NET CASH FLOW FROM INVESTING ACTIVITIES

	2023 £m	2022 £m
Proceeds from sale of operating property, plant and equipment	-	4.8
Advances of loans to subsidiary undertakings	(9,543.8)	(5,429.8)
Repayment of loans by subsidiary entities	9,750.1	5,212.9
Net cash generated / (utilised) by investing activities	206.3	(212.1)

34. NET CASH FLOW FROM FINANCING ACTIVITIES

	2023 £m	2022 £m
Dividends paid (note 31)	(258.1)	(150.3)
Movement on central bank facilities	-	(69.0)
Movement on repurchase facilities	50.1	-
Net cash (utilised) by financing activities	(208.0)	(219.3)

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 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 17 and accrued interest on the investment is shown in note 19.

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 on the loans is provided in note 4. At the balance sheet date, the outstanding loan amounts are shown in note 21 with the accrued interest due shown in note 19. The Bank also provided various management and administrative services to these companies and its subsidiaries.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

35. RELATED PARTY TRANSACTIONS (CONTINUED)

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 5. At the balance sheet date, the outstanding loan amount is shown in note 21 with £0.0m (2022: £0.0m) 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 21.

Outstanding current account balances with group entities are shown in notes 19 and 26. The Bank earned £4.7m (2022: £10.0m) from PM27 and £6.8m (2022: £2.7m) from PM28 in relation to deferred sale consideration but paid £2.9m (2022: earned £2.2m) to PM26, all these amounts are shown in note 6.

Intercompany dividends of £96.50m (2022: £156.0m) 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 £720,000 were outstanding at the year-end (2022: £779,000), and the maximum amounts outstanding during the year totalled £771,000 (2022: £793,000).

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	15
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 (2022: 10 years) with rents subject to review every five years. During the year ended September 2022 the lease was transferred over to another group company.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2023

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	20
Carrying amount of right of use assets	20
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 (2022: 0.0m).

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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 ('Banking Group'). As part of this supervision the regulator will issue a Total Capital Requirement ('TCR') setting the amount of regulatory capital which the Banking 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 2023

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 2023 the Bank's regulatory capital of £1,255.7m (2022: £1,236.3m) was comfortably in excess of the amounts required by the regulator, including £670.7m 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 2023 (2022: 2.5%) and a CCyB, as at 30 September 2023, of 2.0% of risk weighted assets (2022: 0.0%). Firm specific buffers may also be required.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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 PRA Rulebook at 30 September 2023 is set out below

	Note	2023 £m	2022 £m
Total equity in the Bank		1,001.5	1,063.4
Other equity in regulatory consolidation	§	254.5	312.8
		1,256.0	1,376.2
Deductions			
Investments in shares	* §	(19.2)	(18.9)
Intangible assets in regulatory consolidation	† §	(134.1)	(150.4)
Proposed dividend		-	(139.8)
Pension surplus net of deferred tax		(9.5)	(5.3)
Prudent valuation adjustment	§ #	(0.7)	(0.9)
Add back IFRS9 transitional relief	§	13.3	25.4
Insufficient coverage for non-performing exposures	ψ	(0.1)	(0.0)
Common Equity Tier 1 ('CET1') Capital		1,105.7	1,086.3
Other tier 1 capital		-	-
Total Tier 1 capital		1,105.7	1,086.3
Corporate bond	25	150.0	150.0
Total Tier 2 capital		150.0	150.0
Total regulatory capital		1,255.7	1,236.3

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

§ Not audited.

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

ψ Regulatory deduction where there is insufficient coverage for non-performing exposures required under AT1BCAGR 47(c) of the CRR. This requirement remained in force in the UK, at the year end, under the Brexit arrangements but was removed by the PRA with effect from 14 November 2023. The amount required at 30 September 2022 was less than £0.1m..

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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 PRA Rulebook framework, against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	2023 £m	2022 £m
Credit risk		
Balance sheet assets	6,751.6	6,617.8
Off balance sheet	87.2	85.4
IFRS 9 transitional relief	13.3	25.4
Total credit risk	6,852.1	6,728.6
Operational risk	740.4	643.7
Other risk	43.6	118.6
Total risk exposure	7,636.1	7,490.9
	%	%
Solvency ratios		
CET1 capital	14.5	14.5
Total regulatory capital	16.4	16.5

This table is not subject to Audit

The 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 2023

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:

	2023 £m	2022 £m
CET1 Capital	1,105.7	1,086.3
Less: IFRS 9 relief	(13.3)	(25.4)
Fully loaded CET1 Capital	1,092.4	1,060.9
TRC	1,255.7	1,236.3
Add back: IFRS 9 relief	(13.3)	(25.4)
Fully loaded TRC	1,242.4	1,210.9
Total risk exposure	7,636.1	7,490.9
Add back: IFRS 9 relief	(13.3)	(25.4)
Fully loaded TRE	7,622.8	7,465.5
Fully loaded Solvency ratios	**%**	**%**
CET1	14.3	14.2
Total regulatory capital	16.3	16.2

This table is not subject to audit

The total regulatory capital at 30 September 2023 on the fully loaded basis of £1,242.4m was in excess of the Pillar 1 & 2a requirement of £669.6m on the same basis (amounts not subject to audit).

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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%.

	2023 **£m**	**2022** **£m**
Total balance sheet assets	18,748.7	17,242.4
Less: Derivative assets	(615.4)	(779.0)
Central bank deposits	(2,783.4)	(1,612.5)
CRDs	(38.0)	(30.2)
Accrued interest on sovereign exposure	(4.2)	(1.0)
On-balance sheet items	15,307.7	14,819.7
Less: Intangible assets	(134.1)	(150.2)
Investments	(19.2)	(18.9)
Insufficient coverage for non-performing exposures	(0.1)	-
Pension surplus	(12.6)	-
Total on balance sheet exposures	15,141.7	14,650.6
Regulatory exposure for derivatives	179.6	434.7
Total derivative exposures	179.6	434.7
Post offer pipeline at gross notional amount	993.3	1,307.9
Adjustment to convert to credit equivalent amounts	(815.7)	(1,094.1)
Off balance sheet items	177.6	213.8
Tier 1 capital	1,105.7	1,086.3
Total leverage exposure before IFRS 9 relief	15,498.9	15,299.1
IFRS 9 relief	13.3	25.4
Total leverage exposure	15,512.2	15,324.5
UK leverage ratio	7.1%	7.1%

This table is not subject to audit

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

37. CAPITAL MANAGEMENT (CONTINUED)

The fully loaded leverage ratio is calculated as follows:

	2023 £m	2022 £m
Fully loaded Tier 1 capital	1,092.4	1,060.9
Total leverage exposure before IFRS 9 relief	15,498.9	15,299.1
	7.0%	6.9%

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 due to the exclusion of central bank balances from exposures.

The Bank's return on assets for the year is calculated as follows:

	2023 £m	2022 £m
Net profit after tax	196.2	394.4
Divided by		
Total balance sheet	18,124.9	15,389.0
	1.10%	2.56%

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 2023

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 38 to 41 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	**2023**	**2022**
		£m	**£m**
Financial assets at amortised cost			
Cash	12	2,860.0	1,646.1
Loans to customers	16	11,434.6	9,323.6
Investment in structured entities	17	1,427.9	1,791.2
CSA debtor	19	-	19.5
Accrued interest	19	16.0	7.2
Loans to group companies	21	1,404.6	1,610.9
Amounts owed by group companies	19	34.4	58.0
		17,177.5	14,456.5
Financial assets at fair value			
Derivative financial assets	18	518.2	605.9
Maximum exposure to credit risk		17,695.7	15,062.4

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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 2023 and 30 September 2022 are analysed as follows:

	2023 £m	2023 %	2022 £m	2022 %
Buy-to-let mortgages	10,829.0	94.7%	8,697.8	93.3%
Owner occupied mortgages	22.5	0.2%	28.0	0.3%
Total first mortgages	10,851.5	94.9%	8,725.8	93.6%
Second charge mortgages	116.7	1.0%	158.3	1.7%
Development finance	-	-	-	-
Loans secured on property	10,968.2	95.9%	8,884.1	95.3%
Motor finance loans	297.4	2.6%	260.8	2.8%
Structured lending	169.0	1.5%	178.7	1.9%
Total loans to customers	11,434.6	100.0%	9,323.6	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 2023

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 2023 and 30 September 2022 is set out below.

	2023 First Mortgages %	2023 Second charge Mortgages %	2022 First Mortgages %	2022 Second charge Mortgages %
Loan to value ratio				
Less than 70%	69.6	96.8	86.7	97.7
70% to 80%	26.6	1.8	11.9	1.1
80% to 90%	2.6	0.4	0.4	0.3
90% to 100%	0.3	0.0	0.3	0.0
Over 100%	0.9	1.0	0.7	0.9
	100.0	100.0	100.0	100.0
Average loan to value ratio	63.3	52.3	58.6	50.5

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual decrease of 5.3% in the year ended 30 September 2023 (2022: 9.5%).

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	2023 By value %	2023 By number %	2022 By value %	2022 By number %
50% or less	-	-	-	-
50% to 60%	-	-	-	-
60% to 65%	-	-	-	-
65% to 70%	-	-	-	-
	-	-	-	-

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

39. CREDIT RISK (CONTINUED)

The average LTGDV cover at the year end was 0.00% (2022: 0.00%).

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 2023 the development finance portfolio comprised no accounts (2022: 0) with no carrying value (2022: £nil). 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

	2023	**2022**
Number of transactions	9	8
Total facilities (£m)	235.7	220.5
Carrying value (£m)	169.0	178.7

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

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

At 30 September 2023 one of these facilities was identified as Stage 2 with the remainder in Stage 1. At 30 September 2022, all of these facilities were identified as Stage 1.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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 2023 and 30 September 2022, compared to the industry averages at those dates published by the UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	2023	2022
	%	%
Buy-to-let mortgages		
Accounts more than three months in arrears		
Buy-to-Let accounts including receiver of rent cases	0.34	0.09
Buy-to-Let accounts excluding receiver of rent cases	0.15	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	0.69	0.41
Buy-to-Let accounts excluding receiver of rent cases	0.64	0.39
Owner-occupied accounts	0.89	0.80
All mortgages	0.84	0.72
Secured loans		
Accounts more than two months in arrears	10.23	8.90
FLA data for secured loans	6.3	7.50
Car loans		
Accounts more than two months in arrears	1.07	1.58

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 2022 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance 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 2023

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:

	2023 £m	2022 £m
Retail deposits		
Payable on demand	4,181.5	3,934.6
Payable in less than three months	1,649.5	955.1
Payable in less than one year but more than three months	5,447.3	3,813.7
Payable in less than one year or on demand	11,278.3	8,703.4
Payable in one to two years	1,782.5	1,697.8
Payable in two to five years	734.5	452.0
Payable in over five years	44.4	32.0
	13,839.7	10,885.2

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

40. LIQUIDITY RISK (CONTINUED)

The cash flows described above will include those for interest on retail deposits accrued at 30 September 2023 and 30 September 2022 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 2023 and 30 September 2022, the liquidity buffer comprised the following on and off balance sheet assets, all held within the Bank.

	Note	2023	2022
		£m	£m
Short term investments		-	-
Balances with central banks		2,589.7	1,505.5
Total on balance sheet liquidity		2,589.9	1,505.5
Long / short repo transaction		150.0	150.0
		2,739.7	1,655.5

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 2023

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	Corporate Debt	Total
	£m	£m	£m
30 September 2023			
Payable in less than one year	147.8	6.6	154.4
Payable in one to two years	151.3	6.6	157.9
Payable in two to five years	2,788.2	19.7	2,807.9
Payable in over five years	-	169.6	169.6
	3,087.3	202.5	3,289.8
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

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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:

	2023 Total cash outflow / (inflow) £m	2022 Total cash outflow / (inflow) £m
On derivative liabilities		
Payable in less than one year	52.8	88.8
Payable in one to two years	(6.0)	24.0
Payable in two to five years	8.5	3.6
Payable in over five years	0.3	0.1
	55.6	116.5
On derivative assets		
Payable in less than one year	(163.5)	(163.8)
Payable in one to two years	(144.1)	(157.0)
Payable in two to five years	(154.4)	(289.4)
Payable in over five years	-	(2.7)
	(462.0)	(612.9)
	(406.4)	(496.4)

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 completed its transition to the use of alternative reference rates, principally SONIA, during the year ended 30 September 2022. All new wholesale debt and interest rate swaps recognised since that point have referenced SONIA, while existing LIBOR linked instruments were transitioned before the start of the current financial year.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2023

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 18.

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 2023, 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 £12.3m (2022: £30.2m).

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 £16.2m (2022: increase by £32.7m). 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.

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 18.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2023

The notes set out below describe the accounting basis on which the 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 2023 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.

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 2023

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 financial statements have been prepared on the going concern basis.

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

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.

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, 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, 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 PD, LGD and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

While the 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. 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 2023

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.

(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.

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.

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, operating lease income and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(w) Other 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 2023

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 16.

(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 16.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2023

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 model' – 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. There were no significant changes in the nature of the Group's products, nor in the business models in which they are held, during the year.

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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2023

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 (which might include keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

In evaluating the potential impact of the economic situation at 30 September 2023 there is little recent history against which to benchmark likely customer behaviour. Interest rates have risen to higher levels, at a more rapid rate than at any time in recent history. UK base rates had reached 5.25% at the balance sheet date, a level they had not touched since April 2008, since when significant regulatory intervention in the UK's lending markets has taken place. There have also been significant changes in product structures in that period, including the growth of longer term fixed-rate mortgage lending in recent years. All of these make the historical record of behaviours in higher interest rate environments an uncertain guide to the likely impact of current rate levels.

There is also little agreement between economic forecasters as to the future direction of the UK economy, exacerbated by the potential impact of the general election which must be held within the next eighteen months. At the same time, the level to which economic pressures on customers have yet to manifest themselves in credit metrics is still unclear, with credit performance across the markets in which the Group is active being better than some expected over the past year, but considerable uncertainty as to whether this represents a more benign outcome, or merely a delay in credit issues emerging beyond what was anticipated. Together, these factors make forecasting credit behaviour in current conditions particularly challenging.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2023

46. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

(a) Impairment losses on loans to customers (continued)

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. As noted above, there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, although these have converged, to some extent, over the twelve months since 30 September 2022, when the impact of the September 2022 mini-budget had significantly broadened the range of plausible outcomes

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the 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 16.

The position after considering all these matters is set out in note 16, 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 2023

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 £7.8m (2022: £9.7m)
- An increase of the assumed average lives of loans secured on residential property by three months would increase balance sheet assets by £7.8m (2022: £9.8m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £8.2m (2022: £6.6m)

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 £664.4m of investments in shares in group entities £501.6m is directly supported by tangible net assets of subsidiaries with only £162.8m relying in part on the goodwill of the subsidiary.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
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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 16, 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 2023. 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 £13,265.3 million (note 22) are repayable within five years, with 82.9% of this balance (£10,990.5 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Bank is required to hold liquid assets to mitigate this liquidity risk. At 30 September 2023 the Bank held £2,589.7 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 24), bringing the total to £2,739.7 million.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2023

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 £1,715.4 million. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2023 the Bank had £1,205.6 million of such notes available for use, of which £986.9 million were rated AAA. The available AAA notes would give access to £769.8m if used to support drawings on Bank of England facilities.

The Bank's cash analysis, continues to show a strong cash position, even after allowing scope for significant discretionary payments.

As described in note 37 the Bank's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2023 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.

48. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

The Bank had no financial assets or liabilities in the year ended 30 September 2023 or the year ended 30 September 2022 carried at fair value and valued using level 3 measurements.

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	**2023**	**2022**
		£m	**£m**
Financial assets			
Derivative financial assets	18	518.2	605.9
		518.2	605.9
Financial liabilities			
Derivative financial liabilities	18	39.7	118.1
		39.7	118.1

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 18.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
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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	2023 Carrying amount £m	2023 Fair value £m	2022 Carrying amount £m	2022 Fair value £m
Financial assets					
Cash	12	2,860.0	2,860.0	1,646.1	1,646.1
Loans to customers	16	11,434.6	11,135.8	9,323.6	9,084.3
Investment in structured entities	17	1,427.9	1,427.9	1,791.2	1,791.2
Loans to group companies	19	34.4	34.4	58.0	58.0
Sundry financial assets	19	54.2	54.2	57.0	57.0
		15,811.1	15,512.3	12,875.9	12,636.6
Financial liabilities					
Retail deposits		13,265.3	13,177.3	10,669.2	10,592.9
Amounts owed to group companies		389.1	389.1	356.0	356.0
Other financial liabilities		571.9	571.9	442.5	442.5
		14,226.3	14,138.3	11,467.7	11,391.4

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
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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
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50. DETAILS OF SUBSIDIARY UNDERTAKINGS

Subsidiary undertakings of the Bank at 30 September 2023, 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
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
Collett Transport Services Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
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)

Companies in liquidation

The following legal subsidiaries of the Group were in liquidation at 30 September 2023.

Company	Holding	Principal activity
Direct and Indirect subsidiaries of Paragon Bank PLC		
City Business Finance Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
PBAF (No.1) Limited	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading

The 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

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

Registered and head office

51 Homer Road
Solihull
West Midlands B91 3QJ

Telephone: 0121 712 2323

Company Secretariat

company.secretary@paragonbank.co.uk

Internet

www.paragonbankinggroup.co.uk

Auditor

KPMG LLP
One Snowhill
Snow Hill Queensway
Birmingham B4 6GH

Solicitors

Slaughter and May
One Bunhill Row
London EC1Y 8YY