Paragon Bank PLC

Annual Report & Accounts

For the year ended 30 September 2020

CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report and Strategic 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 Bank. 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. 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 these forward-looking statements other than in accordance with its legal or regulatory obligations (including under the Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority).

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

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, such as the Covid-19 pandemic and ongoing challenges and uncertainties posed by the Covid-19 pandemic for businesses and governments around the world; potential changes in future 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 (including, without limitation, actions taken as a result of the Covid-19 outbreak); actions by the Bank's competitors; the UK's exit from the EU which may result in a prolonged period of uncertainty, unstable economic conditions and market volatility, including currency fluctuations; general changes in government policy that may significantly influence investor decisions; 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

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

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

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

PROFITABILITY OF THE BUSINESS

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

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

GENERATION OF ASSETS

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

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

The Bank also generates income through its asset and development finance subsidiaries which provide SME customers with leasing products and related services.

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	
	2020	2019	2020	2019
	£m	£m	£m	£m
Mortgages	1,252.4	1,486.3	5,431.1	4,930.5
Commercial Lending	117.5	198.6	401.2	451.3
	1,369.9	1,684.9	5,832.3	5,381.8

The Bank's total loan book increased by 8.4% in the year, with new advances 18.7% lower than in the previous financial year. The major factor driving the reduction was the Covid-19 lockdown, and its impact on market activity over the summer months.

MORTGAGES

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

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

	2020	2019
	£m	£m
First charge buy-to-let	1,198.1	1,402.5
First charge owner-occupied	0.3	11.9
Second charge	54.0	71.9
	1,252.4	1,486.3

Total mortgage lending, comprising buy-to-let products and other mortgage offerings, decreased by 15.7% in the year. Within this total, buy-to-let lending decreased by 14.6% year on year. This was principally a result of the restricted market in the summer months created by the Covid-19 pandemic.

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

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

STRATEGIC REPORT (Continued)

Lending in the Bank's second charge mortgage operation was in line with plan in the first half year, however it was scaled back in the second half in response to Covid-19. Within the second charge mortgage market the Bank targets only higher credit quality customers, rather than the lower-rated borrowers generally associated with this sector. This limits potential lending in this field but should provide more resilience in adverse economic conditions, as proved to be the case in the pandemic.

The Bank continues to limit its exposure to first charge residential lending to owner-occupiers, given the pressure on market yields and a limited demand for products where its specialist approach adds value. The opportunities for the Bank in this area principally relate to 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 2020 £m	30 September 2019 £m
Originated assets		
First charge buy-to-let	5,101.8	4,567.8
First charge owner-occupied	51.2	68.3
Second charge	182.6	171.5
	5,335.6	4,807.6
Acquired assets		
Second charge	95.5	122.9
	5,431.1	4,930.5

At 30 September 2020 the balance on the Bank's mortgage portfolio was 10.2% higher than a year earlier, with the buy-to-let book having grown by 11.7%, despite the sale of a £732.00m portfolio of loans into Paragon Mortgages (No. 27) PLC ('PM27') securitisation.

The annualised redemption rate on all of the post-2010 buy-to-let mortgage assets at 7.4% (2019: 10.7%), has continued to reduce, driven partly by the slowing of the market due to Covid-19, partly as a result of continuing initiatives to encourage existing customers to remain with the Bank and partly as a result of the increasing average length of fixed rate periods over recent years.

Arrears on the buy-to-let book as a whole have remained stable in the year at 0.03% (2019: 0.03%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.52% across the buy-to-let sector at 30 September 2020 (2019: 0.42%). This exemplary performance reflects the Bank's underwriting approach, underpinned by a detailed and thorough assessment of the value and suitability of the property as security.

Arrears on originated second charge mortgages increased to 0.62% from 0.38% in the year, as the book began 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 9.0% (2019: 7.7%), 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)

The Bank has established a significant market position in specialist buy-to-let which offers good prospects for future earnings and profitability, though significant expansion of volumes is not anticipated in the year ending 30 September 2021.

COMMERCIAL LENDING

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

New lending volumes have been depressed in the year across most of the sectors in which the commercial lending business is active as a result of the global Covid-19 pandemic, together with other political and economic uncertainties.

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.

	2020 £m	2019 £m
Motor finance	109.9	148.9
Structured lending	7.6	49.7
	117.5	198.6

Commercial lending decreased by 40.8% in the period. After a positive first six months of the year, business was sharply reduced in the second half due to the impact of Covid-19.

The motor finance business saw a drop in advances with a 26.2% decrease in new lending. The Bank's strategy for motor finance is to target its offerings on those specialist propositions not typically addressed by mass-market lenders. New business was sharply reduced in the second half due to the substantially reduced levels of activity seen in the automotive market throughout the Covid-19 crisis.

The Bank's structured lending exposure has grown in the period by 7.7%, mostly as a result of additional drawings on extant facilities in the first half year, although new facilities of £8.0 million came on stream during the year. These loans generally fund non-bank lenders, of various kinds, and as such facilities are carefully constructed to provide a buffer for the Bank in the event of default in the ultimate customer population, with first loss cover of at least 20% in all cases. The impact of Covid-19 on each of the exposures varies with the nature of the underlying assets and the Bank's experienced account managers have carefully monitored each of the facilities, maintaining a high level of contact with the counterparties.

Across all business lines growth has been carefully controlled with credit quality and margins prioritised over expansion and care has been taken to focus effort on those sectors or subsectors of the market most suited to the Bank's business model and most likely to provide it with a good return on capital.

STRATEGIC REPORT (Continued)

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

	30 September 2020 £m	30 September 2019 £m
Motor finance	256.9	281.3
Development finance	49.4	81.9
Structured lending	94.9	88.1
	401.2	451.3

Margins on commercial lending have remained strong. Arrears on the commercial lending business remain low with arrears in the motor finance business at 1.76% (2019: 1.27%).

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

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectations. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 30 September 2020 no accounts had been identified by the monitoring process as being likely to result in a loss. The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 61.6% (2019: 61.6%).

The Bank's intention is to continue to develop its commercial lending business, both on balance sheet and through investment in subsidiaries, selectively focussing on those areas where the greatest return can be achieved. This will involve both increasing the reach of its existing offerings and adding further product lines or specialisms, to improve the diversity of its loan book. It will also prioritise maintaining margins and customer relationships in the existing books.

GROUP ENTITIES

During the period the amounts loaned to other Group entities increased to £1,224.7 million (2019: £1,176.0 million). The increase principally resulted from the Bank's subscription for £772.1 million of notes as part of the PM27 securitisation.

STRATEGIC REPORT (Continued)

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.

The Bank's external funding at 30 September 2020 and 30 September 2019 is summarised as follows:

	2020 £m	2019 £m
Retail deposit balances	7,856.6	6,391.9
Central bank facilities	1,854.4	994.4
Total on balance sheet funding	9,711.0	7,386.3
Off balance sheet central bank facilities	-	108.9
	9,711.0	7,495.2

RETAIL FUNDING

The Bank's savings business provides customers with a range of deposit options, offering value for money and competitive rates, combined with the protection provided by the Financial Services Compensation Scheme ('FSCS'). While the business currently sources the majority of deposits through its own website, it also has an increasing presence on wealth management platforms.

Retail deposits continue to represent a reliable, cost-effective and scalable source of finance for the Bank. The volume of retail deposits has continued to grow significantly during the period, in line with the Bank's funding strategy, with balances at 30 September 2020, at £7,856.6 million, having increased by 22.9% over the year (2019: £6,391.9 million).

The Bank's share of the overall UK savings market remains small, with opportunities identified to expand the franchise. Household savings balances reported by the Bank of England increased by 5.5% in the year ended 30 September 2020 to £1,287.9 billion (2019: £1,220.9 billion), although these deposits remain overwhelmingly with clearing banks and building societies. While this market position enhances the Bank's funding flexibility, it does mean that rates may be influenced by the funding needs of other, larger, participants in the market, which are beyond the Bank's control.

New entrants in the banking market have sought to access similar segments of the savings market as the Bank, and therefore competition for internet-sourced deposits has increased. However, the Bank's competitive position on pricing, products and service, have meant that it has been able to achieve its required funding levels at attractive prices.

STRATEGIC REPORT (Continued)

Savings balances at the year end are analysed below.

	Average interest rate		Proportion of deposits	
	2020	2019	2020	2019
	%	%	%	%
Fixed rate deposits	1.69%	2.02%	63.3%	65.0%
Variable rate deposits	0.72%	1.43%	36.7%	35.0%
All balances	1.34%	1.81%	100.0%	100.0%

The average initial term of fixed rate deposits was 27 months (2018: 28 months).

Market savings rates in the year have fallen substantially, with the Bank of England quoting average interest rates at 30 September 2020 for new 2-year fixed rate deposits at 0.48% (2019: 1.41%) and for instant access balances at 0.07% (2019: 0.42%). Some market disruption was created in the second half year by the short-term pricing strategy adopted by National Savings and Investments, but the strength of the market meant that the Group was able to source its funding requirements throughout the period.

The core route to market for the deposit proposition is through its online presence, with traffic driven by strong repeat business flows, organic searches, a presence on price comparison websites and recommendations from industry savings experts. The Bank also offers postal products, which tend to appeal to a different demographic to the online offering.

Growth in the deposit balance was enhanced by the launch of a flexible ISA product, which proved successful in the spring 2020 ISA season. Other enhancements to the product range are also being developed.

Offerings through third-party channels, including investment platforms and savings marketplaces operated by digital banks for their customers, provide access to further demographics and enhance the Group’s ability to manage deposit inflows. The Bank currently has four such relationships and is investing in people and systems to further develop this part of the business.

In customer feedback 88% of those opening a savings account with the Bank in the year who provided data, stated that they would ‘probably’ or ‘definitely’ take a second product (2019: 89%). The net promoter score in the same survey was +61 (2019: +65).

When customers with maturing savings balances in the year were surveyed, 90% stated that they would ‘probably’ or ‘definitely’ consider taking out a replacement product with the Bank (2019: 91%) with a net promoter score at maturity of +50, similar to the +53 recorded for the 2019 financial year.

Given the benefits to customer and deposit retention of maintaining high service standards, these results give the Bank great confidence in its market position. This is supported by continued success in industry awards. During the year, Paragon Bank won the ‘Best Monthly Interest Provider’ award in the 2020 Moneynet awards, the third year in a row it had received this accolade, and was named ‘Best Multi-Channel Savings Provider’ at the 2020 Savings Champion Awards.

STRATEGIC REPORT (Continued)

The Bank's outsourced deposit administration platform continues to perform well, and its service levels have not been significantly impacted by Covid-19 during the year. It provides a cost-effective, stable and scalable solution in the medium to long term, and the Bank has invested in its systems to manage the relationship.

Overall, the savings proposition provides the Bank with a stable funding platform, with a focus on term funding to manage interest rate risk and the ability to limit product availability to short periods of time, giving the funding channel flexibility and manageability. The operation will continue to expand the scope of its products, address wider demographics and explore new channels to market. The Bank's broad product offering and the FSCS guarantee are likely to reduce the potential for any Covid-19 related economic downturn to impact liquidity and the Bank's profiling of its target customers suggests they may be more resilient than average in such circumstances.

CENTRAL BANK FACILITIES

During the year the Bank has increased its use of central bank funding as the Bank of England channelled funds into the UK economy through the banking sector in order to support SMEs through the Covid-19 crisis.

The Bank has been approved to participate in the SME Term Funding scheme ('TFSME') and had drawn £910.0 million by 30 September 2020. This scheme provides access to funding appropriate for the Bank's operations with a four year term with interest payable at the bank base rate, using either mortgage assets or mortgage securities as collateral. This makes these borrowings readily accessible and cost effective for the Group.

Drawings under the Term Funding Scheme ('TFS') remain in place and provide £944.4 million of the Bank's funding (2019: £944.4 million). These begin to fall due for repayment during the next financial year, with repayments allowed for in the Bank's liquidity planning.

The Bank also utilised the Indexed Long-Term Repo scheme ('ILTR') for six-month borrowings, although no borrowings remained outstanding at the year end (2019: £50.0 million) and the Contingent Term Repo Facility ('CTRF') during the year. The Bank's off balance sheet exposure under the Funding for Lending Scheme ('FLS') was settled in the year (2019: £109.0 million).

The Bank has also pre-positioned mortgage loans and certain other assets with the Bank of England to act as collateral for future drawings on central bank funding lines, including the TFSME, if and when required, providing access to liquidity or funding of up to £684.0 million.

The Bank will continue to utilise central bank facilities in future, subject to availability, as part of its integrated funding framework.

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 £338.4 million at 30 September 2019 to £409.6 million at 30 September 2020.

STRATEGIC REPORT (Continued)

DIVIDENDS AND DISTRIBUTIONS

During the year the Bank paid an interim dividend of £110.2 million (2019: £18.2 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 to 2020. The Bank anticipates making a dividend payment in respect of its 2020 profit during the year ending 30 September 2021, subject to its anticipated capital requirements and its trading performance.

REGULATORY CAPITAL

The Bank is subject to supervision by the PRA. As part of this supervision, the regulator will issue individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Bank is required to hold relative to its risk weighted assets in order to safeguard depositors in the event of severe losses being incurred. For the Bank, these amounts are calculated by reference to the entity together with certain subsidiaries (together the 'Bank's regulatory group').

The Bank regulatory group maintains extremely strong capital and leverage ratios, with a total capital ratio of 16.6% at 30 September 2020 (2019: 17.2%) and a UK leverage ratio at 7.1% (2019: 7.2%) (note 7). The CET1 ratio, 14.4% at 30 September 2020, reduced during the period (2019: 14.9%), reflecting the growth in the balance sheet and distributions to shareholders.

As a matter of strategy, the Bank maintains strong capital and leverage ratios, its principal capital measures being set out below. It was granted transitional relief on the adoption of IFRS 9, with the impact on capital of additional impairments being phased in over a five-year period, with only 15.0% of the effect being recognised in this, the second year (2019: 5.0%). However, firms are also required to disclose capital measures as if the relief has not been given (referred to as the 'fully loaded' basis).

During the year, as part of a package of measure to mitigate the economic impacts of Covid-19, regulators increased the scope of this IFRS 9 relief to additionally defer impairment provisions made in the current year. This has widened the gap between the basic and fully loaded bases.

		2020 IFRS 9 £m	2019 IFRS 9 £m
CET1 capital	Basic	983.81	977.21
	Fully loaded	943.11	956.76
Total Regulatory Capital ('TRC')	Basic	1,133.81	1,127.21
	Fully loaded	1,093.11	1,106.76

The Bank's CET1 capital comprises its equity shareholders' funds, adjusted as required by the CRD IV rules. TRC, in addition, includes tier 2 capital representing the Tier 2 Bonds.

The Bank's capital requirements include the Pillar 1 + 2a amount which is specific to the Group and is set by the regulator. This may include both variable and fixed components. At 30 September 2019 this requirement was £738.85 million on the transitional basis and £734.63 million on the fully loaded basis (2018: IAS 39 £705.0 million), with the increased requirement principally driven by the growth in the Group's asset base.

STRATEGIC REPORT (Continued)

Available capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of total risk exposure. While the CCoB remained at 2.5%, its long-term rate, throughout the year, the CCyB was cut from 1.0% to zero during the period as a regulatory response to the pandemic. However, it was also announced that the long-term normal rate of the CCyB in the UK would be 2.0%. Further buffers may be set by the PRA on a firm-by-firm basis but may not be disclosed.

The Total Capital Requirement for the Bank (Pillar 1 and Pillar 2A) must be met with at least 56% Common Equity Tier 1 (CET1) capital, and can include no more than 44% Additional Tier 1 ('AT1') capital and no more than 25% Tier 2 capital. Other capital requirements, including the CRD IV buffers, must be satisfied with CET1 capital.

The Bank's capital ratios are set out below.

		2020 IFRS 9	2019 IFRS 9
CET1 ratio	Basic	14.4%	14.9%
	Fully loaded	13.9%	14.6%
Total capital ratio	Basic	16.6%	17.2%
	Fully loaded	16.1%	16.9%
UK leverage ratio	Basic	7.1%	7.2%
	Fully loaded	6.8%	7.0%

Capital ratios remain largely in line with previous performance, with IFRS 9 transition not having a major impact.

As a result of the Covid-19 situation the Basel Committee on Banking Supervision has deferred the implementation date of its revisions to the Basel III framework which were to take effect on 1 January 2022 to 1 January 2023, subject to those revisions being enacted in the relevant jurisdiction (expected to be CRD VI / CRR III in the EU framework). This means that changes which would have potentially increased the Group's Total Risk Exposure ('TRE') calculated under the standardised approach will be delayed.

The first stage of the Group's application for the accreditation of its Internal Ratings Based ('IRB') approach to credit risk for capital adequacy purposes was submitted to the PRA in March 2020. This phase of the application covers the Group's buy-to-let mortgage assets and considerable work has taken place to reach this stage. Models have been built and tested, governance frameworks enhanced, and IRB outputs are now being regularly considered internally. Work on this project has continued to progress throughout the second half of the year.

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 set out below.

STRATEGIC REPORT (Continued)

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 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 monthly average LCR for the year was 173.7% compared to 143.7% during 2019, reflecting the steps taken to enhance liquidity in response to the Covid-19 situation. The year end NSFR stood at 114.7%, in line with the 115.0% reported at 30 September 2019. This shows the available liquidity at the year end to be well in excess of regulatory minimums.

FINANCIAL REVIEW

The Bank receives interest income from the assets on its own balance sheet but, also receives significant levels of dividends and other returns from its operating subsidiaries, reflected as other operating income in its income statement. Operating profits before tax for the Bank increased to £110.2 million in 2020 (2019: £107.0 million).

	2020 Total £m	**2019 Total £m**
Interest receivable	274.4	247.4
Interest payable and similar charges	(149.1)	(136.2)
Net interest income	125.3	111.2
Other operating income	58.9	72.8
Total operating income	184.2	184.0
Operating expenses	(64.0)	(61.6)
Provisions for losses	(15.5)	(3.8)
	104.7	118.6
Fair value net gain / (loss)	5.5	(11.6)
Operating profit being profit on ordinary activities before taxation	110.2	107.0
Tax charge on profit on ordinary activities	(15.6)	(9.8)
Profit on ordinary activities after taxation	94.6	97.2

Total operating income was broadly unchanged when compared to 2019 at £184.2 million (2019: £184.0 million).

Net interest income increased by 12.7% to £125.3 million from the £111.2 million recorded in the year ended 30 September 2019. The increase principally reflects growth in the size of the loan book, which rose by 8.4% to £5,832.3 million over the year (2019: £5,381.8 million).

Other operating income in 2020 included £53.0 million of dividends from subsidiary companies (2019: £68.7 million). Aside from this, fee income decreased to £2.9 million (2019: £4.1 million) reflecting the lending conducted during the year.

STRATEGIC REPORT (Continued)

Operating expenses increased to £64.0 million from £61.6 million reported in the previous year. The Board remains focussed on controlling operating costs through the application of rigorous budgeting and monitoring.

Impairment charges totalled £11.5 million for 2020 compared to £3.8 million during 2019. The major factors driving this increase was the impact of Covid-19 on expected customer behaviour and the impact of lower projected asset values in the event of default. Up to the point of the impact of Covid-19 on the UK in March, the Group's provision data was largely positive, with charges remaining in line with expectations. However, from the half year onwards the Bank factored the potential impact of Covid-19 into its consideration of expected credit losses. While IFRS 9 is intended to provide for expected future losses, the unprecedented and unexpected nature of the Covid-19 crisis resulted in a sharp increase in provisions to reflect the fundamental change in economic outlook.

In addition to applying a more severe suite of economic projections to the Bank's IFRS9 impairment models, the year-end analysis also takes explicit account of payment holidays granted to customers during the year, together with adjusting for the lagging effect government policy has had, and potentially continues to have, on observable impairment. Careful consideration was also given to the extent to which the Group's base models, derived on the basis of historic data, can accurately predict behaviour in these unprecedented circumstances.

The impairment calculations generate £5.5 million of the £11.5 million total balance sheet provision, with the balancing £6.0 million being post model adjustments ('PMAs') based on management's judgement of the effects of lagging and payment reliefs.

Whilst almost 95% (by value) of accounts which had been granted relief have since returned to a fully paying status, there has been materially more arrears volatility amongst those loans where extensions were granted, both worsening and improving. This generally increased level of volatility for the portfolio has resulted in management increasing the probability of default for this population above the levels suggested by the underlying models, but this increase is only considered significant in respect of accounts that have taken a payment holiday extension. Such accounts have been transferred from Stage 1 to Stage 2 for impairment purposes.

The Bank creates four macro-economic scenarios to underpin its IFRS 9 impairment modelling, and business forecasting. These comprise a base case position, an upside, a downside and a severe case. Covid-19 has had a material impact on the most recent iteration of these forecasts when compared to the Bank's 2019 economic outlook for the same periods. The forecast economic assumptions within each scenario, and the weightings applied are set out in more detail in note 17 to the accounts.

These economic assumptions are principal inputs to the Bank's IFRS 9 models. The probability of default profiles arising from the models have, in turn, been re-phased to reflect the impacts of policy reactions to Covid-19, essentially incorporating a lag in the profile. Intervention by the UK Government has suppressed enforcement action by lenders, while recorded arrears performance and market credit data is currently not fully representative of underlying credit quality due to the payment relief rules.

The lag applied by the Bank ensures that the consequences of the GDP reduction experienced since the half year are still adequately reflected in the model output, where, thus far, the impairments that would normally be expected to arise from such changes are yet to emerge.

The material reductions in both spot and forward rates during 2020 have resulted in a fair value gain of £5.5 million for the year arising from the Bank's hedging activities. This compares to a charge of £11.6 million during 2019. The fair value movements reflect non-cash items and revert to zero over the lives of the instruments involved.

STRATEGIC REPORT (Continued)

Corporation tax has been charged at the rate of 14.2%, increased from 9.1% 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 27.3%, with the underlying rate of UK corporation tax applying to the Bank in the year, 19.0%, being increased by the 8.0% Bank Tax Surcharge for a proportion of the Bank's profits.

Profit after taxation of £94.6 million (2019: £97.2 million) have been transferred to consolidated equity, which totalled £770.4 million at the year end (2019: £786.1 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 16 to 23 and in notes 35 to 39. A discussion of critical accounting estimates is set out in note 43.

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

OPERATIONS

ENVIRONMENT

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

EMPLOYEES

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

Approved by the Board of Directors

and signed on behalf of the Board

RICHARD WOODMAN

Director

15 December 2020

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 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.

This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Bank but rather those which the Bank believes have the potential to have a significant impact on its financial performance and future prospects.

To identify and control the risks to which it is exposed, the Bank employs a risk management framework. As part of this framework, principal risks are identified and assessed within the key categories of Business Risk, Credit Risk, Conduct Risk, Operational Risk, Liquidity and Capital Risk and Market Risk.

The change in the perceived level of each risk in the last financial year is indicated using the symbols shown below:

	Risk increasing		Risk decreasing		Risk stable

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Capital Risk</th></tr>
<tr><th>Description</th><th colspan="2">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 its strategic goals.

In addition, the changes made in the Basel III capital regime by the BCBS regarding minimum capital requirements, which will now impact from 1 January 2023 could have an impact on the capital position of the Bank.</td><td colspan="2">A robust process exists over Pillar 1 reporting with a comprehensive annual ICAAP assessment including all material capital risks.

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

The Bank took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB (‘Internal Ratings Based’) approach for credit risk. The first stage of the Group’s application for the accreditation of its IRB approach to credit risk for capital adequacy purposes was submitted to the PRA in March 2020. Models have been built and tested, governance frameworks enhanced, and IRB outputs are now being regularly considered internally.</td></tr>
<tr><td>Change</td><td>Outside of the impact of Covid-19, which resulted in the delay of the BCBS changes by 12 months (to 2023) and policy amendments to the Pillar 2A regime there has been little impact on the overall capital risk framework and the Bank’s assessment of the likely impact of these changes.</td><td></td></tr>
</table>

<table>
<tr><th colspan="3">Liquidity and Funding Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>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.</td><td colspan="2">The Bank maintains a diversified range of retail medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs.

Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due, even under stressed conditions.

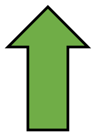
The Bank utilises the Group’s dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements. The Board, through the delegated authority provided to the ALCO, sets limits as to the level, composition and maturity of liquidity resources.</td></tr>
<tr><td>Change</td><td>The Bank remains well placed to access funding from a wide range of sources to meet its future funding requirements. During the year, the Bank completed a fully retained securitisation which boosted its contingent funding options and also obtained access to the TFSME which remains open for drawings until April 2021.</td><td></td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Market Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The Bank is exposed to the risk that changes in interest rates at which it lends and those at which it borrows may adversely affect its net interest income and profitability. In addition, its financial performance may be affected by fluctuations in the exchange rates between currencies.</td><td colspan="2">This risk is managed within Board approved risk appetite limits with comprehensive treasury polices in place to ensure that the risk posed by changes and mismatches in interest or exchange rates are effectively managed.

Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO.

The Bank seeks to match the maturity profile of assets and liabilities and uses financial instruments, such as interest rate swaps, to hedge the exposure arising from repricing gaps.</td></tr>
<tr><td>Change</td><td>The Bank's market risk profile, relative to its balance sheet, has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. However, with LIBOR expected to cease to exist before the end of December 2021, the Bank will need to transition LIBOR referenced assets and liabilities to alternative risk-free rates, and this process is expected to increase interest rate risk over the next 12 months.

A LIBOR Transition steering committee has been established to oversee the transition and the Bank is working with several industry and regulatory bodies as part of the process.</td><td></td></tr>
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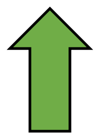
PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Credit Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>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 colspan="2">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>Change</td><td>At the onset of the Covid-19 pandemic, the Bank immediately tightened credit criteria for new lending to preserve credit standards and reflect immediate lending uncertainty.
The Bank's credit discipline remains firm, but in view of the wider economic conditions, additional provision for credit losses has been allocated in line with a prudent, forward-looking view of loan performance.</td><td></td></tr>
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PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Model Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>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 colspan="2">As the use of internally developed models has increased across the Bank, a robust framework and governance has been developed to manage the associated risks. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Bank and the wider group.

The Model Governance Framework provides a structured and disciplined approach to the management of model risk. This includes clear development, implementation and ongoing oversight principles together with the requirements for independent validation based on model materiality criteria.</td></tr>
<tr><td>Change</td><td>It is recognised that the increasing use of internally developed models will drive a commensurate risk to the Bank. However, given the strength of the framework and oversight processes, model risk remains within appetite and the outlook remains stable.</td><td></td></tr>
<tr><th colspan="3">Reputational Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>Maintenance of a strong reputation across all lines of business and operational activities is core to the Group’s philosophy.

Detrimental reputational impacts may result from crystallisation of other principal risks, but also through failure to safeguard the integrity of the brand or failing to meet external expectations in conducting business practices.</td><td colspan="2">The reputational impacts of any changes to strategy, pricing, processes are explicitly considered in the decision-making process and are reviewed by the Director of External Relations.

The Group has an experienced External Relations function who manage all Group communications and ensure that the reputational profile of the Group remains protected at all times.

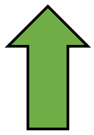
All material risk events are reviewed for reputational impact and mitigating actions are initiated as appropriate.</td></tr>
<tr><td>Change</td><td>The Group continues to manage its reputation effectively in all its dealings. Whilst it is mindful that the threat to reputation can emanate from many sources, the Group remains well-placed to respond quickly and efficiently to any reputational issue.</td><td></td></tr>
</table>

PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Strategic Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The Bank's strategy as a specialist lender is key to its operating model and business planning. However, there is a risk that changes to the business model or macroeconomic, geopolitical, regulatory, competitive or other factors may impact delivery of strategic objectives.</td><td colspan="2">The Bank closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors.

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

The Bank continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed lender.</td></tr>
<tr><td>Change</td><td>UK economic performance remains highly uncertain. The medium and longer- term impacts of Covid-19 are still to be determined. Whilst the Bank has continued to remain resilient in the immediate crisis, the potential for future waves of the pandemic and associated lockdowns still present a significant risk.

In addition, there is still a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. The continuing high levels of uncertainty has resulted in an increase in the overall risk assessment.</td><td></td></tr>
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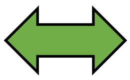
<table>
<tr><th colspan="3">Climate Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The Bank considers the impact of climate change either directly on the Bank or indirectly through its third-party relationships.

This includes the transitional risk to its strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment</td><td colspan="2">The Bank proactively manages physical risk and has specific underwriting policies aimed at mitigation, for example, risks associated with flooding and coastal erosion.

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 tightening of efficiency standards for domestic properties has the potential to impact the buy-to-let market and the energy performance of property stock. The Credit Committee has considered the EPC data to provide an insight into the energy efficiency of properties on which the Group lends.

Longer term strategic planning will also be informed by the ongoing analysis.</td></tr>
<tr><td>Change</td><td>During the year the CFO has been assigned the SMF with responsibility for climate change and has taken the lead in developing Paragon's understanding of the issue.

The Board has adopted climate change as a new principal risk. A working group reporting to ERC has been established to consider the plan of work required to embed the management of climate related risks within the Group.</td><td></td></tr>
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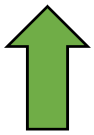
PRINCIPAL RISKS AND MITIGATIONS

<table>
<tr><th colspan="3">Conduct Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The commitment to delivering fair customer outcomes is at the heart of the Bank's and the Group's culture.

Conduct risk arises where the culture and behaviours fail to promote the customer's best interests resulting in unfair outcomes for the customer.</td><td colspan="2">The Bank is covered by the Group's formal Conduct Risk Management framework, which includes detailed policies addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy. This sets out the overarching approach to the management of conduct risk.

The management of conduct risk within the Bank is tailored to the specific product and customer type concerned including dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers and appropriate management of vulnerable customers.

All employees are required to undertake conduct risk related training.

The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.</td></tr>
<tr><td>Change</td><td>Given the unprecedented challenges of Covid-19 and the need to respond quickly to changing circumstances, there is a heightened risk that customer outcomes have not been fully considered or unintended consequences may arise.</td><td></td></tr>
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PRINCIPAL RISKS AND MITIGATIONS

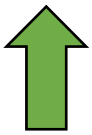
<table>
<tr><th colspan="3">Operational Risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>Operational Risk arises across the Bank through the possible inadequacy or failure of internal processes, people and systems or from external events.

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.</td><td colspan="2">The Group’s operational risk framework, which covers the Bank, has been enhanced over the last 18 months to ensure that it is comprehensive and enables timely and accurate analysis of operational risk exposures and drives accountability and remedial actions where issues are identified.

Management of operational risk is enabled through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Change Management, Procurement, Data Protection, Financial Crime and People.

The Bank is committed to ensuring it remains resilient particularly in respect of IT capability. Significant investment has been undertaken to ensure it is well-protected in the face of the evolution of cyber threats. The Bank relies on third party providers for a number of key services including in the provision of its savings offering and in respect of critical IT services. The robust oversight of third parties is seen as critical to overall resilience.

Continued investment in people has been undertaken to ensure that risk exposures are minimised. This includes management of key dependency risk through effective succession planning, recruitment, development and retention strategies.</td></tr>
<tr><td>Change</td><td>Inevitably with the Covid-19 pandemic there have been increased challenges in managing the business operations. The impacts of new working arrangements, rapid redeployment of people to support additional processes such as payment holidays and the need to manage the IT challenges arising as a consequence, increase the risk that process failings may occur.

Whilst the Bank has successfully navigated the transition to operating effectively in the pandemic environment, given the ongoing uncertainties and economic outlook, the potential for operational risk issues remains heightened.</td><td></td></tr>
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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 2020.

DIRECTORS

The directors who served during the year:

Fiona J Clutterbuck

Nigel S Terrington

Richard J Woodman

John A Heron (resigned 6 January 2020)

Finlay F Williamson

Peter J Hartill (resigned 30 September 2020)

Barbara A Ridpath

Hugo R Tudor

Graeme H Yorston

Alison C M Morris (appointed 26 March 2020)

Peter A Hill was appointed to the Board on 27 October 2020, after the end of the financial year.

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 161 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 directors of all of the Company's subsidiary entities.

CORPORATE GOVERNANCE STATEMENT

As part of the wider Paragon Banking Group, the Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in July 2018 ('the Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2020, the Bank complied with the principles and provisions of the Code, so far as these can be applied to a subsidiary entity.

Although the Listing Rules and the Code only strictly applies to Paragon Banking Group PLC ('PBG'), PBG promotes high standards of governance and there is a clear need to ensure that corporate governance practices are applied throughout the Group to meet these standards and in order to ensure that the Bank is able to discharge its own governance responsibilities effectively. Additionally, as a significantly-sized company in its own right, the Bank is required to adopt and disclose against its own corporate governance arrangements. With this in mind, insofar as the Code and this 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)

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.

The Bank's Annual Report is the first to be produced since our adoption of the new Code. The table below indicates the relevant sections of the Group's Annual Report for the year ended 30 September 2020 which describe in further detail how the Code's Principles have been applied, throughout the Group and to the Bank, and explains at a high level how the Company has aligned its practices with the principles of the Code.

Section 1: Board Leadership and Company Purpose	Section (s)
A: The Company is led by an effective and entrepreneurial board, who promote the long-term sustainable success of the Company, generating shareholder value and contributing to wider society.	B3
B: The Company's purpose, values and strategy, which aligns with its culture, has been established and is promoted by the Board.	B1
C. The Board ensures that necessary resources are in place for the Company to meet its objectives and measure performance and has established a framework of effective controls which enables risk to be assessed and managed	B8
D. The Board ensures effective engagement with stakeholders and encourages their participation.	B4.3
E. The Board ensures that workforce policies and practices are consistent with the Company's values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.	B4.3
Section 2: Division of Responsibilities	
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.	B4.1
I. The Board, supported by the Company Secretary, has the policies, processes, information, time and resources required to function effectively and efficiently.	B4.1
Section 3: Composition, Succession and Evaluation	
J. Appointments to the Board are subject to a formal, rigorous and transparent procedure, and an effective succession plan is in place for Board and senior management. Appointments and succession plans are based on merit and objective criteria and promote diversity.	B5
K. There is an appropriate mix of skills, experience and knowledge. Tenure and membership of the Board and its committees are regularly reviewed.	B4.4
L. As part of an annual evaluation the Board, and each individual director, considers composition, diversity and effectiveness.	B4.4

DIRECTORS' REPORT (Continued)

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 Company's position and prospects.	B6
O. The Board has established procedures to manage risk, oversee the internal control framework, and determine the principal risks the Company is willing to take in order to achieve its long-term strategic objectives.	B8
Section 5: Remuneration	
P. Remuneration policies and practices support strategy and promote long-term sustainable success. Executive remuneration is aligned to the Company'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 director and senior management remuneration.	B7
R. Directors should exercise independent judgement and discretion over remuneration outcomes, taking account of company and individual performance, and wider circumstances	B7

BOARD AND STAKEHOLDERS

While good corporate governance is important to the Board, so is maintaining a reputation for high standards of business conduct in all of the Bank's operations, and management of conduct risk is a key part of the risk management framework. Paragon Banking Group PLC's ('PBG') 2020 Annual Report sets out information on corporate responsibility, including the Group's people policies and engagement with employees, involvement in industry initiatives, support for the community and environmental, social and conduct impacts. All of these policies apply to the Bank, which shares a unified business framework with the rest of the Group.

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

The Board is kept updated on all material issues by the executive directors and receives regular updates from Executive Committee members, other senior managers and external advisers. Members of the Board also engage directly with employees, shareholders of PBG as the Company's ultimate shareholders and regulators.

DIRECTORS' REPORT (Continued)

The Board confirms that, for the year ended 30 September 2020, it has acted to promote the success of the Bank for the benefit of its members and continues to have due regard to the following matters laid out in section 172 (1) of the Companies Act 2006:

a. The likely consequences of any decision in the long-term;

b. The interests of the Group's employees;

c. The need to foster the Bank's business relationships with suppliers, customers and others;

d. The impact of the Bank's operations on the community and the environment;

e. The desirability of the Bank maintaining a reputation for high standards of business conduct; and

f. The need to act fairly as between members of the Bank.

From 2020, companies have been 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, stakeholder engagement takes place at a group level and the Company looks to group initiatives for guidance and takes them into account in its decision making as there is substantial common identity between the non-shareholder stakeholders of the Company and those of the Group. The Company 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 2020 Annual Report and Accounts.

The PBG and the Company'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 Company makes autonomous decisions on each decision's own merits, after due consideration of the long-term success of the Company, 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 groups entities (s172 (1)(b)). It has a single shareholder, Paragon Banking Group PLC (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 and how this is aligned to its strategic priorities. Reference is made, where appropriate, to engagement with stakeholders effected at Group level where appropriate.

DIRECTORS' REPORT (Continued)

Shareholders

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

How we engage and / or monitor

- The Group's ongoing Investor Relations Programme, where over fifty meetings were held with PBG's shareholders
- The Director of External Relations updates each meeting of the Executive Committee on PBG's shareholder movements and shareholder interaction

Outcome

- The summary of PBG's shareholder feedback provided to the Board helps to align the Bank's strategy with the interests of the Group's ultimate shareholders

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

Although the Bank has no external shareholders, as a direct subsidiary of PBG the Board actively considers the Group's shareholders' interests and views

DIRECTORS' REPORT (Continued)

Customers

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

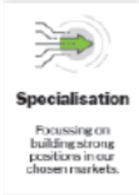
How we engage and / or monitor

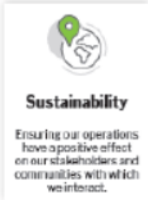
- Regular customer satisfaction surveys on key product lines are reported to the Board
- Focussed analysis on key customer groups
- Deep dive presentation on Customer Insights from the Director of External Relations
- Customer metrics were introduced as a key element of the Performance Share Plan ('PSP') from 2020

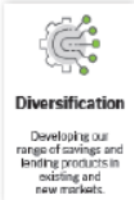
Outcome

- Customer support designated as a strategic priority in the Bank's Covid-19 response
- Customer feedback on key product lines, as measured by NPS, has remained strong
- Web portal updated to reflect specific customer feedback
- Greater understanding of our customers and their priorities refines product offerings, documentation and processes
- Roadmap to improve our savings maturity process is underway

Further information on the Group's relationship with its customers is set out in section A6.2 of PBG's 2020 Annual Report and Accounts.







DIRECTORS' REPORT (Continued)

Employees

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

How we engage and / or monitor

- Regular employee Pulse Surveys and employee check-ins conducted
- The People Director updates the Board and the Executive Committee on employee feedback from surveys and from the Group's People Forum, as well as other metrics
- The Board received a deep dive presentation on culture from the People Director
- Members of the Board attend the Group's People Forum at least twice a year
- Executive Committee members with responsibility for gender diversity and wider diversity have been designated and regularly report progress on these matters
- Nomination Committee receives six-monthly succession planning updates from the People Director
- People metrics were introduced as a key element of the PSP from 2020

Outcome

- Enhanced support for employees impacted by Covid-19 put in place
- The feedback from employee surveys enables the Board to support and understand employees
- Tailored career development programmes embedded across the Group for apprentices through to high potential senior leaders
- Internal appointment of two Executive Committee appointments; CRO and Managing Director – Commercial Lending
- Increased communication to employees regarding culture and values
- Enhanced maternity provision and pension contributions in the year
- Creation of the Equality Diversity and Inclusion network

Further information on the involvement of the Group's people and the impact of policies on them, including steps taken to support them during Covid-19, can be found in section A6.3 of PBG's 2020 Annual Report and Accounts.

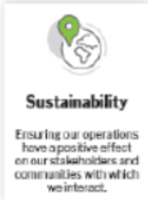
DIRECTORS' REPORT (Continued)

Regulators

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

How we engage and / or monitor

- Regular engagement with the PRA, throughout the year on key regulatory matters, including the IRB implementation
- Direct contact between the Chair and non-executive directors and regulators
- The Executive Committee and Board are kept updated on all interaction with the FCA and PRA
- SMCR is embedded across the Group, with conduct measures monitored monthly, overseen by ERC
- Dialogue maintained with HMRC, with the CFO designated as Senior Accounting Officer, directly responsible for the Group's tax policies
- The Risk element of the PSP includes an assessment of any material regulatory breaches



Outcome

- The Board approved the submission of IRB Module 1 to the PRA in March 2020.
- All changes to the Board and Senior Management Functions are approved by the PRA and FCA.

Further information on the Group's tax policies is set out in Section A6.5 of PBG's 2020 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

Society and community

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

Sustainability

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

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
- Executive Committee members actively support community activities within the business
- Employees support a nominated charity each year via payroll donations and fund-raising efforts

Outcome

- During the first nine months of 2020 our employees raised over £25,000 for this year's nominated charity, Macmillan Cancer Support
- The Board approved the donation of £100,000 across four different organisations supporting people impacted by Covid-19

Further information of the Group's community involvement is set out in Section A6.5 of PBG's 2020 Annual Report and Accounts.

Environment and climate change

Reducing our environmental impact and designing products that support positive environmental change (s172 d)

Sustainability

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

How we engage and / or monitor

- The Board took part in an Insight session on climate change in the context of financial services
- Reporting to the Board on potential risks and business impacts from climate change
- The CFO has been designated as the responsible director for climate change exposures and reports to the Board
- The Group complies with all applicable laws and regulations relating to the environment

Outcome

- Climate Change has been designated as principal risk for the Group in the year
- The Board established new objectives against current energy performance to further reduce consumption

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 2020 Annual Report and Accounts.

DIRECTORS' REPORT (Continued)

Business partners and suppliers -

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

How we engage and / or monitor

- Key business partner relationships, including intermediaries and suppliers are identified actively monitored and reported to the Board and Executive Committee

Sustainability

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

Outcome

- This year the Group published a new Supplier Code of Conduct which sets out our overall approach to supplier engagement and corporate responsibility
- Our suppliers understand the minimum standards we expect from them and our commitments and expectations around bribery and corruption, data protection and modern slavery
- Ongoing engagement with our key suppliers ensuring operational resilience and reduced risk

The Group's management of business partner relationships is discussed further in Section A6.7 of PBG's 2020 Annual Report and Accounts.

AUDITOR

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

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

POLITICAL CONTRIBUTIONS

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

DIVIDENDS

An interim dividend of 19.9 pence per share was paid in the year (2019: 3.3 pence per share) and no final dividend is proposed (2019: nil).

DIRECTORS' REPORT (Continued)

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.
- Information on events occurring after the balance sheet date is shown in note 17.
- 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 note 8 to the accounts.
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in the strategic report.

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

RICHARD WOODMAN

Director

15 December 2020

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 requires the directors to prepare financial statements for the Bank in respect of each financial year. In respect of the financial statements for the year ended 30 September 2019, that law includes the Companies Act 2006 ('the Act'). As permitted by that law the directors have elected to prepare the accounts in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union.

International Accounting Standard 1 – 'Presentation of Financial Statements' requires that financial statements present fairly for each financial year the Bank's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

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 the Act
- 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 proper accounting records for the Bank which disclose with reasonable accuracy at any time its financial position, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a strategic report and directors' report which comply with the applicable requirements of the Act.

The directors are responsible for the maintenance and integrity of the Bank's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

in relation to Financial Statements (continued)

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

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

RICHARD WOODMAN

Director

15 December 2020

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 2020 which comprise the:

- Income Statement
- Balance Sheet
- Cash Flow Statement
- Statement of Movements in Equity
- Related notes, including the accounting policies in note 41, other than the disclosures labelled as unaudited in note 34.

In our opinion:
- the financial statements give a true and fair view of the state of the Company's affairs as at 30 September 2020 and of the Company's profit for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. 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 five financial years ended 30 September 2020. 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 listed public interest entities. No non-audit services prohibited by that standard were provided.

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

Key audit matters are those matters that, in our professional judgment, 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, 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 2019: ▲ (£19.9 million; 2019: £7.2 million) *Refer to the Audit Committee Report, accounting policy note and note 17 (financial disclosures).* ***Subjective estimate*** The measurement of expected credit losses ('ECL') involves significant judgements and estimates. There is increased risk of material misstatement of ECL in the current year due to the increased judgement and estimation uncertainty as a result of COVID-19. The key areas where we identified greater levels of	Our audit procedures included: • **Test of details:** Key aspects of our testing involved: - We tested the key inputs and assumptions impacting the Company's overall ECL calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; benchmarking procedures to compare the Company's key assumptions to comparable peer group organisations; and assessing the key assumptions against the Company's historical experience; and - We performed recalculations of the ECL

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management judgement and 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 determining the economic scenarios used, particularly in the context of COVID-19, and the probability weightings assigned to each economic scenario.
Qualitative adjustments – Adjustments to the model-driven ECL results are raised by management to address issues relating to model responsiveness or emerging trends relating to COVID-19. Such adjustments are inherently uncertain 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. Increased judgement exists in the current year relating to the treatment of those customers who were granted one or more COVID-19 payment reliefs.
Model estimations – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default
('EAD'). The LGD models used in the portfolios are the key drivers of the Company's ECL results and are therefore the most significant judgmental aspect of the Company's ECL modelling approach.
The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Company (note 43).
Disclosure quality
The disclosures regarding the Company's application of IFRS 9 are key to explaining the key judgements and material inputs to the IFRS 9 ECL results.
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measured on each of the Company's loan portfolios.

Our economic scenario expertise: We involved our own economic specialists to assist us in assessing the appropriateness of the Company's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic forecasts by comparing the Company's forecasts to our own modelled forecasts. As part of this work we assessed the reasonableness of the Company's considerations of the economic uncertainty relating to COVID-19.
Qualitative adjustments: For each of the adjustments to the model-driven ECL results we assessed the reasonableness of the adjustments by challenging, the key assumption being the probability of default floors, inspecting the calculation methodology and tracing a sample of data used back to source data.
SICR: We assessed the ongoing predictability of the SICR criteria and independently recalculated the loans' stage for 100% of the Company's loans and receivables. In addition, we assessed the reasonableness of management's treatment of COVID-19 payment relief customers from a SICR perspective.
Our financial risk modelling expertise: We involved our own financial risk modelling specialists in evaluating certain IFRS 9 models. We used our knowledge of the Company and our experience of the industry that the Company operates in to independently assess the appropriateness of the Company's IFRS 9 models and key components.
Assessing transparency: We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's overall ECL. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made, including in respect of COVID-19, was sufficiently clear.

Our results
The results of our testing were satisfactory, and we considered the ECL charge, provision recognised and the related disclosures to be acceptable (2019: acceptable).
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Interest receivable on loan accounts Risk vs 2019: ▲ (£224.4 million; 2019: £247.4 million) *Refer to the Audit Committee Report, accounting policy note and note 4 (financial disclosures).* ***Subjective estimate*** The recognition of interest receivable on loan accounts under the effective interest rate ("EIR") method requires the directors to apply judgement, with the most critical estimate being the loans' expected behavioural life for originated assets. The subjectivity in respect of these assumptions has increased further at the current year-end as a result of the uncertainties arising from COVID-19. The expected life assumptions utilise repayment profiles which represent how customers are expected to pay. These profiles extend significantly into the future which creates a high degree of estimation uncertainty and subjects the judgement to future market changes. The Company makes its expected life assumptions based on its forecasting process which incorporates both historical experience and judgmental overlays by management.	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. This included considering the impact of uncertainties arising from COVID-19 in the current behavioural life forecasts; • **Our sector experience:** We critically assessed key assumptions behind the expected behavioural lives against our own knowledge of industry experience and trends, and challenged the appropriateness of the level of segmentation applied to the loan portfolios by management when determining the expected behavioural lives; and • **Sensitivity analysis:** We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures. • **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's EIR adjustments and interest receivable. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the critical estimates and assumptions made, including in respect of COVID-19, was sufficiently clear; **Our results** We found the resulting estimate of interest receivable on loan accounts and the related disclosures to be acceptable (2019: acceptable).
Recoverability of Company's investment in subsidiaries Risk vs 2019: ◄► (£422.7 million; 2019: £422.7 million) *Refer to the accounting policy note and note 22 (financial disclosures).* **Forecast based valuation** The carrying amount of the Company's investments in subsidiaries are significant and the investment in each of the Company's acquired businesses is at risk of recoverability due to changes in market factors since acquisition. The estimated recoverable amount of this balance is subjective due to the inherent uncertainty involved in forecasting future cash flows and deriving an appropriate discount rate to reflect the time value of money. In calculating the recoverable amount, the directors made assumptions over the following key inputs: profitability growth, the discount rate and the long-term growth rate.	Our procedures included: • **Tests of detail:** We assessed the reasonableness of the carrying amount of each of the Company's investments by comparing the Company's cost of investment to the respective subsidiaries net asset position and/or the forecasted future cash flows that the subsidiary is expected to generate. **Our results** We found the resulting carrying amount of the investments in subsidiaries to be acceptable (2019: acceptable).

Going concern including the impact of COVID-19 New risk in 2020 *Refer to the Chief Executive's Review and accounting policy note 41* ***Disclosure quality*** The financial statements explain how the Directors have formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Company. That judgement is based on an evaluation of the inherent risks to the Company's business model and how those risks might affect the Company's financial resources or ability to continue operation over a period of at least a year from the date of approval of the financial statements. The risk most likely to affect the Company's available financial resources over the period is an increase in the level of expected credit losses measured against loans to customers due to the impact of COVID-19. This impact could lead to insufficient regulatory capital levels over the course of the next 12 months. There are also less predictable but realistic impacts, such as the impact of COVID-19 on liquidity and operational resilience. The risk for our audit was whether or not those risks were such that they amounted to a material uncertainty that may have cast significant doubt on the ability to continue as a going concern. Had they been such, then that fact would have been required to have been disclosed.	Our audit procedures included: ■ **Our sector experience** – We considered the directors' assessment of COVID-19 related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We assessed the directors' plan to take action to mitigate the risks; ■ **Sensitivity analysis –** We assessed the stressed scenarios used by the Company in forecasting profitability, capital and liquidity taking account of possible adverse effects that could arise from these risks individually and collectively; ■ **Challenge of assumptions –** We assessed the Company's forecast profitability, and the Company's capital and liquidity models to identify key assumptions. We challenged the reasonableness of assumptions underpinning the Company's forecasts; and ■ **Assessing transparency –** We critically assessed the completeness and accuracy of the matters covered in the going concern disclosure within the financial statements using our knowledge of the relevant facts and circumstances developed during our audit work, considering the economic outlook, key areas of estimation uncertainty, including in particular the level of expected credit losses for loans to customers and mitigating actions available to the Company to respond to these risks. **Our results:** We found the going concern disclosure without any material uncertainty to be 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 £5.8million (2019: £4.9million), determined with reference to a benchmark of the Group's profit before tax from continuing operations, normalised by averaging over the last three years due to the impact of COVID-19 on the financial performance in the period to 30 September 2020, of which it represents 4.5%. The averaging of the benchmark as a result of the impact of COVID-19 reflected a revision to our initial materiality set for planning purposes, which was based on current year forecast profit before tax.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.29million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

4 We have nothing to report on 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 their 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 their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. 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 absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, we are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement in Note 41 of 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 a period of at least twelve months from the date of the approval of the financial statements.

We have nothing to report in these respects.

5 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.

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

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

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

We have nothing to report in these respects.

7 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 45, 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 other irregularities (see below), 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, other irregularities 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.

Irregularities – ability to detect

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. 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 license to operate. We identified the following areas as those most likely to have such an effect: regulatory capital and liquidity and certain aspects of company legislation recognising the financial and regulated nature of the Company's activities and its legal form. 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.

Through these procedures, we became aware of actual or suspected non-compliance and considered the effect as part of our procedures on the related financial statement items. The identified actual or suspected non-compliance was not sufficiently significant to our audit to result in our response being identified as a key audit matter.

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 (irregularities) 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 irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

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

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

Simon Clark (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
One Snowhill
Snow Hill Queensway Birmingham
B4 6GH

15 December 2020

The Accounts

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

INCOME STATEMENT
For the year ended 30 September 2020

	Note	2020 £m	2019 £m
Interest receivable	4	274.43	247.38
Interest payable and similar charges	5	(149.11)	(136.23)
Net interest income		125.32	111.15
Other operating income	6	58.85	72.76
Total operating income		184.17	183.91
Operating expenses	7	(64.04)	(61.54)
Provisions for losses	9	(15.50)	(3.82)
Operating profit before fair value items		104.63	118.55
Fair value net gain / (loss)	10	5.52	(11.54)
Operating profit being profit on ordinary activities before taxation		110.15	107.01
Tax charge on profit on ordinary activities	11	(15.60)	(9.79)
Profit on ordinary activities after taxation for the financial year		94.55	97.22

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 2020

	Note	2020 £m	2019 £m
Assets			
Cash – central banks	12	1,637.06	816.40
Cash – retail banks	12	36.51	20.83
Short term investments	13	-	-
Loans to customers	14	7,146.78	5,848.32
Derivative financial assets	19	17.98	9.72
Sundry assets	20	574.87	344.53
Deferred tax asset	21	1.29	2.51
Investment in subsidiary undertakings	22	1,647.34	1,598.65
Total assets		11,061.83	8,640.96
Liabilities			
Retail deposits	23	7,866.59	6,395.87
Derivative financial liabilities	19	107.62	72.30
Central bank facilities	24	1,854.40	994.40
Corporate bond	25	150.00	150.00
Sundry liabilities	26	297.89	229.37
Current tax liabilities	27	14.89	12.95
Total liabilities		10,291.39	7,854.89
Called up share capital	28	552.62	552.62
Reserves	29	217.82	233.45
Total equity		770.44	786.07
Total liabilities and equity		11,061.83	8,640.96

Approved by the Board of Directors on 15 December 2020.

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 2020

	Note	2020 £m	2019 £m
Net cash generated by operating activities	30	86.52	47.92
Net cash (utilised) by investing activities	31	-	(80.00)
Net cash generated / (utilised) by financing activities	32	749.82	(48.24)
Net increase / (decrease) in cash and cash equivalents		836.34	(80.32)
Opening cash and cash equivalents		837.23	917.55
Closing cash and cash equivalents		1,673.57	837.23
Represented by balances within:			
Cash	12	1,673.57	837.23
Short term bank borrowings		-	-
		1,673.57	837.23

STATEMENT OF MOVEMENTS IN EQUITY
For the year ended 30 September 2020

Year ended 30 September 2020	Share capital £m	Profit and loss account £m	Total equity £m
Transactions arising from			
Profit for the year	-	94.55	94.55
Other comprehensive income	-	-	-
Total comprehensive income	-	94.55	94.55
Transactions with owners			
Shares issued	-	-	-
Dividends paid	-	(110.18)	(110.18)
Net movement in equity in the year	-	(15.63)	(15.63)
Opening equity	552.62	233.45	786.07
Closing equity	552.62	217.82	770.44

Year ended 30 September 2019	Share capital £m	Profit and loss account £m	Total equity £m
Transactions arising from			
Profit for the year	-	97.22	97.22
Other comprehensive income	-	-	-
Total comprehensive income	-	97.22	97.22
Transactions with owners			
Shares issued	-	-	-
Dividends paid	-	(18.24)	(18.24)
Net movement in equity in the year	-	78.98	78.98
Opening equity			
As previously reported	552.62	156.71	709.33
Change of accounting policy (note 40)	-	(2.24)	(2.24)
As restated	552.62	154.47	707.09
Closing equity	552.62	233.45	786.07

NOTES TO THE ACCOUNTS
For the year ended 30 September 2020

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 2020

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 Company.

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 received from other Group companies.

Transactions with other Group entities are described in note 33.

3. REVENUE

	Note	2020 £m	2019 £m
Interest receivable	4	274.43	247.38
Other operating income	6	58.85	72.76
Total revenue		333.28	320.14

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

4. INTEREST RECEIVABLE

	2020 £m	2019 £m
Interest receivable in respect of		
First mortgages	181.89	161.99
Secured consumer loans	14.95	16.25
Development finance	5.65	9.55
Finance leases	15.32	13.50
Other loans	6.61	4.38
Interest on loans to customers	224.42	205.67
Other interest receivable	13.51	15.70
Interest on group loan	24.15	23.16
Interest on investments	12.35	2.85
Total interest on financial assets	274.43	247.38

The above interest arises from:

	2020 £m	2019 £m
Financial assets held at amortised cost	259.11	233.88
Finance leases	15.32	13.50
	274.43	247.38

5. INTEREST PAYABLE AND SIMILAR CHARGES

	2020 £m	2019 £m
On retail deposits	130.00	114.20
On bank loans and overdrafts	0.50	0.58
On corporate bonds	9.94	9.96
On central bank facilities	4.47	7.99
On intercompany loans	4.16	3.48
Total interest on financial liabilities	149.07	136.21
Other finance costs	0.04	0.02
Total interest payable and similar charges	149.11	136.23

All interest payable on financial liabilities relates to financial liabilities held at amortised cost.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

6. OTHER OPERATING INCOME

	2020 £m	2019 £m
Loan account fee income	2.86	4.06
Deferred sale consideration	2.99	-
Dividend income	53.00	68.70
	58.85	72.76

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

7. OPERATING EXPENSES

	Note	2020 £m	2019 £m
Auditor remuneration	8	0.44	0.39
Financial Services Compensation Scheme levy		0.63	0.73
Other administrative costs		62.97	60.42
		64.04	61.54

Other administrative costs relate to management and administrative services provided by fellow group companies as disclosed in note 33.

8. AUDITOR REMUNERATION

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

	2020 £m	2019 £m
Audit fee of the company	0.44	0.39
Total fees	0.44	0.39
Irrecoverable VAT	-	-
Total cost to the Bank	0.44	0.39

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

9. PROVISION FOR LOSSES

	Note	2020 £m	2019 £m
Impairment of financial assets:			
Loan accounts	17	10.87	3.30
Finance leases	17	0.60	0.52
Balances with group companies		4.03	-
		15.50	3.82

10. FAIR VALUE NET GAIN / (LOSS)

	2020 £m	2019 £m
Ineffectiveness of fair value hedges (note 19)		
Portfolio hedges of interest rate risk		
Deposit hedge	0.24	(0.22)
Loan hedge	(0.58)	(5.57)
	(0.34)	(5.79)
Other hedging movements	5.81	(3.07)
Net gain / (loss) on other derivatives	0.05	(2.68)
	5.52	(11.54)

The fair value net loss 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 losses and gains are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Bank.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

11. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

(a) Analysis of charge in the year

	2020 £m	2019 £m
Current tax		
UK Corporation Tax on profits of the period	14.45	12.53
Adjustment in respect of prior periods	(0.07)	0.39
Total current tax	14.38	12.92
Deferred tax	1.22	(3.13)
Tax charge on profit on ordinary activities	15.60	9.79

The standard rate of corporation tax in the UK applicable to the Bank in the period was 19.0% (2019: 19.0%), based on currently enacted legislation. During the period, legislation was substantively enacted, reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. Consequently, temporary differences which had been expected to reverse at a tax rate of 18% in the current year, or 17% in subsequent years, have either reversed or are expected to reverse at a rate of 19%. The impact of this change has been accounted for in the year.

The Bank's Corporation Tax Surcharge was introduced with effect from 1 January 2016. 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 shown in note (c) below.

(b) Deferred tax charge / (credit) for the year

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

	2020 £m	2019 £m
Change in tax rate	0.28	(0.80)
Other timing differences	0.88	(2.36)
Deferred tax charge / (credit) for the year	1.16	(3.16)
Prior period adjustment	0.06	0.03
Deferred tax charge / (credit) (note 21)	1.22	(3.13)

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

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

(c) Factors affecting tax charge for the year

Accounting standards require companies to explain the difference between the effective rate of tax in the accounts 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. At the current levels of profitability, it is considered appropriate to use the prevailing rate of corporation tax as the 'applicable rate' and to treat the impact of Banking Surcharge as an adjustment as shown below. As noted in (b) above, the UK corporation tax rate applicable to the Bank for the year was 19.0% (2019: 19.0%).

	2020 £m	2019 £m
Profit on ordinary activities before taxation	110.15	107.01
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	20.93	20.33
Effects of:		
Non taxable income	(9.31)	(13.05)
Bank Corporation Tax Surcharge	3.71	2.89
Change of tax rate	0.28	(0.80)
Prior year (credit) / charge	(0.01)	0.42
Tax charge for the year	15.60	9.79

(d) Factors affecting future tax charges

Whilst practically all of the Bank's profit is subject to UK corporation tax, the relationship of its future effective tax rate to the standard rate of UK corporation tax is expected to be primarily driven by the proportion of its taxable profit subject to the Bank Surcharge.

The banking surcharge was introduced with effect from 1 January 2016. This subjects any taxable profits arising in the Bank to an additional 8% of tax to the extent they exceed £25.0m.

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 OECD project on Base Erosion and Profit Shifting ('BEPS').

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

12. CASH AND CASH EQUIVALENTS

	2020 £m	2019 £m
Deposits with the Bank of England	1,637.06	816.40
Balances with central banks	1,637.06	816.40
Deposits with other banks	36.51	20.83
Cash and cash equivalents	1,673.57	837.23

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

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

13. SHORT TERM INVESTMENTS

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

No such securities were held at either 30 September 2020 or 30 September 2019, but the Bank held this type of investment during the year.

14. LOANS TO CUSTOMERS

	Note	2020 £m	2019 £m
Loan accounts	15	5,575.47	5,100.47
Finance lease receivables	16	256.86	281.28
Loans to customers		5,832.33	5,381.75
Fair value adjustments from portfolio hedging		94.14	57.15
Investment in structured entities	18	1,220.31	409.42
		7,146.78	5,848.32

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

15. LOAN ACCOUNTS

Loan accounts at 30 September 2020 and 30 September 2019, which are all denominated and payable in sterling, were:

	2020 £m	2019 £m
First mortgage loans	5,153.01	4,636.12
Second charge mortgage loans	278.13	294.42
Development finance loans	49.45	81.93
Other secured commercial lending	94.88	88.00
	5,575.47	5,100.47

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 24. 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 2020				
In respect of:				
Central bank facilities	2,379.64	-	-	2,379.64
Total pledged as collateral	2,379.64	-	-	2,379.64
Prepositioned with Bank of England	1,072.30	-	-	1,072.30
Other assets not pledged as collateral	1,701.07	278.13	144.33	2,123.53
	5,153.01	278.13	144.33	5,575.47
30 September 2019				
In respect of:				
Central bank funding	1,484.49	-	-	1,484.49
Total pledged as collateral	1,484.49	-	-	1,484.49
Prepositioned with Bank of England	1,873.62	-	-	1,873.62
Other assets not pledged as collateral	1,278.01	294.42	169.93	1,742.36
	4,636.12	294.42	169.93	5,100.47

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

16. FINANCE LEASE RECEIVABLES

With effect from 1 October 2019, the Bank's finance leases have been accounted for in accordance with IFRS 16 (note 40). Balance shown in preceding periods are accounted for in accordance with IAS 17, however both standards require the same accounting treatment.

The minimum lease payments due under these loan agreements are:

	2020 £m	2019 £m
Amounts receivable		
Within one year	83.13	84.40
Within one to two years	76.84	80.59
Within two to three years	60.70	71.05
Within three to four years	37.32	46.87
Within four to five years	13.76	15.16
After five years	25.08	25.27
	296.83	323.34
Less: future finance income	(35.57)	(38.42)
Present value	261.26	284.92

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

	2020 £m	2019 £m
Amounts receivable		
Within one year	73.17	74.34
Within two to five years	166.01	188.31
After five years	22.08	22.27
Present value	261.26	284.92
Allowance for uncollectible amounts	(4.40)	(3.64)
Carrying value	256.86	281.28

None of the Bank's finance lease receivables were pledged as collateral for liabilities at 30 September 2020 or 30 September 2019.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Bank's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 14, including both finance leases, accounted for under IAS 17, 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 month or lifetime ECL, dependant on whether an account has experienced a significant increase in credit risk ('SICR').

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

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

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

In extreme or unprecedented economic conditions, such as the Covid-19 pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. In these circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2020 the effects of the material reductions in GDP since the onset of the Covid-19 crisis had not yet been evidenced in customer credit performance and defaults, due to the lagging effect of government policy interventions. Where customers were given payment reliefs arrears, adverse credit indicators were not recorded by the Bank or other lenders, meaning that both internal credit metrics and external credit bureau data might not accurately reflect the customer's credit position leading to modelled PDs being underestimated.

While forecast economics assume the current economic situation, the future, generally upward, trends also tend to reduce PDs, in a way that may not be justifiable where an underlying credit issue on an account has not emerged, which may result in default as government support initiatives unwind.

In reviewing the subsequent payment patterns of accounts that have been granted Covid-19 reliefs, it is evident that there is higher payment volatility (both in terms of account improvement and deterioration) so whilst credit risk is increased, it is not significant in scale in all cases. The Bank has reflected this position by applying PD floors to its payment holiday population in the main portfolios at Stage 1, and moved accounts with payment holiday extensions to Stage 2, again with floors reflecting extrapolations of recent cohort experience to reflect the more adverse economic conditions forecast within the Bank's macroeconomic scenarios and to allow for the potential under-recognition of losses caused by these effects.

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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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 will future economic expectations.

Where 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.

In determining whether an account has an SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Bank has accepted the advice of UK regulatory bodies that the grant of initial Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

For customers with extended payment reliefs in place, the account has been placed in Stage 2, regardless of other indicators, as a result of the analysis described above. This aligns the Bank's approach to regulatory guidance which suggested that while initial payment reliefs should not automatically be taken as an indication of an SICR, an extension to such a relief was more likely to be so.

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 Bank uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point it is one day past due until it is thirty days past due.

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The Bank's definitions of default for its various portfolios are aligned to its internal operational procedures and the regulatory definitions of default used internally. 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.

IFRS 9 provides a rebuttable presumption that an account is in default when it is ninety days overdue and this was used as the basis of the Bank's definition. A combination of qualitative and quantitative measures were used in developing the definitions. These include account management activities and internal statuses.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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 ninety 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 receiver of rent account, accounts subject to realisation / enforcement procedures and long-term managed accounts, all of which are treated as credit impaired.

IFRS 9 Staging

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 2020

17. 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 2020					
Gross loan book	5,378.77	436.04	37.46	-	5,852.27
Impairment provision	(5.17)	(6.41)	(8.36)	-	(19.94)
Net loan book	5,373.60	429.63	29.10	-	5,832.33
Coverage ratio	0.09%	1.47%	22.31%	-	0.34%
30 September 2019					
Gross loan book					
Gross loan book	5,251.65	112.67	24.64	-	5,388.96
Impairment provision	(2.37)	(0.82)	(4.02)	-	(7.21)
Net loan book	5,249.28	111.85	20.62	-	5,381.75
Coverage ratio	0.04%	0.73%	16.31%	-	0.13%

* 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 2020					
Gross loan book	247.15	10.82	3.29	-	261.26
Impairment provision	(2.05)	(0.54)	(1.81)	-	(4.40)
Net loan book	245.10	10.28	1.48	-	256.86
30 September 2019					
Gross loan book	272.07	10.39	2.46	-	284.92
Impairment provision	(1.73)	(0.39)	(1.52)	-	(3.64)
Net loan book	270.34	10.00	0.94	-	281.28

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

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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, which are automatically deemed to have an SICR.

	< 1 month arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m
30 September 2020			
Gross loan book	421.38	14.66	436.04
Impairment provision	(5.94)	(0.47)	(6.41)
Net loan book	415.44	14.19	429.63
Coverage ratio	1.41%	3.21%	1.47%
30 September 2019			
Gross loan book	98.58	14.09	112.67
Impairment provision	(0.52)	(0.30)	(0.82)
Net loan book	98.06	13.79	111.85
Coverage ratio	0.53%	2.13%	0.73%

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between accounts in the process of enforcement or where full recovery is considered unlikely ('Realisations' in the table), loans being managed on a long term basis where full recovery is possible but which are considered in default for regulatory purposes and buy-to-let mortgages where a receiver of rent ('RoR') has been appointed by the Bank to manage the property on the customer's behalf. 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.

Accounts which no longer meet default criteria but which are being retained in Stage 3 for a probationary period are included with the > 3 month arrears accounts below.

	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
30 September 2020				
Gross loan book	15.65	14.81	7.00	37.46
Impairment provision	(1.51)	(3.39)	(3.46)	(8.36)
Net loan book	14.14	11.42	3.54	29.10
Coverage ratio	9.65%	22.89%	49.42%	22.31%
30 September 2019				
Gross loan book	10.78	9.76	4.10	24.64
Impairment provision	(0.78)	(1.15)	(2.09)	(4.02)
Net loan book	10.00	8.61	2.01	20.62
Coverage ratio	7.23%	11.78%	50.98%	16.31%

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.

	2020 £m	2019 £m
First mortgages	13.96	6.80
Second mortgages	6.90	4.72
Motor finance	1.52	0.97
	22.38	12.49

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17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

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

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

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

	30 September 2020		1 October 2019	
	No.	£m	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	56	9.19	27	4.36
2011 to 2013	13	3.08	7	2.07
2014 to 2016	6	0.80	1	0.14
2016 and later	11	1.74	24	3.19
Total managed accounts	86	14.81	59	9.76
Accounts in the process of realisation	27	4.40	9	1.79
	113	19.21	68	11.55

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

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Movements in impairment provision by stage

An analysis of movements by IFRS 9 stage for the years ended 30 September 2020 and 30 September 2019 is set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 1 October 2019	2.37	0.82	4.02	-	7.21
New assets originated or purchased	0.88	1.38	2.70	-	4.96
Changes in loss allowance					
Transfer to stage 1	0.29	(0.26)	(0.03)	-	-
Transfer to stage 2	(1.55)	1.58	(0.03)	-	-
Transfer to stage 3	(8.63)	(0.20)	8.83	-	-
Changes due to credit risk	11.87	3.09	(5.22)	-	9.74
Write offs	-	-	(1.91)	-	(1.91)
Assets derecognised	(0.06)	-	-	-	(0.06)
Loss allowance at 30 September 2020	5.17	6.41	8.36	-	19.94
Loss allowance at 1 October 2018	1.31	0.54	3.54	-	5.39
New assets originated or purchased	0.78	-	-	-	0.78
Changes in loss allowance					
Transfer to stage 1	0.18	(0.16)	(0.02)	-	-
Transfer to stage 2	(0.20)	0.25	(0.05)	-	-
Transfer to stage 3	(0.37)	(0.15)	0.52	-	-
Changes due to credit risk	0.67	0.34	1.51	-	2.52
Write offs	-	-	(1.48)	-	(1.48)
Assets derecognised	-	-	-	-	-
Loss allowance at 30 September 2019	2.37	0.82	4.02	-	7.21

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 1 October 2019	5,251.65	112.67	24.64	-	5,388.96
New assets originated or purchased	1,645.26	28.59	9.34	-	1,683.19
Changes in staging					
Transfer to stage 1	54.57	(53.77)	(0.80)	-	-
Transfer to stage 2	(397.99)	398.40	(0.41)	-	-
Transfer to stage 3	(35.63)	(5.00)	40.63	-	-
Redemptions and repayments	(419.10)	(47.77)	(34.05)	-	(500.92)
Assets derecognised	(731.16)	(0.84)	-		(732.00)
Write offs	-	-	(1.91)	-	(1.91)
Other changes	11.17	3.76	0.02	-	14.95
Balance at 30 September 2020	5,378.77	436.04	37.46	-	5,852.27
Loss allowance	(5.17)	(6.41)	(8.36)	-	(19.94)
Carrying value	5,373.60	429.63	29.10	-	5,832.33
Balances at 1 October 2018	4,567.66	66.79	26.37	-	4,660.82
New assets originated or purchased	1,748.69	-	-	-	1,748.69
Changes in staging					
Transfer to stage 1	21.31	(20.95)	(0.36)	-	-
Transfer to stage 2	(65.97)	67.59	(1.62)	-	-
Transfer to stage 3	(14.24)	(4.54)	18.78	-	-
Redemptions and repayments	(543.97)	(9.10)	(13.00)	-	(566.07)
Assets derecognised	(469.56)	-	-	-	(469.56)
Write offs	-	-	(1.48)	-	(1.48)
Other changes	7.73	12.88	(4.05)	-	16.56
Balance at 30 September 2019	5,251.65	112.67	24.64	-	5,388.96
Loss allowance	(2.37)	(0.82)	(4.02)	-	(7.21)
Carrying value	5,249.28	111.85	20.62	-	5,381.75

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 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

At 30 September 2020 enforceable contractual balances of £1.69m (2019: £2.44m) 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.

	2020	2019
	£m	£m
Provided in period	11.77	3.30
Recovery of written off amounts	(0.30)	0.52
	11.47	3.82
Of which		
Loan accounts	9.52	0.60
Finance leases	1.95	3.22
	11.47	3.82

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. The Bank 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 Bank and must be consistent.

In developing its economic scenarios, the Bank considers analysis from reputable external sources to form a general market consensus which inform its central scenario. These sources included forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies.

The four economic scenarios comprise a base case, which will normally carry the highest scenario weighting, an upside case, a downside and a severe downside, the latter typically being benchmarked to be at least as severe as scenarios provided by the Bank of England for stress testing purposes. For the 2020 year end, each of the Group's scenarios represents a differing level of impact of the pandemic on the economy and different timings of recovery. They have been reviewed against emerging economic data and updated external forecasts reflecting the most recent information available, including the impact of the UK's second lockdown. The approach utilises data and forecasts from both economic advisers and from public sources, such as Bank of England statements and projections.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

30 September 2020

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	18.0	(7.6)	18.8	(5.9)	17.8	(15.1)	20.5	(17.9)
HPI	5.0	(4.0)	4.0	0.0	4.0	(10.0)	4.0	(20.0)
BBR	0.8	0.1	1.0	0.1	1.0	0.1	0.8	(0.4)
CPI	2.4	0.6	2.3	0.7	2.3	0.2	2.3	(0.3)
Unemployment	7.6	4.0	7.0	4.0	9.0	4.5	9.0	5.3
Secured lending	3.9	3.5	4.8	4.0	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

30 September 2019

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.9	1.2	3.1	1.2	1.6	(1.0)	1.3	(4.7)
HPI	4.3	0.7	9.7	0.9	4.9	(4.7)	5.7	(17.8)
BBR	0.8	0.8	2.5	0.8	0.5	0.5	0.0	0.0
CPI	2.2	2.0	2.2	1.4	3.2	2.0	4.9	2.0
Unemployment	4.1	3.8	3.9	3.5	6.1	4.2	9.2	4.5
Secured lending	3.9	3.2	4.8	3.3	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.2	6.0	1.5	5.9	(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.

	2020 £m	2019 £m
Calculated provision	19.94	41.9
100% weighted central scenario	14.31	37.7
Effect of multiple economic scenarios	5.63	4.2

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The fundamental rebasing of the Bank's scenarios in the year, resulting from the impact of the Covid-19 pandemic, means that it is not useful to discuss detailed changes in the scenarios year-on-year.

The Bank revised its weightings at the time of the half year accounts. Whilst the base case represents the highest individually weighted scenario at 40%, the combined downside and severe downside cases carry a combined 50% weighting, reflecting the scale of uncertainty and potentially adverse economic impact from Covid-19.

It should be noted that 'Severe Downside' in the Covid-19 scenarios is based on a potential outcome and is less severe than that used at 30 September 2019 which was based on the PRA 'once in 200-year' stress test. Therefore, the 2020 scenario carries a higher probability.

Sensitivity

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

Economic conditions

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

	2020	
Scenarios	**Provision**	**Difference**
	£m	**£m**
Central	14.31	(5.63)
Upside	11.68	(8.26)
Downside	19.49	(0.45)
Severe downside	41.50	21.56

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging. However due to the significant impact of post model stage adjustments, the effect on the PD SICR test of 100% weighting has not been taken into account above.

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 £1.28m would transfer from stage 1 to stage 2, and the total provision would increase by £0.64m 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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Value of security

The principal assumptions impacting on loss given default are the estimated security values. If the rate of growth in house prices assumed by the model were halved, ignoring any PD effects, then the provision for the Group's first and second mortgages assets under the central scenario would increase by £1.29m.

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 (2019: £0.1m).

18. INVESTMENT IN STRUCTURED ENTITIES

Investments in structured entities represent the Bank's investment in publicly traded, asset backed floating rate notes originally issued by Paragon Mortgages (No. 14) PLC, Paragon Mortgages (No. 25) PLC, Paragon Mortgages (No. 26) PLC and Paragon Mortgages (No. 27) PLC, special purpose vehicle ('SPV'). In addition debt issued by Paragon Second Funding Limited was also acquired by the Bank during the year. These companies were established and controlled by entities in common control with the Bank to purchase pools of loan assets.

As Paragon Mortgages (No. 14) PLC, Paragon Mortgages (No. 25) PLC, Paragon Mortgages (No. 26) PLC, Paragon Mortgages (No. 27) PLC and Paragon Second Funding Limited are controlled by Paragon Banking Group PLC, 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 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.

	2020 **£m**	**2019** **£m**
AAA	963.42	399.99
AA	175.52	69.43
A	22.81	-
BBB	22.81	-
Not rated	35.75	-
At 30 September 2020	1,220.31	409.42

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

18. INVESTMENT IN STRUCTURED ENTITIES (CONTINUED)

The movements in the Bank's investment in structured entities in the year ended 30 September 2020 and the year ended 30 September 2019 were:

	2020 £m	2019 £m
Cost		
At 1 October 2019	409.42	8.22
Additions	849.62	412.22
Effective Interest Rate ('EIR') income	2.06	0.58
Payments received	(40.79)	(11.60)
At 30 September 2020	1,220.31	409.42

£2.56m (2019: £1.06m) is included in Sundry Assets (note 20) in respect of accrued interest on these Notes at the year end.

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Introduction

The Bank uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 35 to 39) 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 its lending denominated in foreign currencies.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

19. 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 2020 or the preceding year.

	2020 Assets £m	2020 Liabilities £m	2019 Assets £m	2019 Liabilities £m
Derivatives in accounting hedge relationships				
Fair value hedges				
Interest rate swaps				
Fixed to floating	0.04	(104.21)	0.18	(70.18)
Floating to fixed	14.36	(0.04)	7.62	(0.13)
	14.40	(104.25)	7.80	(70.31)
Total derivatives in accounting hedge relationships	14.40	(104.25)	7.80	(70.31)
Other derivatives				
Interest rate swaps	3.37	(3.37)	1.88	(1.99)
Currency futures	0.21	-	0.04	-
Total recognised derivative assets/(liabilities)	17.98	(107.62)	9.72	(72.30)

The credit risk inherent in the derivative financial assets shown above is discussed in note 36.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

a) Fair value hedges

Background and hedging objectives

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

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings but may also arise where retail deposit funding is used. Where possible the Bank takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing risk and controlled within limits under the Bank's interest rate risk management process, described in note 38. 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; and
- 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.

The Bank is in the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA and all new interest rate swap agreements since 1 February 2020 have referenced SONIA.

This means that each of these macro hedges can be divided into two sections, one referencing LIBOR and one SONIA. Through the year, as assets and deposits matured and were replaced by new business, the LIBOR linked element of the hedges reduced, and the SONIA linked element increased.

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

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

There remains a back book of swaps referencing three-month LIBOR, which is currently running off as the instruments reach maturity. Certain of these swaps have a maturity after December 2021, when LIBOR is expected to become unavailable and the Bank is closely following emerging market practice for the treatment of such contracts. The International Swaps and Derivative Association ('ISDA'), the trade organisation for derivatives, have released a Protocol which incorporates fallback provisions to facilitate transition to SONIA when LIBOR ceases or if it is deemed unrepresentative by the FCA. The Bank expects to adhere to transition in accordance with the protocol by December 2020.

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

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

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

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 36).
- 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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

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

Hedging Instruments

The hedging portfolios at 30 September 2020 and 30 September 2019 consist of a large number of sterling denominated swaps In addition, at 30 September 2020 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.

	2020		2019	
	Deposit Hedge	**Loan hedge**	**Deposit Hedge**	**Loan Hedge**
Average fixed notional interest rate	0.42%	1.03%	0.83%	1.08%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	**£m**	**£m**	**£m**
Notional principal value				
LIBOR swaps	1,147.50	3,422.10	1,619.00	3,681.27
SONIA BGS		25.21	-	-
SONIA swaps	1,043.00	223.00	-	-
	2,190.50	3,670.31	1,619.00	3,681.27
Maturing				
Within one year	1,287.50	359.25	805.50	316.57
Between one and two years	669.00	576.25	449.50	420.25
Between two and five years	234.00	2,698.10	364.00	2,773.45
More than 5 years	-	36.71	-	171.00
	2,190.50	3,670.31	1,619.00	3,681.27
Fair value	14.39	(104.25)	7.49	(69.99)

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 2020

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Accounting impacts

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

	2020		2019	
	Deposit Hedge £m	Loan Hedge £m	Deposit Hedge £m	Loan Hedge £m
Hedging items				
Interest rate swaps				
Included in derivative financial assets	14.36	(0.04)	7.62	0.18
Included in derivative financial liabilities	0.03	(104.21)	(0.13)	(70.17)
	14.39	(104.25)	7.49	(69.99)
Notional principal value	2,190.50	3,670.31	1,619.00	3,681.27
Change in fair value used in calculating hedge ineffectiveness	6.64	(31.98)	7.88	(87.31)

	2020		2019	
	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	2,083.85	-	1,473.70	-
Fixed rate loans				
Monetary amount of risk relating to Loans to Customers	-	3,679.58	-	3,750.03
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 14 and 23) *	(10.33)	96.95	(3.92)	65.55
Of which: amounts related to discontinued hedging relationships being amortised	-	(2.45)	-	(8.43)
Change in fair value used in recognising hedge ineffectiveness	(6.40)	31.40	(8.10)	81.74
Hedge ineffectiveness recognised				
Included in fair value gains/losses in the profit and loss account	0.24	(0.58)	(0.22)	(5.57)

* 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 2020

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

b) Derivatives not in a hedging relationship

The Bank's other derivatives comprise:

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

The principal terms of these derivatives are set out below.

Interest rate swaps

	2020		2019	
	Pay fixed	Pay floating	Pay fixed	Pay floating
Average fixed notional interest rate	0.30%	0.23%	0.76%	0.77%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	174.60	237.00	268.10	554.00
SONIA swaps	364.00	698.00	-	8.00
	538.60	935.00	268.10	562.00
Maturing				
Within one year	78.50	715.00	33.50	424.00
Between one and two years	50.10	47.00	35.00	95.00
Between two and five years	213.00	173.00	88.60	43.00
More than 5 years	197.00	-	111.00	-
	538.60	935.00	268.10	562.00
Fair value	3.37	(3.37)	1.87	(1.99)

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

19. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Currency futures

	2020	2019
US *Dollar* futures		
Average future exchange rate	1.27	1.22
	£m	**£m**
Notional principal value	14.10	5.74
Maturing		
Within one year	14.10	5.74
Between one and two years	-	-
Between two and five years	-	-
	14.10	5.74
Fair value	0.21	0.04

20. SUNDRY ASSETS

	Note	2020 £m	2019 £m
Current assets			
Amounts owed by Group companies		452.73	258.90
Accrued interest income		2.66	1.30
CSA assets		103.51	72.14
CRDs		15.09	11.36
Other receivables		0.88	0.83
Sundry financial assets	44	574.87	344.53

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 2020

21. DEFERRED TAX

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

	2020 £m	2019 £m
Net liability at 1 October 2019	2.51	(1.37)
Income statement (charge) / credit	(1.22)	3.13
Change in accounting policy on adoption of IFRS 9 (note 40)	-	0.75
Net asset at 30 September 2020	1.29	2.51

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

	2020 £m	2019 £m
Other timing differences	1.29	2.51
Net deferred tax asset	1.29	2.51

As stated in note 11, legislation in the year has reversed the expected reduction in the standard rate of UK tax to 17% which had already been accounted for. 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.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

22. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Shares in Group companies £m	Loans to Group companies £m	Total £m
At 1 October 2018	342.67	1,215.41	1,558.08
Investments in subsidiaries	80.00	-	80.00
Loans advanced	-	14,511.27	14,511.27
Loans repaid	-	(14,550.70)	(14,550.70)
Provision movements	-	-	-
At 30 September 2019	422.67	1,175.98	1,598.65
Investments in subsidiaries	-	-	-
Loans advanced	-	1,509.65	1,509.65
Loans repaid	-	(1,460.96)	(1,460.96)
Provision movements	-	-	-
At 30 September 2020	422.67	1,224.67	1,647.34

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

During the year ended 30 September 2020 the Company received £53.0m in dividend income from its subsidiaries (2019: £68.7m) and £29.1m of interest on loans to Group companies (2019: £26.2m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 46.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

23. RETAIL DEPOSITS

The Bank's retail deposits, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	2020 £m	2019 £m
Fixed rate	4,975.96	4,154.38
Variable rates	2,880.67	2,237.53
	7,856.63	6,391.91

The weighted average interest rate on retail deposits at 30 September 2020 and 30 September 2019, analysed by charging method, was:

	2020 %	2019 %
Fixed rate	1.69	2.02
Variable rates	0.72	1.43
All deposits	1.34	1.81

The contractual maturity of these deposits is analysed below.

	2020 £m	2019 £m
Amounts repayable		
In less than three months	565.01	466.64
In more than three months, but not more than one year	2,725.62	2,088.43
In more than one year, but not more than two years	1,541.57	1,158.02
In more than two years, but not more than five years	664.82	900.87
Total term deposits	5,497.02	4,613.96
Repayable on demand	2,359.61	1,777.95
	7,856.63	6,391.91
Fair value adjustments for portfolio hedging	9.96	3.96
	7,866.59	6,395.87

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

24. CENTRAL BANK FACILITIES

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

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. While no drawings under the ILTR were outstanding at 30 September 2020, the scheme was regularly accessed during the year. At 30 September 2019 the average rate of interest on the Group's ILTR drawings was 0.90%.

Drawings under the original Term Funding Scheme ('TFS') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 9 months (2019: 22 months). As these drawings are provided at rates below those available commercially, by a government agency, they are accounted for under IAS 20. The TFS is no longer available for new drawings.

Drawings under the Term Funding Scheme for SMEs ('TFSME') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 46 months.

During the year, the Group also accessed the Contingent Term Repo Facility ('CLTRF'), which was a temporary short term facility for collateralised drawings introduced by the Bank of England in response to the Covid-19 pandemic.

Drawings under the FLS were used to provide off balance sheet liquidity and formed part of the Bank's HQLA. Fees were charged under the FLS at 0.25% of the market value of the liquidity drawn and the facility expired in June 2020.

The amounts drawn under these facilities are set out below.

	2020 £m	2019 £m
TFSME	910.0	-
TFS	944.4	944.40
ILTR	-	50.00
On balance sheet funding	1,854.4	994.40
FLS	-	108.89
Total central bank facilities	1,854.4	1,103.29

TFS includes £700.0m falling due within one year (2019: £nil).

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes. The assets pledged in support of these drawings are set out in note 14.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

24. CENTRAL BANK FACILITIES (CONTINUED)

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

	2020 £m	2020 £m	2019 £m	2019 £m
TFSME at IAS 20 carrying value	874.11		-	
Deferred government assistance	35.89		-	
		910.00		-
TFS at IAS 20 carrying value	937.50		930.50	
Deferred government assistance	6.90		13.90	
		944.40		944.40
		1,854.40		944.40

25. CORPORATE BOND

On 20 December 2017 the Bank issued £150.0m of 6.62% Fixed Rate Reset Callable Subordinated Tier 2 Notes due 2026 at par to its parent company, PBG, to provide it with long term capital. These bonds bear interest at a fixed rate of 6.62% per annum until 9 September 2021, after which interest will be payable at a rate of fixed rate which is 5.605% over the sterling 5-year-mid market swap rate at the time. These notes are unsecured and subordinated to any other creditors of the Bank. Interest is included within Accrued interest.

26. SUNDRY LIABILITIES

	2020 £m	2019 £m
Current liabilities		
Accrued interest	37.49	40.13
Amounts owed to group companies	259.64	188.44
CSA liabilities (note 20)	-	-
Other accruals	0.76	0.80
Sundry financial liabilities	297.89	229.37

All of the above balances represent financial liabilities carried at amortised cost.

27. CURRENT TAX LIABILITIES

Current tax represents UK corporation tax owed.

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

28. 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:

	2020 Number	2019 Number
Ordinary shares		
At 1 October 2019 and 30 September 2020	552,625,034	552,625,034

29. RESERVES

Profit and loss account

	Note	2020 £m	2019 £m
At 1 October 2019		233.45	156.71
Profit for the year		94.55	97.22
Dividends paid		(110.18)	(18.24)
Change of accounting policy	40	-	(2.24)
At 30 September 2020		217.82	233.45

An interim dividend of £0.20 per share was paid during the year (2019: £0.03 per share). No final dividend is proposed (2019: nil).

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

30. NET CASH FLOW FROM OPERATING ACTIVITIES

	2020 £m	2019 £m
Profit before tax	110.15	107.01
Non-cash items included in profit and other adjustments:		
Impairment losses on loans to customers	15.50	3.82
Net (increase) / decrease in operating assets:		
Loans to customers	(1,276.97)	(1,134.33)
Derivative financial instruments	(8.26)	12.68
Fair value of portfolio hedges	(36.99)	(80.20)
Other receivables	(279.03)	45.13
Net increase / (decrease) in operating liabilities:		
Retail deposits	1,464.72	1,095.34
Derivative financial instruments	35.32	68.00
Fair value of portfolio hedges	6.00	7.73
Other liabilities	68.52	(70.14)
Cash generated by operations	98.96	55.04
Income taxes (paid)	(12.44)	(7.12)
	86.52	47.92

31. NET CASH FLOW FROM INVESTING ACTIVITIES

	2020 £m	2019 £m
Investment in subsidiary undertakings	-	(80.00)
Net cash (utilised) by investing activities	-	(80.00)

32. NET CASH FLOW FROM FINANCING ACTIVITIES

	2020 £m	2019 £m
Dividends paid (note 29)	(110.18)	(18.24)
Movement on central bank facilities	860.00	(30.00)
Net cash generated / (utilised) by financing activities	749.82	(48.24)

NOTES TO THE ACCOUNTS - ANALYSIS
For the year ended 30 September 2020

33. RELATED PARTY TRANSACTIONS

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

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

During the year the Bank purchased £772.1m floating rate notes issued by Paragon Mortgages (No 27) PLC and £77.5m of debt issued by Paragon Second Funding Limited.

Floating rate notes issued by Paragon Mortgages (No. 14) PLC, Paragon Mortgages (No. 25) PLC, Paragon Mortgages (No. 26) PLC, Paragon Mortgages (No. 27) PLC and Paragon Second Funding Limited, companies in common control with the Bank, which are therefore related parties have been acquired by the Bank. At the balance sheet date, the outstanding investment is shown in note 18 and accrued interest on the investment is shown in note 20.

During the year the Bank sold assets to the value of £732.0m to Paragon Mortgages (No. 27) PLC. The value of the loans sold is included within note 17.

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 22 with the accrued interest due shown in note 20. The Bank also provided various management and administrative services to these companies and its subsidiaries.

During the year the Bank had an interest bearing loan from the parent company, Paragon Banking Group Plc, which is a related party. Details about the amount charged on the loan is provided in note 4. At the balance sheet date, the outstanding loan amount is shown in note 22 with £603k (2019: £600k) shown within ‘accrued interest’ in note 26.

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

Outstanding current account balances with Group entities are shown in notes 20 and 26. The Bank earned £2.99m (2019: £nil) from Paragon Mortgages (No.26) PLC in relation to deferred sale consideration shown in note 6. An impairment provision was charged during the year on loans with Group entities which is shown in note 9.

Intercompany dividends of £53.0m (2019: £68.7m) 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 of the 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 £301,000 were outstanding at the year end (2019: none), and the maximum amount outstanding during the year was £500,000 (2019: £250,000).

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

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.

34. 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
- To ensure that the Bank complies with capital adequacy rules laid down by the PRA. This is discussed further below

The Group's response to the Covid-19 situation has been planned and executed with the protection of its capital base and its long-term viability as key strategic priorities.

The Bank sets the amount of capital required 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 this supervision the regulator will issue an individual capital requirement setting an amount of regulatory capital, which the Bank is required to hold in order to safeguard depositors from loss in the event of severe losses being incurred by the Bank. This comprises variable elements based on its total risk exposure and also fixed elements. This requirement is set in accordance with the international Basel III rules, issued by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR').

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 2020

34. 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-19, 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 ending 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before the current period. In order to increase institutions lending capacity in the short term, the EU has determined that these additional provisions should be to be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

These responses also allow, under paragraph 7a of the Article, the impact of transitional adjustments to be weighted at 100% in calculating RWA. The Bank has taken advantage of this derogation and hence the IFRS 9 adjustment to RWA is equal to the adjustment to capital at 30 September 2020.

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 2020 the Bank's regulatory capital of £1,133.81m (2019: £1,127.21m) was comfortably in excess of the amounts required by the regulator, including £738.85m in respect of Pillar 1 and Pillar 2a capital (unaudited), which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer of 2.5% of risk weighted assets (at 30 September 2020) (2019: 2.5%) and a Counter-Cyclical Buffer, currently 0.0% of risk weighted assets (2019: 1.0%). Firm specific buffers may also be required.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

34. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

The Bank's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Bank's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2020 is set out below.

	Note	2020 £m	2019 £m
Total equity in the Bank		770.44	786.07
Other equity in regulatory consolidation	§	336.11	332.24
		1,106.55	1,118.31
Deductions			
Investments in shares	* §	(14.67)	(11.16)
Goodwill in regulatory consolidation	† §	(149.16)	(149.71)
Prudent valuation adjustment	§ #	(0.61)	(0.69)
Add back IFRS9 transitional relief	§	41.70	20.46
Common Equity Tier 1 ('CET1') Capital		983.81	977.21
Other tier 1 capital		-	-
Total Tier 1 capital		983.81	977.21
Corporate bond	25	150.00	150.00
Total Tier 2 capital		150.00	150.00
Total regulatory capital		1,133.81	1,127.21

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

§ Not audited.

† Goodwill which arises on consolidation for regulatory purposes deducted from available capital.

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

This was first included in the Group's regulatory capital position in the year and has been included in comparative amounts for consistency.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

34. CAPITAL MANAGEMENT (CONTINUED)

Regulatory capital (continued)

The total risk exposure for the Bank and subsidiary entities included in its regulatory consolidation calculated under the CRD IV framework, against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	2020 £m	2019 £m
Credit risk		
Balance sheet assets	6,102.12	5,920.30
Off balance sheet	104.06	85.46
IFRS 9 transitional relief	41.70	10.12
Total credit risk	6,247.88	6,015.88
Operational risk	509.94	442.69
Other risk	84.61	108.22
Total risk exposure	6,842.43	6,566.79
	%	%
Solvency ratios		
CET1 capital	14.4	14.9
Total regulatory capital	16.6	17.2

This table is not subject to Audit

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

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

34. 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:

	2020 £m	2019 £m
CET1 Capital	983.81	977.21
Add back: IFRS 9 relief	(40.70)	(20.45)
Fully loaded CET1 Capital	943.11	956.76
TRC	1,133.81	1,127.21
Add back: IFRS 9 relief	(40.70)	(20.45)
Fully loaded TRC	1,093.11	1,106.76
Total risk exposure	6,842.43	6,566.79
Add back: IFRS 9 relief	(40.70)	(10.12)
Fully loaded TRE	6,801.73	6,556.67
Fully loaded Solvency ratios	**%**	**%**
CET1	13.9	14.6
Total regulatory capital	16.1	16.9

This table is not subject to audit

The total regulatory capital at 30 September 2020 on the fully loaded basis of £1,093.11m was in excess of the Pillar 1 & 2a requirement of £734.63m on the same basis (amounts not subject to audit).

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

34. 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 set a minimum leverage ratio of 3.25% for UK firms.

	2020 £m	2019 £m
Total balance sheet assets	15,406.78	14,295.85
Less: Derivative assets	(463.29)	(592.39)
Central bank deposits	(1,637.06)	(816.40)
CRDs	(15.09)	(11.36)
Accrued interest on sovereign exposure	(0.06)	(0.20)
On-balance sheet items	13,291.28	12,875.50
Less: Intangible assets	(149.16)	(149.71)
Investments	(14.67)	(11.16)
Total on balance sheet exposures	13,127.45	12,714.63
Derivative assets	463.29	592.39
Potential future exposure on derivatives	92.31	19.95
Total derivative exposures	555.60	612.34
Post offer pipeline at gross notional amount	949.09	903.37
Adjustment to convert to credit equivalent amounts	(773.80)	(739.15)
Off balance sheet items	175.29	164.22
Tier 1 capital	983.81	977.21
Total leverage exposure before IFRS 9 relief	13,858.34	13,591.19
IFRS 9 relief	41.70	24.96
Total leverage exposure	13,900.04	13,616.15
UK leverage ratio	7.1%	7.2%

This table is not subject to audit

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

34. CAPITAL MANAGEMENT (CONTINUED)

The fully loaded leverage ratio is calculated as follows

	2020 £m	2019 £m
Fully loaded Tier 1 capital	942.11	956.76
Total leverage exposure before IFRS 9 relief	13,858.34	13,591.19
Fully loaded UK leverage exposure	6.8%	7.0%

This table is not subject to audit

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

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

	2020 £m	2019 £m
Net profit after tax	94.55	97.22
Divided by		
Total balance sheet	11,061.83	8,640.96
Fully loaded UK leverage exposure	0.85%	1.12%

35. 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 Executive Risk Committee ('ERC'). ERC discharges its duties through a number of sub-committees and escalates issues of concern to the Risk and Compliance Committee where appropriate.

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

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 36 to 39 is materially similar to that existing throughout the year.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

36. 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	**2020**	**2019**
		£m	**£m**
Financial assets at amortised cost			
Loans to group companies	22	1,224.67	1,175.98
Loans to customers	17	5,832.33	5,381.75
Investment in structured entities	18	1,220.31	409.42
Amounts owed by group companies	20	452.73	258.90
CSA debtor	20	103.51	72.14
Cash	12	1,673.57	837.23
Accrued interest	20	2.66	1.30
		10,509.78	8,136.72
Financial assets at fair value			
Derivative financial assets	19	17.98	9.72
Maximum exposure to credit risk		10,527.76	8,146.44

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

36. 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 2020 and 30 September 2019 are analysed as follows:

	2020 £m	2020 %	2019 £m	2019 %
Buy-to-let mortgages	5,101.83	87.5%	4,567.81	84.9%
Owner occupied mortgages	51.18	0.9%	68.31	1.3%
Total first mortgages	5,153.01	88.4%	4,636.12	86.2%
Second charge mortgages	278.13	4.8%	294.42	5.5%
Development finance	49.45	0.8%	81.93	1.5%
Loans secured on property	5,480.59	94%	5,012.47	93.2%
Motor finance loans	256.86	4.4%	281.28	5.2%
Structured lending	94.88	1.6%	88.00	1.6%
Total loans to customers	5,832.33	100.0%	5,381.75	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 2020

36. 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 2020 and 30 September 2019 is set out below.

	2020 First Mortgages %	2020 Second charge Mortgages %	2019 First Mortgages %	2019 Second charge Mortgages %
Loan to value ratio				
Less than 70%	52.5	76.0	40.3	68.0
70% to 80%	45.7	17.7	52.6	19.7
80% to 90%	0.8	4.2	6.5	8.8
90% to 100%	0.3	0.6	0.2	1.4
Over 100%	0.7	1.5	0.4	2.1
	100.0	100.0	100.0	100.0
Average loan to value ratio	67.0	62.1	69.3	65.4

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 5.0% in the year ended 30 September 2020 (2019: 0.2%).

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	2020 By value %	2020 By number %	2019 By value %	2019 By number %
50% or less	1.8	4.5	1.3	3.2
50% to 60%	35.4	27.3	24.4	27.4
60% to 65%	59.4	54.5	65.7	56.5
65% to 70%	3.4	13.7	8.4	11.3
70% to 75%	-	-	0.2	1.6
Over 75%	-	-	0.0	0.0
	100.0	100.0	100.0	100.0

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

36. CREDIT RISK (CONTINUED)

The average LTGDV cover at the year end was 61.6% (2019: 61.6%).

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 2020 the development finance portfolio comprised 22 accounts (2019: 62) with a total carrying value of £49.45m (2018: £81.93m). The Bank's development finance portfolio is reducing 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

	2020	2019
Number of transactions	8	8
Total facilities (£m)	139.00	132.50
Carrying value (£m)	94.88	88.00

The maximum advance under these facilities was 80% of the underlying assets.

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 2020 there were no significant concerns regarding the credit performance of these facilities.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

36. 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 2020 and 30 September 2019, compared to the industry averages at those dates published by the UK Finance ('UKF') formally Council of Mortgage Lenders ('CML') and the Finance and Leasing Association ('FLA'), was:

	2020	2019
	%	%
Buy-to-let mortgages		
Accounts more than three months in arrears		
Buy-to-Let accounts including receiver of rent cases	0.03	0.03
Buy-to-Let accounts excluding receiver of rent cases	0.03	0.02
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	0.52	0.42
Buy-to-Let accounts excluding receiver of rent cases	0.50	0.37
Owner-occupied accounts	0.90	0.81
All mortgages	0.82	0.73
Secured loans		
Accounts more than two months in arrears	6.50	5.89
FLA data for secured loans	8.40	8.70
Car loans		
Accounts more than two months in arrears	1.76	1.27
FLA data for point of sale hire purchase	*	2.70

* Not published

As a significant proportion of the loans in the Bank were advanced in the last three years, the arrears statistics will not be strictly comparable to the industry data at this stage. Where revised data at 30 September 2019 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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 the CML 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.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

36. CREDIT RISK (CONTINUED)

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.

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 and at the Bank of England, in current accounts and as short fixed term deposits and money market placements. 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.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

37. 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 is subject to regulation by the PRA which aims to ensure that sufficient liquid assets are held to mitigate the liquidity risk inherent in deposit taking. The Bank also seeks to manage the maturities of the deposits it accepts and the likely terms of the loans it offers to reduce liquidity risk.

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the Bank's retail deposit borrowings, should those balances remain outstanding until the contracted repayment date are set out below.

	2020 £m	2019 £m
30 September 2020		
Payable on demand	2,363.70	1,783.89
Payable in less than three months	598.39	482.70
Payable in less than one year but more than three months	2,777.89	2,151.45
Payable in less than one year or on demand	5,739.98	4,418.04
Payable in one to two years	1,608.21	1,210.05
Payable in two to five years	704.48	982.39
Payable in over five years	-	-
	8,052.67	6,610.48

Amounts payable in respect of the 'accrued interest' shown in note 26 fall due within one year. The cash flows described above will include those for interest on retail deposits accrued at 30 September 2020 and 30 September 2019 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 2020 and 30 September 2019, the liquidity buffer comprised the following on and off balance sheet assets, all held within the Bank.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

37. LIQUIDITY RISK (CONTINUED)

	Note	2020 £m	2019 £m
Short term investments	13	-	-
Balances with central banks	12	1,637.06	646.40
Total on balance sheet liquidity		1,637.06	646.40
FLS drawings		-	108.89
Long / short repo transaction		150.00	-
		1,787.06	755.29

Borrowings

The Bank issued £150.0m of tier 2 debt in December 2017 with an optional call date in December 2022 and a final maturity of September 2026. Amounts expected to be payable, including interest, are set out below.

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

	Central Bank Facilities £m	Corporate Debt £m	Total £m
30 September 2020			
Payable in less than one year	701.91	9.93	711.84
Payable in one to two years	245.39	9.93	255.32
Payable in two to five years	912.05	29.79	941.84
Payable in over five years	-	159.93	159.93
	1,859.35	209.58	2,068.93
30 September 2019			
Payable in less than one year	55.30	9.93	65.23
Payable in one to two years	702.20	9.93	712.13
Payable in two to five years	244.90	29.79	274.69
Payable in over five years	-	169.86	169.86
	1,002.40	219.51	1,221.91

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

37. 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:

	2020 Total cash inflow / (outflow) £m	2019 Total cash inflow / (outflow) £m
On derivative assets		
Payable in less than one year	5.09	(0.16)
Payable in one to two years	5.16	2.94
Payable in two to five years	1.79	1.80
Payable in over five years	0.01	0.01
	12.05	4.59
On derivative liabilities		
Payable in less than one year	(29.79)	(12.51)
Payable in one to two years	(34.75)	(19.00)
Payable in two to five years	(38.04)	(40.14)
Payable in over five years	(0.16)	(0.46)
	(102.74)	(72.11)
	(90.69)	(67.52)

38. 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 Bank has historically been LIBOR, which has been used to set rates for certain loan assets and borrowings. However, the Bank has continued to move towards the use of alternative reference rates during the year, with new wholesale debt and interest rate swaps referencing SONIA in response to the expected withdrawal of LIBOR from late 2021. This process is expected to continue in the new financial year.

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.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

38. INTEREST RATE RISK (CONTINUED)

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

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

Generally, these factors ensure the matching of changes in interest rates on the Bank's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

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

Interest rate sensitivity

To assess the Bank's exposure to interest rate movements the notional impact of a 1% change in UK interest rates on the equity of the Bank at 30 September 2020, 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.

On this basis a 1% increase in UK interest rates would reduce the Bank's equity at 30 September 2020 by £0.00m (2019: £0.00m) and decrease profit before tax by £0.10m (2019: decrease profit before tax by £6.00m).

This calculation allows 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 Bank's business and results.

IBOR transition

Interest rate benchmarks such as LIBOR have been subject to increasing global regulatory scrutiny. In July 2017 the FCA announced that it was its intention that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR is expected to be discontinued. The Bank of England's Working Group on Sterling Risk-Free Interest Rates has recommended SONIA as its replacement. However, there remains significant uncertainty as to how the transition from LIBOR and other Interbank Offered Rates to alternative benchmarks will be managed across the banking industry.

LIBOR is used in setting interest rates on significant amounts of the Bank's loan assets and borrowings and an internal working group exists to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates across all classes of financial instrument. Derivative financial assets and liabilities where cash flows are based on IBOR rates are shown in note 19, where the Bank's transition planning activities are also discussed. The Bank has loans assets of £983.02m with interest rates linked to LIBOR.

NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK MANAGEMENT
For the year ended 30 September 2020

39. CURRENCY RISK

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

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

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

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

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.

40. BASIS OF PREPARATION

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU. In the financial years reported upon this means that, in the Bank's circumstances, the financial statements accord also with International Financial Reporting Standards as approved by the International Accounting Standards Board.

The particular accounting policies adopted have been set out in note 41 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in note 42 and 43 respectively

Adoption of new and revised reporting standards

In the preparation of these financial statements, the following accounting standards are being applied for the first time.

- IFRS 16 – 'Leases'
- 2019 amendments to IAS 39 – 'Interest Rate Benchmark Reform' and consequential amendments to IFRS 7

IAS 39 amendments 'Interest Rate Benchmark Reform'

This amendment was issued by the IASB to address the impact of uncertainties arising from IBOR reform (including the withdrawal of LIBOR) on hedge accounting. The Standard excludes the effect of such uncertainties from the evaluation of hedging relationships for accounting purposes and allows the continuation of IBOR based hedging relationships despite these uncertainties, all other things being equal.

This amendment is applicable for periods beginning on or after 1 January 2020, but early application is permitted. The Group has elected to early apply this amendment retrospectively in these financial statements. As the amendment allows the continuation of existing arrangements, its adoption has no impact on reported amounts.

IFRS 16 – 'Leases'

The Group is required to adopt IFRS 16, which replaces IAS 17, the standard currently governing the accounting for operating and finance leases, in preparing its financial statements for the year ended 30 September 2020. It has transitioned to the new standard with effect from 1 October 2019, in accordance with the transitional provisions set out in the standard, using the modified retrospective approach. The standard addresses accounting by lessees and lessors, however the Bank has no interest in leases as a lessee.

40. BASIS OF PREPARATION (CONTINUED)

The provisions for lessor accounting under IFRS 16 are little changed from those in IAS 17 and so the accounting for the Bank's finance lease receivables, shown in note 16 is not materially changed.

Impact of UK departure from the EU

Under the International Accounting Standards and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, despite the UK's exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Bank until its first financial year commencing after the conclusion of the UK's Transition Period, currently expected to end on 31 December 2020.

Therefore, while EU endorsed IFRS applies to these financial statements and will apply to the financial statements for the year ending 30 September 2021, those for the year ending 30 September 2022 will instead be prepared under 'UK-adopted international accounting standards'. It is anticipated that 'UK-adopted international accounting standards' will be equivalent to IFRS as adopted by the EU at the point of transition and that there would be no amendments required in the Bank's accounting as a result of that change.

Standards not yet adopted

In August 2020 the IASB issued a further amendment to IAS 39 'Interest Rate Benchmark Reform – Phase 2'. This amendment sets out accounting requirements for the treatment of IBOR linked financial assets and liabilities under the amortised cost method and IBOR related hedge accounting when a firm replaces the IBOR linkage in the underlying instruments with a replacement benchmark. It is therefore potentially applicable to the Group's LIBOR linked loan assets where interest is charged on the basis of LIBOR or other IBOR rates. It also affects the Bank's LIBOR (and other IBOR) referenced derivative assets and liabilities (note 19) and the hedging relationships which they form part of.

The intention of the standard is that, where the transition is effectively a like for like replacement, no windfall gain or loss should occur on transition, and hedging relationships should be able to continue.

This amendment is effective from the Group's financial year ending 30 September 2022 but will be available for early adoption once endorsed by the EU. The Group expects to implement the provisions of the amendment when it transitions its IBOR linked assets and liabilities, subject to appropriate endorsement. The impact of the amendment will depend upon the IBOR related assets liabilities and hedging relationships at the point at which transition occurs.

Other standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

Accounting changes at 1 October 2018

The accounting changes affecting equity at 1 October 2018 relate to the adoption of IFRS 9 – 'Financial Instruments' are described in detail in note 41 to the accounts for the year ended 30 September 2019.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. 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

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014.

Particular focus is given to 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.

In compiling the most recent forecast, for the period commencing 1 October 2020, particular attention was paid to the potential consequences of Covid-19 on the Bank's operations, customers, funding and prospects, both in the short and longer term. In common with the Bank's approach to IFRS 9, the economics used in the forecasting process were updated in October in light of the continuing development of the Covid-19 crisis, based on updated external projections. Future business activity was reforecast reflecting the potential impacts of the pandemic on markets and products.

The forecast was based on the best available information at the time of its approval, but the uncertainties surrounding the potential ongoing impact of Covid-19 and the nature, duration and effectiveness of government and regulatory measures to address it, mean that accurate forecasting is a more complex task than in normal circumstances. Therefore, further scenario modelling was undertaken to evaluate the impact of adverse stresses of the forecast variables with the greatest impact.

The key stresses modelled in detail to evaluate the Group's forecasting addressed: increased buy-to-let volumes; higher funding costs; increased impairments; and higher funding costs and more Covid-19 disruption, without reducing lending. These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used. Additionally, a further, more material impairment stress was modelled, based on the severe macroeconomic scenario set out in note 17.

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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. ACCOUNTING POLICIES (CONTINUED)

The Bank started the Covid-19 period with a strong capital surplus and has also built up a significant liquidity buffer during the second half of the year, as described below, to ensure that any significant outflows of deposits and / or reduced inflows from customer receipts can be managed. 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 £7,856.6 million (note 23) are repayable within five years, with 71.9% of this balance (£5,650.2 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 2020 the Bank held £1,637.1 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 12). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 25), bringing the total to £1,787.1 million.

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 £684.0 million. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2020 the Bank had £1,063.5 million of such notes available for use, of which £872.9 million were rated AAA.

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

(d) As described in note 34 the Bank's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2020 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

(e) **Cash and cash equivalents**

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

(f) **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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. ACCOUNTING POLICIES (CONTINUED)

(g) **Loans to customers**

Loans to customers includes assets accounted for as financial and 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 a provision impairment.

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' (2019: IAS 17) 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 expected credit loss ('ECL'), determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

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

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

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. ACCOUNTING POLICIES (CONTINUED)

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

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

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

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

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

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

(j) **Investment in structured entities**

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

(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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. ACCOUNTING POLICIES (CONTINUED)

(l) **Deferred sale consideration**

Under the mortgage sale agreements profits of Paragon Mortgages (No. 26) PLC ("PM26") and Paragon Mortgages (No. 27) PLC ("PM27") 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.

(m) **Investments in subsidiaries**

The Bank's investments in subsidiary undertakings are valued at cost less provision for impairment. An impairment is measured as the deficit between the carrying value of the investment and the net assets of the subsidiary.

(n) **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.

(o) **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.

(p) **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.

(q) **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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. ACCOUNTING POLICIES (CONTINUED)

(r) **Hedging**

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

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

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

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

(s) **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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

41. ACCOUNTING POLICIES (CONTINUED)

(t) 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.

(u) Revenue

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

(v) Other operating income

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

- Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed
- Fees charged to third parties for account administration services, which are credited as those services are performed
- Commissions receivable on the sale of insurances, as agent of the third-party insurer, which are taken to profit at the point at which the Bank becomes unconditionally entitled to the income
- Broker fees receivable on the arrangement of loans funded by third parties, on an agency basis, which are taken to profit at the point of completion of the related loan

(w) 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 2020

42. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 41 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 probability of default, 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 a SICR, for account types where days overdue is an appropriate measure.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

In determining whether an account has a SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that a SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

Where accounts have received secondary periods of relief beyond the initial three month period, this has generally been considered to be strongly indicative of underlying problems and such accounts have been identified as having an SICR. Furthermore, adjustments to correct probabilities of default in models will also have a consequent result of identifying more SICRs.

More information on the definition of SICR adopted is given in note 17.

(b) Definition of default

In applying the impairment provisions of IFRS 9 and the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Bank's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default. If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Bank's definition of default adopted is given in note 17.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

42. CRITICAL ACCOUNTING JUDGEMENTS (CONTINUED)

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business mode' – how it intends to generate cash and profit from the assets; and
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit or loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Bank has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all of the Bank's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Bank's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Bank does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Bank has classified its customer loan assets as carried at amortised cost.

The Bank's policy is to hold the FRN's acquired and included in 'investment in structured entities', for liquidity purposes and has no intentions to sell them at any point, as such, has categorised the business model for these assets as Held to Collect. The FRNs provide cash returns in the form of LIBOR 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 2020

43. CRITICAL ACCOUNTING ESTIMATES

Certain of the 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 significant of these are:

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

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

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

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs.

These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

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

All of this information may be impacted by Covid-19, its economic effect on customers and the forms of the reliefs given to ameliorate that impact. These may both change the underlying data and impact on the derivation of metrics normally used to monitor credit performance.

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.

43. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

In order to provide forward looking economic inputs to the modelling of the ECL, the Bank must derive a set of scenarios which are internally coherent. The Bank addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2020 have been derived specifically in light of the Covid-19 situation, modelling a variety of possible outcomes. It should be noted, however, that there is currently little agreement between economists on the longer-term prospects for the UK and there is unlikely to be so until the country's path out of lockdown becomes clearer.

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 therefore considered, 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.

The position after considering all these matters is set out in note 17, together with further information on the Group's approach. The Covid-19 economic scenarios described above and their impact on the overall provision are also set out in that note.

(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.

No evidence has so far been identified which would require the adjustment of EIR income as a result of Covid-19.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

43. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

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 £7.9m (2019: £4.9m).
- An increase of the assumed average lives of loans secured on residential property by three months would increase balance sheet assets by £7.4m (2019: £4.3m)
- 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 £7.29m

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

44. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Bank's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Bank had no financial assets or liabilities in the year ended 30 September 2020 or the year ended 30 September 2019 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.

44. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

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	2020 £m	2019 £m
Financial assets			
Derivative financial assets	19	17.98	9.72
Short term investments	13	-	-
		17.98	9.72
Financial liabilities			
Derivative financial liabilities	19	107.62	72.30
		107.62	72.30

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 LIBOR and SONIA sterling benchmark interest rates.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 19.

Short term investments

The short-term investments described in note 13 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

44. 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	2020 Carrying amount £m	2020 Fair value £m	2019 Carrying amount £m	2019 Fair value £m
Financial assets					
Cash	12	1,673.57	1,673.57	837.23	837.23
Loans to customers	17	5,832.33	5,991.16	5,381.75	5,534.38
Investment in structured entities	18	1,220.31	1,220.31	409.42	409.42
Loans to group companies	20	452.73	452.73	258.90	258.90
Sundry financial assets	20	122.14	122.14	85.63	85.63
		9,301.08	9,459.91	6,972.93	7,125.56
Financial liabilities					
Retail deposits		7,856.63	7,900.60	6,391.91	6,408.95
Amounts owed to group companies		409.64	409.64	338.44	338.44
Other financial liabilities		38.25	38.25	40.93	40.93
		8,304.52	8,348.49	6,771.28	6,788.32

The fair values of retail deposits shown above will include amounts for the related accrued interest

Cash and investment in structured entities

The fair values of cash and cash equivalents and investments in structured entities which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises.

While the Group’s asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market based, they are considered to be level 2 measurements.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

44. 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.

45. ULTIMATE PARENT COMPANY

The smallest and largest group into which the Bank is consolidated, and the Bank's immediate and ultimate parent company and ultimate controlling party is Paragon Banking Group PLC, a company registered in England and Wales.

Copies of the consolidated financial statements of Paragon Banking Group PLC are available from that company's registered office at 51 Homer Road, Solihull, West Midlands, B91 3QJ.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

46. DETAILS OF SUBSIDIARY UNDERTAKINGS

Subsidiary undertakings of the Bank at 30 September 2020, 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
Direct and indirect subsidiaries of Paragon Asset Finance Limited		
Paragon Commercial Finance Limited	80%	Asset finance
Paragon Business Finance PLC	100%	Asset finance
Paragon Technology Finance Limited	100%	Asset finance
PBAF (No. 1) Limited	100%	Holding company
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
PBAF Acquisitions Limited	100%	Residential mortgages and asset investment
Capital Professions Finance Limited	100%	Non-trading
City Business Finance Limited	100%	Non-trading
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading
Direct subsidiaries of Paragon Mortgages Limited		
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Options PLC	100%	Non-trading
Direct subsidiaries of Mortgage Trust Limited		
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
First Flexible No. 6 PLC	100%	Residential mortgages
Direct subsidiaries of Paragon Development Finance Limited		
Paragon Development Finance Services Limited	100%	Portfolio administration

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2020

46. DETAILS OF SUBSIDIARY UNDERTAKINGS (CONTINUED)

The financial year end of all of the Bank's subsidiary companies is 30 September. They are all registered in England and Wales and they all operate in the UK.

The remaining 20% of the equity of Paragon Commercial Finance Limited is subject to a call option agreed as part of the acquisition of the company by PBAF. No material minority interest attaches to this holding.

All of the entities listed in this note are included in the consolidated accounts of Paragon Banking Group PLC.

The registered office of each of the entities listed in this note is the same as that of the Bank (note 1), except that the registered office of State Security Limited is Burlington House, Botleigh Grange Office Campus, Grange Drive, Hedge End, Southampton, SO30 2AF.

E. Useful Information

Information which may be helpful to shareholders and other users of the Annual Report and Accounts

This section includes

E1 Glossary	A summary of abbreviations used in the Annual Report and Accounts.
E2 Contacts	Names and addresses of the Bank's advisers.

E1 GLOSSARY

ALCO	Asset and Liability Committee
AT1	Additional Tier 1
BBR	Bank Base Rate
BEPS	Base Erosion and Profit Shifting
BGS	Balance Guarantee Swaps
CCC	Customer and Conduct Committee
CCoB	Capital Conservation Buffers
CCyB	Counter-Cyclical Buffers
CET1	Core Equity Tier 1
CFO	Chief Financial Officer
CML	Council of Mortgage Lenders
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
ERC	Estimated Remaining Collections
EU	European Union
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
HQLA	High Quality Liquid Assets
IAS	International Accounting Standard(s)
IBOR	Interbank Offered Rates
ICAAP	Internal Capital Adequacy Assessment Process

E1 GLOSSARY (Continued)

IFRS	International Financial Reporting Standard(s)
ILAAP	Internal Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
ILTR	Indexed Long Term Repo Scheme
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
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
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
POCI	Purchased or Originated Credit Impaired (assets)
PRA	Prudential Regulatory Authority
PSP	Performance Share Plan
RoR	Receiver of Rent
RWA	Risk Weighted Assets
SA	Standardised Approach
Schedule 7	Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

E1 GLOSSARY (Continued)

SICR	Significant Increase in Credit Risk
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
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
TRE	Total Risk Exposure
UK	United Kingdom
UKF	UK Finance

E2 CONTACTS

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