

The Paragon Group of Companies PLC
2016 Annual Report and Accounts



The Paragon Group of Companies uses its core risk and credit expertise to develop lending products for specialist finance markets.

Best known as one of the UK's largest, independent buy-to-let lenders, Paragon is growing its business by expanding further in buy-to-let lending and diversifying into new consumer and SME lending markets through its subsidiary, Paragon Bank.

The Group is also one of the UK's largest debt purchasers through Idem Capital, where it purchases, co-manages and services secured and unsecured consumer loan portfolios.

CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report, the Strategic Report and the Directors' Remuneration Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report. 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 Group and depend upon circumstances that may or may not occur in the future. 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. Nothing in this document should be construed as a profit forecast.

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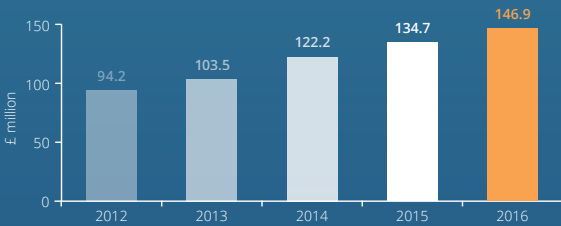
FINANCIAL HIGHLIGHTS

For the year ended 30 September 2016

Underlying profit before tax

£146.9 million

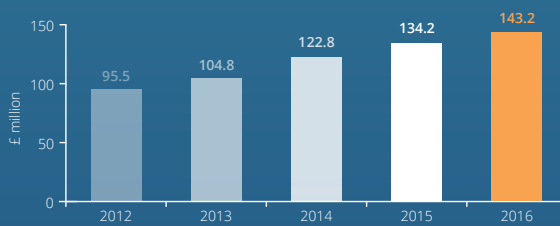
9.1% higher (2015: £134.7 million)



Profit before tax

£143.2 million

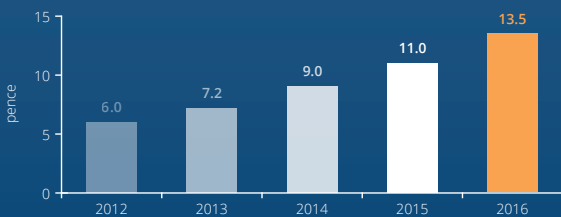
6.7% higher (2015: £134.2 million)



Dividend per share

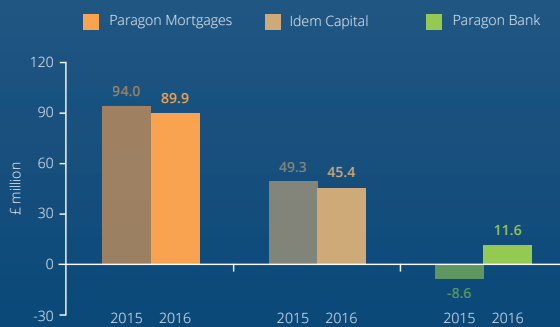
13.5 pence

22.7% higher (2015: 11.0 pence)



Underlying profit by division

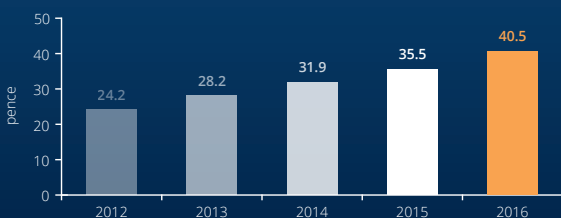
2015 and 2016 (£ million)



Basic earnings per share

40.5 pence

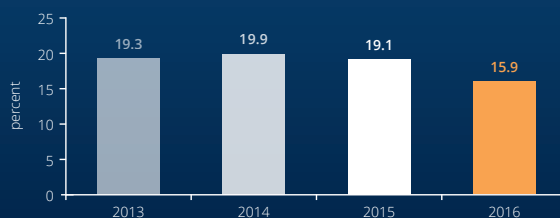
14.1% higher (2015: 35.5 pence)



Capital - CET 1 ratio

15.9%

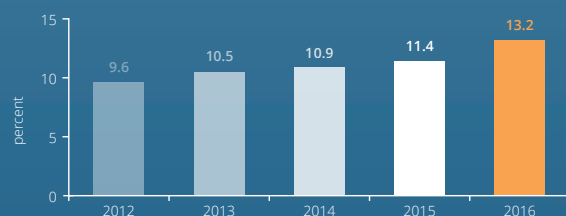
Remains strong (2015: 19.1%)



Underlying return on tangible equity

13.2%

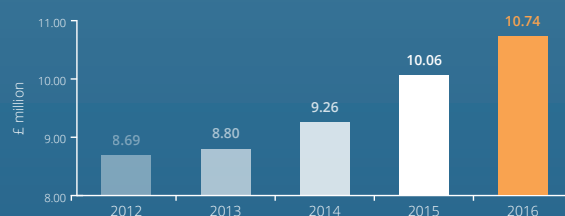
15.8% higher (2015: 11.4%)



Total loans to customers

£10.7 billion

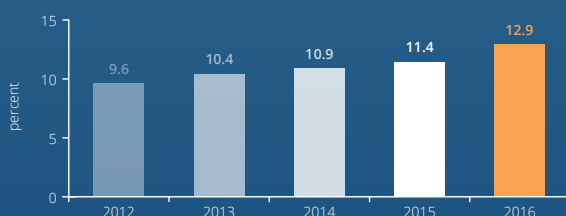
6.7% higher (2015: £10.1 billion)



Return on tangible equity

12.9%

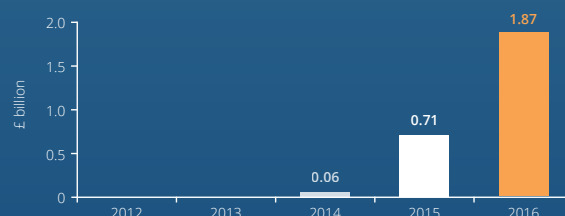
13.2% higher (2015: 11.4%)



Retail deposits

£1.9 billion

164.4% higher (2015: £0.7 billion)



Five year performance summary

	2012	2013	2014	2015	2016
	£m	£m	£m	£m	£m
Underlying profit before taxation	94.2	103.5	122.2	134.7	146.9
Profit before taxation	95.5	104.8	122.8	132.2	143.2
Profit after taxation	72.2	84.7	97.2	107.1	116.0
Total loans to customers	8,694.6	8,801.5	9,255.9	10,062.4	10,737.5
Shareholders' funds	803.5	873.3	947.1	969.5	969.5

	2012	2013	2014	2015	2016
Return on tangible equity	9.6%	10.4%	10.9%	11.4%	12.9%
Underlying return on tangible equity	9.6%	10.5%	10.9%	11.4%	13.2%
Earnings per share					
- basic	24.2p	28.2p	31.9p	35.5p	40.5p
- diluted	23.5p	27.3p	31.1p	34.8p	39.7p
Dividend per ordinary share	6.0p	7.2p	9.0p	11.0p	13.5p

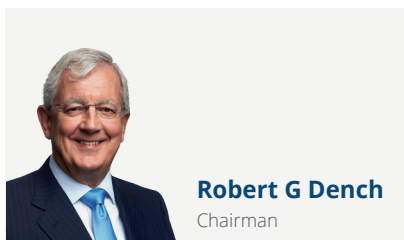
The derivation of underlying profit before taxation and underlying return on tangible equity are described in Appendices C and D.

A. STRATEGIC REPORT

The Group's business, risk profile, performance and prospects

A1	Chairman's Statement <i>The year in summary</i>	Page 10
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A1 CHAIRMAN'S STATEMENT



Dear Shareholder

I have the pleasure of introducing the Annual Report and Accounts of the Group for a year which has seen us make progress against our strategy. We have expanded into asset finance through acquisition, enhanced utilisation of retail funding and developed new areas of lending, while improving profits and returns to shareholders.

The business

The Group has continued to develop its business, described in section A2, in the year. Highlights included the acquisition of Five Arrows Leasing Group, now Paragon Bank Asset Finance ('PBAF'), and Premier Asset Finance ('Premier'), establishing our asset finance business; the expansion of consumer lending through organic growth and acquisition; and the launch of a development finance capability. The close of the year also saw preparation for the Group's launch of products to specific niches of the residential mortgage market.

The Group's business is described more fully in section A2

Results

The growth in the Group's loan books, up 6.7% to £10,737.5 million, contributed to an increase in underlying profit by 9.1% to £146.9 million (2015: £134.7 million). Profit before tax on the statutory basis grew by 6.7% to £143.2 million. This led to earnings per share increasing by 14.1% to 40.5 pence (2015: 35.5 pence) and underlying return on tangible equity reaching 13.2% (2015: 12.1%).

Funding was enhanced with the issue of the Group's first Tier 2 bond, the growth of the Group's savings deposit base to £1,873.9 million from £708.7 million a year earlier and Paragon Bank's first drawing on the Bank of England Funding for Lending Scheme ('FLS').

The Group's capital position remains strong, with regulatory Common Equity Tier 1 ('CET1') capital of £838.6 million (2015: £939.7 million). The CET1 ratio at 30 September 2016 was 15.9% (2015: 19.1%).

The financial results and operational performance are reviewed in section A3

Stakeholders

We continue to be committed to acting in a socially responsible manner and I am pleased to confirm that the wages paid to our employees in the year met the standards of the Living Wage, set by the Living Wage Foundation.

The Group recognises the benefits of a diverse workforce and was pleased to sign up to the Women in Finance Charter, sponsored by HM Treasury.

We recognise the importance of the contribution of the Group's people to its results in the year and I would like to thank all of them for their hard work and dedication throughout the period.

Social responsibility issues are discussed in section A5

Governance

The Group is committed to good corporate governance and complied with the UK Corporate Governance Code (the 'Code') in the year. We have reviewed the new version of the Code which will apply for the coming financial year and I can confirm that we are well placed to comply with its requirements.

I was pleased to participate in the Board's triennial external evaluation during the year and am happy that the results were overwhelmingly positive.

In addition to our normal duties, the Board and I have been much involved with the oversight of the Group's new asset finance business including the strategic review of PBAF and the Premier acquisition.

Corporate governance is discussed in section B3

Auditors

As a result of a competitive tender last year, KPMG LLP present their first report as the Group's independent external auditors on these accounts. I welcome them and look forward to working with them going forward.

The Audit Committee report is set out in section B4

Risk

The Group has further enhanced its risk management systems in the year, adding greater strength in specialisms such as operational risk and broadening sector expertise to address risks posed by new business areas. I was pleased to note the Group's receipt of new regulatory permissions from the Financial Conduct Authority ('FCA') for consumer loan business in the year.

The Risk Management report is set out in section B6

Shareholder returns

The positive results have enabled the Board to declare a final dividend for the year of 9.2 pence per share, bringing the dividend for the year to 13.5 pence per share, up 22.7%, subject to shareholder approval. £51.0 million has also been spent on the share buy-back programme which will be continued into the new financial year, with the purchase of further shares up to a value of £50.0 million. Each of these actions enhance returns for shareholders.

Conclusion

The Board and I have enjoyed an exciting and challenging year as the Group has grown and developed in a changing economic and regulatory environment, while enhancing returns to shareholders. These developments leave the Group well placed for further strong performance. Despite economic uncertainties and the potential for more regulatory change, I remain confident that our broader based business and strategy as a specialist lending institution will continue to deliver strong growth, supported by a robust and sustainable business model.

Robert G Dench

Chairman

23 November 2016

A2 BUSINESS MODEL AND STRATEGY

A2.1 Paragon Overview

A growing business

Paragon is a specialist financial services business operating in the UK. Best-known as one of the country's leading, independent buy-to-let lenders, the Group is growing its business by expanding into broader mortgage, consumer and small or medium-sized enterprise ('SME') markets through its banking subsidiary, Paragon Bank. Paragon is also one of the nation's largest debt purchasers through its Idem Capital division, where it purchases, co-manages and services secured and unsecured consumer loan portfolios.

A specialist business

The Group has a core expertise in data analytics, together with advanced risk and credit management capabilities. These strengths are complemented by a highly developed loan servicing platform and through the cycle experience in its senior management team. It is this expertise that enables it to tailor lending products for specialist target markets and effectively manage complex consumer loan portfolios.

A simple business

The Group has a simple business model, underpinned by a focus on people and a commitment to a single set of values.



Income

The Group generates income from interest, fees and charges earned on its mortgage, consumer and SME loan assets. It also earns fees from third parties for administering similar loans on their behalf.



Assets

To grow its income, the Group focuses on building its asset base by originating new loans, developing new products and acquiring loan portfolios.



Funding

The Group funds its assets using a variety of sources, including savings deposits, securitisation and bond issuance. It takes care to secure competitive funding over an appropriate term to underpin its assets, cover working capital requirements and maintain a strong financial position.



Profitability

Profitability is a key measure of success and the Group manages all aspects of its business closely to deliver sustainable and growing returns to its shareholders.

Operations

Paragon's operations are organised into three divisions, each with responsibility for achieving asset and profit growth. The three divisions are supported by the Group through the provision of capital to support growth and, where appropriate, with central services including loan servicing, marketing, information technology and legal support. The Group's central funding is provided by a mix of equity and corporate and retail bonds.

paragon mortgages

Originates and services buy-to-let mortgages

Funded through dedicated warehouse facilities and securitisations which provide long-term, match funding for the loan book at London Interbank Offered Rate ('LIBOR') linked interest rates

- Over 67,000 buy-to-let loan accounts
- £8.6 billion buy-to-let assets
- £89.9 million operating profit †



Acquires and services consumer loan portfolios

Funded through a mix of external limited-recourse funding and Group working capital

- Over 346,000 customer accounts managed
- £283.3 million investment in loan assets
- £45.4 million operating profit †

paragon bank

Develops and delivers savings and loans products for consumers, SMEs and landlords

Funded with a mix of Group capital, retail savings deposits and the Funding for Lending Scheme

- £1.7 billion loan assets
- £1.9 billion retail deposits
- £11.6 million operating profit †
- SME asset finance business acquired in the year

† Underlying profit
Figures at 30 September 2016

Paragon Group fast facts

- Established in 1985
- Over 1,250 employees
- Over 450,000 customer loan accounts managed
- £12.3 billion of gross assets under management
- £146.9 million underlying operating profit
- Headquartered in Solihull
- FTSE-250 listed

Success Factors

Eight key factors affect the Group's ability to maintain and grow profits and enhance shareholder returns:

1. Credit quality

Paragon is a conservative lender. When underwriting any new loan or portfolio purchase, the Group makes a detailed credit assessment of the customer and the strength of the underlying loan collateral to help minimise the risk of non-payment and portfolio losses.

Buy-to-let 3 months+ arrears

Paragon

0.11%

Buy-to-let industry average

0.55%

2. Loan pricing

Paragon prices all new advances and portfolio purchases to be competitive and achieve an appropriate margin over funding costs.

Net interest margin

2.15%

3. Funding

The Group makes sure that its loan assets are financed using appropriately dated and priced funding. It seeks to build a broad and diversified funding mix to underpin the business.

£150 million Tier 2 bond issued, rated Senior unsecured rating

BB+ BBB-

4. Strong financial foundations

Strong cash generation helps to support new investment and growth in each of the Group's three operating divisions. The Group's conservative capital and debt positions, which rank among the strongest in the UK, give the Group material balance sheet capacity for further development.

Total regulatory capital ratio

19.0%

Leverage ratio

6.2%

5. Efficient utilisation of the Group's capital base

Returns increasing whilst maintaining prudent capital ratios.

Underlying RoTE **13.2%** (2015: 11.4%)

CET1 **15.9%** (2015: 19.1%)

6. Loan servicing

Each loan is serviced to optimise retention and minimise the risk of non-payment. We also operate a specialist receiver of rent operation for buy-to-let cases.

615 million

pieces of customer data collected and analysed each month

Behavioural scoring models applied

7. Cost control

The Group has a low cost:income ratio and controls costs carefully to maintain this advantage. It operates mainly from a centralised location, maximising the potential for operating leverage. Loan products are distributed principally via third party brokers and savings deposits are collected online.

Underlying cost:income ratio

36.7%
(excluding acquisition related costs)

8. A customer-focused culture

All the Group's employees share a common culture with a single set of values at its core. These values – fairness, integrity, respect, professionalism, teamwork, commitment, humour and creativity – inform the way that we interact with our customers, our colleagues and our wider stakeholders. Importantly, Paragon's employees agree that customers are at the heart of our business and recognise the value of treating customers fairly.

93%

of Paragon employees feel the service we give to customers is improving

93%

of Paragon employees feel there are a clear and consistent set of values and behaviours that support the way we do business

85%

of Paragon employees feel the customer is at the heart of everything we do

Source: 2016 employee survey

Amounts above at 30 September 2016

Paragon Mortgages

paragon mortgages



What we do

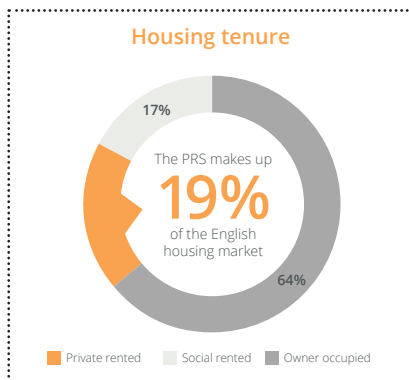
Paragon Mortgages provides buy-to-let mortgage finance for landlords operating in the UK's Private Rented Sector ('PRS'). Paragon was one of the first lenders to develop buy-to-let finance and, in 2000, became the only major UK mortgage lender to focus exclusively on buy-to-let products. We develop and distribute our products using two distinct brands, each with a product set and underwriting approach tailored to meet the needs of our landlord customers according to the size and complexity of their property portfolios. The funding of the Group's buy-to-let lending is increasingly being undertaken by Paragon Bank.

Market dynamics

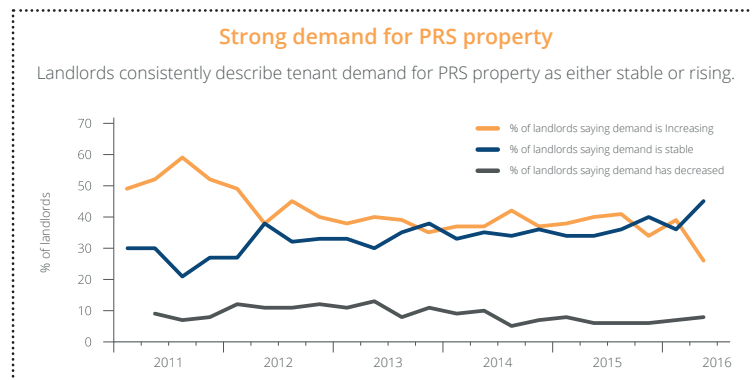
Renting in the PRS is the second most common housing tenure in the UK today, after owner-occupation. Economic, social and demographic changes, together with the flexibility that renting provides, have all combined to make renting in the PRS an increasingly popular choice. Against a UK backdrop of limited house building, low investment in social housing and mortgage affordability constraints, tenant demand is expected to remain strong.

Market outlook

Whilst UK buy-to-let lending contracted sharply following the financial crisis, the market began its recovery in 2009 and had grown to £37.9 billion by 2015 – still 15% below its peak. Government changes to the tax treatment of buy-to-let property and finance, combined with the Prudential Regulation Authority's ('PRA') introduction of minimum underwriting standards for buy-to-let mortgages are expected to moderate the rate of market growth going forward. As an established buy-to-let specialist, Paragon is well-aligned with the PRA approach and has the opportunity to grow its market share under the new regime.



Source: English Housing Survey 2014-15



Source: BDRC Continental



"Paragon has extensive experience gained over a long and successful history in the buy-to-let market. I believe we are uniquely positioned to develop our business as the demand for more rigorous and specialist buy-to-let underwriting is introduced."

John Heron

Managing Director – Paragon Mortgages

What we do

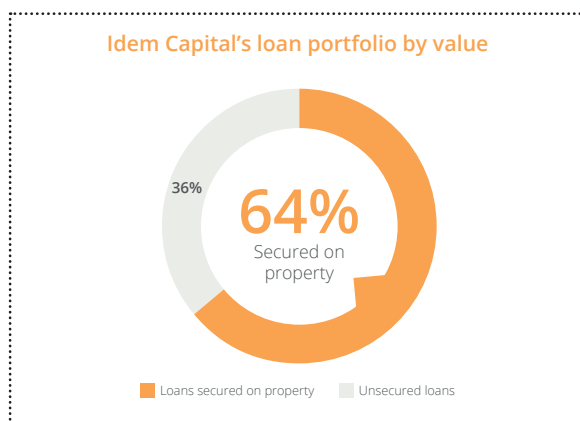
Idem Capital is a leading UK consumer debt purchaser, acquiring and servicing loan portfolios, including first and second mortgages as well as unsecured loan assets. In addition, it services loan portfolios for clients including banks, private equity houses and specialist lenders.

Market dynamics

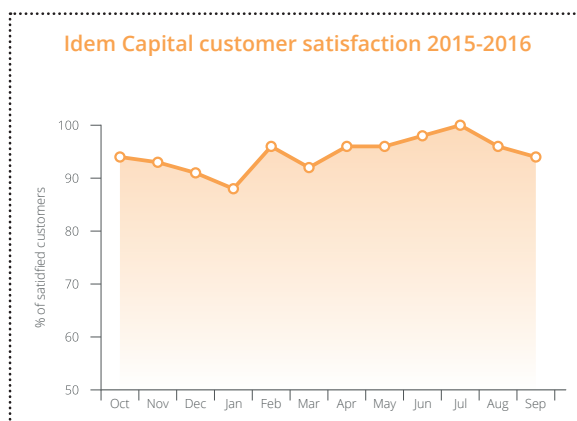
Idem Capital acquires loan portfolios from banks that are either restructuring or refocusing their activities. It focuses on the acquisition and servicing of paying and semi-performing debt. Idem does not actively compete to acquire non-paying debt.

Treating customers fairly

Idem Capital has managed more than one million customer accounts and we are proud of the reputation we have established for customer service. We assist our customers in managing their accounts and strive to create fair and affordable repayment solutions should they encounter financial difficulties.



Source: Amounts above as at end September 2016



Source: Idem Capital customer survey

Market outlook

The UK's well-established debt purchase market is worth over £1 billion annually, with further strong growth forecast as banks continue to de-leverage and focus on core lending markets and customers.

Market consolidation amongst debt purchasers combined with improved availability of funding has led to greater competition for individual portfolios. Importantly, Idem Capital has maintained pricing discipline and this year partnered with Paragon Bank on a portfolio acquisition, where Paragon Bank took ownership and funded a group of secured loan assets with strong performance characteristics.



"Idem Capital's success is built upon the Group's long history of loan servicing. For each potential portfolio acquisition, we undertake a detailed analysis of the underlying loan performance characteristics and stay disciplined in our pricing."

Dave Newcombe

Managing Director – Idem Capital

What we do

Launched in 2014, Paragon Bank is a retail deposit-funded lending bank. It is at the heart of our Group strategy to grow and diversify our funding and lending. Alongside buy-to-let mortgage products, Paragon Bank also offers a targeted range of consumer finance products and has most recently entered the SME asset finance market.

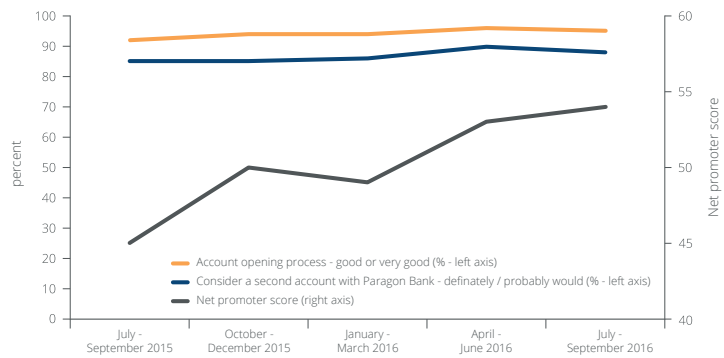
Market dynamics

Paragon Bank aims to bring new competition and choice to UK consumers and SMEs. With a focused range of consistently competitive savings accounts, we are developing our lending into specialist markets where there are good growth prospects and a demonstrable need for increased competition. In November 2015, the Bank entered the SME asset finance market with the acquisition of the Five Arrows Leasing Group – now rebranded Paragon Bank Asset Finance.

Customer satisfaction

Paragon Bank funds its lending through a range of safe, simple and transparent Easy Access, Notice and Fixed Term savings accounts. In May 2016, ISAs were added to the range.

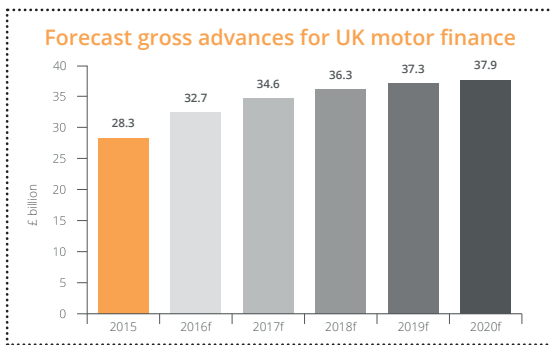
Our regular survey of new savings customers demonstrates a high level of satisfaction with our products and our online application process.



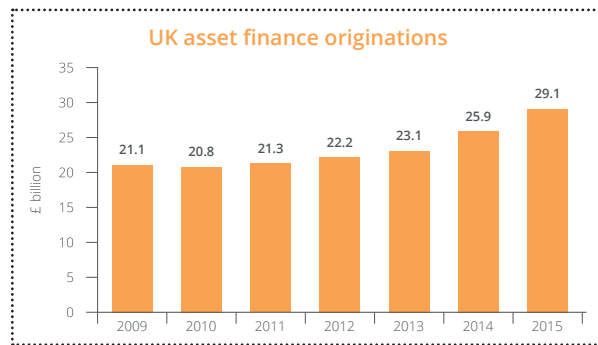
Source: Paragon Bank account opening savings satisfaction study

Market outlook

Both the UK consumer finance market and the SME asset finance market are forecast to continue growing strongly.



Source: Verdict Financial - UK Consumer Credit 2015 - Forecasts and Future Opportunities



Source: Finance and Leasing Association



“Delivering our maiden profit two years after launch is a significant milestone and highlights our success in attracting new customers from the established UK banking brands.”

Richard Doe
Managing Director – Paragon Bank

A2.2 Principal Risks and Uncertainties

The principal risks to which the Group is exposed and which could impact significantly on its ability to conduct its business successfully are summarised below.

Category	Risk	Description
Business	Economic	A downturn in the UK's economic performance in light of the 'Brexit' referendum decision to leave the European Union ('EU') could impact demand for loans, customers' ability to re-pay outstanding balances and security values.
	Concentration	The Group's business plans could be particularly affected by any downturn in the performance of the UK private rented sector and / or further regulatory intervention to control buy-to-let lending.
	Transition	Failure to integrate acquired businesses safely and effectively could adversely affect the Group's business plans and damage its reputation.
Credit	Customer	Failure to target and underwrite lending effectively could result in customers becoming less able to service debt, exposing the Group to credit losses.
	Counterparty	Failure of an institution holding the Group's cash deposits or providing hedging facilities for risk mitigation could expose the Group to loss or liquidity issues.
Conduct	Fair outcomes	Failure to deliver appropriate customer outcomes could impact on the Group's reputation and its financial performance.
Operational	People	Failure to attract or retain appropriately skilled key employees at all levels could impact upon the Group's ability to deliver its business plans.
	Systems	The inability of the Group's systems to support its business operations effectively and / or guard against cyber security risks could result in reputational and financial losses.
	Regulation	Given the highly regulated sectors in which the Group operates, compliance failures or failures to respond effectively to new and emerging regulatory developments could result in reputational damage and financial loss.
Liquidity and Capital	Funding	Increased volatility in wholesale markets could reduce the Group's funding and liquidity options, restricting its ability to lend.
	Capital	Proposals by the Basel Committee on Banking Supervision ('BCBS') to change the capital requirements for lending secured on residential property could have adverse financial implications for the Group.
Market	Interest rates	Reduction in margins between market lending and borrowing rates or mismatches in the Group balance sheet could impact profits.
Pension Obligation	Pensions	The obligation to support the Group's defined benefit pension plan might deplete resources.

The Group has considered and responded to all of these risks, undertaking mitigating actions where required to ensure that exposures are maintained within risk appetite as far as is practicable. Further details of these risks and the mitigants against them are given in section B6.5.

A3 CHIEF EXECUTIVE'S REVIEW



A3.1 Strategy Review

The Group operates in specialist finance markets with its key objective being to support the funding needs of UK consumers and SMEs whilst growing shareholder returns through operating a robust and sustainable business model. The strategy to deliver this objective combines organic growth, diversification of income streams, M&A activity and capital management utilising a prudently funded and strongly capitalised operating model.

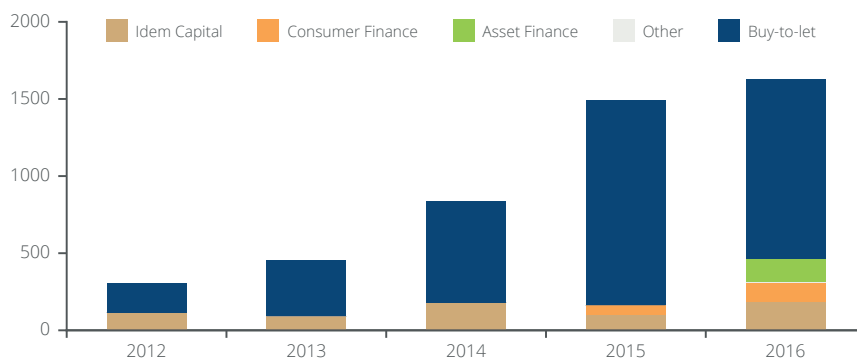
Strong progress has been made in achieving this objective in 2016, with underlying profits (excluding non-repeating acquisition related costs) rising by 9.1% to £146.9 million during the year (2015: £134.7 million) and profits on the statutory basis increasing by 6.7% to £143.2 million (2015: £134.2 million). The combined effects of this growth and the Group's share buy-back programme have resulted in strong earnings per share ('EPS') growth (rising by 14.1% to 40.5p from 35.5p in 2015) and a further improvement in underlying return on tangible equity ('RoTE') to 13.2% (2015: 11.4%) and unadjusted RoTE to 12.9% (2015: 11.4%) (note 6).

The Group's operating model is evolving from its historic, non-bank, securitisation funded position to that of a more broadly based banking group, with a more diversified product set and an increasingly retail deposit focused funding base.

The year has seen strong levels of new organic lending, debt purchase activity and M&A. Group-wide new advances and investments were £1,647.9 million compared to £1,490.1 million last year, taking net loan growth to £657.0 million over the last 12 months. The growth and diversification of new business flows over the past five years is shown in the table below.

Annual lending volumes by asset class (£m)

Year ended 30 September 2012 - 2016

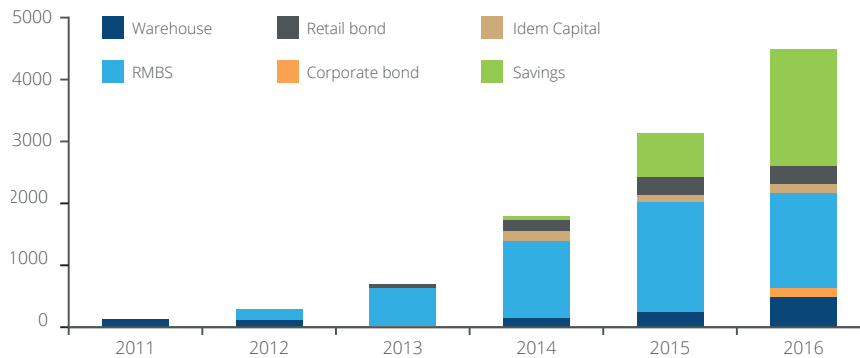


The Group's banking subsidiary, Paragon Bank PLC, is now at the heart of its development plans and moved into profit in 2016. In addition to accessing the deep and reliable retail deposit market to finance organic balance sheet growth, the Bank's retail deposit funding enables it to work with the wider group to participate in debt purchases and also to refinance previously securitised or externally financed portfolios. The Bank has continued to extend its range of loan products, with the launch of its development finance proposition and, more significantly, the completion of two acquisitions in the asset finance market during the period. The Bank also intends to launch a range of specialist residential lending products in the forthcoming year.

The increasingly diversified nature of the Group's funding for new business following the financial crisis is illustrated in the chart below.

New funding by type (£m)

Year ended 30 September 2011 - 2016



The scale of retail deposits in Paragon Bank increased by 164.4% over the year, standing at £1,873.9 million at 30 September 2016 (30 September 2015: £708.7 million), and had grown further, to £2,009.6 million, by 21 November 2016. Retail deposits now represent the Group's primary source of funding for new lending, with its traditional securitisation approach taking a more tactical role as and when conditions in that market are attractive. Further evidence of the Bank's growing scale and maturity is provided by its first draw-down under the Funding for Lending Scheme ('FLS'), with £108.8 million of liquidity accessed during the year. The Bank also plans to access the Bank of England's recently announced Term Funding Scheme ('TFS') during the coming year.

The £117.0 million acquisition of Five Arrows Leasing Group (subsequently re-branded Paragon Bank Asset Finance ('PBAF')) marked a scale change in the Group's lending diversification strategy. A well respected business with a long history, PBAF operates in a number of niche sectors in the asset finance market. Following a post-acquisition strategic review, a number of operational and system enhancements have been identified which deliver the opportunity to increase volumes materially and improve earnings with only modest additional investment. These systems enhancements are expected to be implemented in the first half of 2017, further increasing the capacity of the asset finance business.

The scope of the Group's asset finance operation was further developed at the end of the year with the acquisition of Premier Asset Finance Limited ('Premier') on 30 September 2016. Premier is one of the UK's leading asset finance brokers and its acquisition is expected to provide the Group with access to new markets within the asset finance sector.

The UK private rented sector has seen strong levels of demand from tenants and this strong demand for rented property is expected to continue. Despite this positive backdrop the buy-to-let market has experienced a period of disruption, following a series of fiscal and regulatory changes aimed at both landlords and lenders. These changes disrupted activity during the year and may serve to dampen demand in the sector at an aggregate level. However, the structural changes arising as a consequence are expected to have a positive influence on the Group's ability to take market share, given its twenty-year experience of servicing the complex needs of professional landlords.

The Group's capital requirements are influenced by the risk weighting of its loan portfolios and other assets. The Group assesses risk weightings by reference to the Standardised Approach to Credit Risk ('SA'), and in its December 2015 consultation paper the Basel Committee on Banking Supervision ('BCBS') proposed a set of higher risk weights for buy-to-let loans. These proposals are still under review. The bulk of UK buy-to-let lending is undertaken by banks using an Internal Ratings Basis ('IRB') for assessing risk weights. The IRB typically results in a lower risk weight for buy-to-let lending. The Group has commenced its move to an IRB application, where its long history and rich data are expected to deliver a further competitive advantage once IRB status is granted. The achievement of IRB status, with its enhanced approach to risk management and consequential commercial benefits is one of the Group's key medium term strategic goals.

Idem Capital and Paragon Bank have formed a strong combination in acquiring loan portfolios, accessing appropriate leverage for high quality assets. This joint approach will be used on an increasing basis going forward. Idem Capital has also refinanced a number of legacy portfolios during the period, improving returns made on the capital it employs and returning surplus funds to the Group. Activity in the debt purchase market has been disrupted during the summer as a result of the Brexit referendum, however there is evidence of activity levels recovering more recently.

Enhancing shareholder returns on a sustainable basis is a key objective for the Group. The 14.1% growth in EPS has supported a 22.7% increase in the dividend for the year to 13.5 pence, meeting the Group's target of a three-times dividend cover ratio for the full year in line with the policy announced in 2012. The increase in the Group's EPS and annual dividend rate over the period of this policy, together with their compound annual growth rates ('CAGR') is set out below.

	2016	2011	Increase	CAGR
	p	p	p	%
EPS	40.5	20.2	20.3	14.9
Dividend	13.5	4.0	9.5	27.5
Dividend cover (times)	3.0	5.1		

The Group intends to operate a progressive dividend policy going forward, while maintaining its three-times cover ratio target.

The share buy-back programme has also progressed well, with £100.0 million having been invested to date. The programme will be extended by an additional £50.0 million in the coming financial year, further enhancing shareholder returns.

The share buy-back and goodwill associated with the acquisitions in the year have contributed to the Group's core equity tier 1 ratio ('CET1') reducing to 15.9% in 2016 (2015: 19.1%). The Group issued its first Tier 2 Corporate Bond in September 2016, raising £150.0 million, taking its total capital ratio to 19.0% (2015: 19.8%). Free cash resources totalled £366.5 million at the end of the period, leaving the business well placed to finance further growth, maintain its capital management programme and repay its £110.0 million subordinated bond which matures in April 2017.

The business remains well funded, strongly capitalised and effectively placed to continue to deliver long term, sustainable returns through its robust operating model. The Group is positioned to respond quickly to the challenges and also to take advantage of the opportunities that will arise given changes in the broader operating environment.

A more detailed discussion of the Group's performance is given below covering:

Business review	Funding review	Financial review	Operational review
Lending, performance and markets	Retail deposits, wholesale funding and capital management	Results for the year	People, risk and regulation
A3.2	A3.3	A3.4	A3.5

A3.2 Lending Review

The Group's operations are organised into three divisions, each with responsibility for delivering asset and profit growth. The Paragon Bank segment includes all of the Group's retail deposit funded assets, some of which are of similar types to those in the Paragon Mortgages and Idem Capital segments.

The Group's investments in loans and the amounts invested in the year for each of its division are summarised below:

	Advances and investments in the year		Investments in loans at the year end	
	2016	2015	2016	2015
	£m	£m	£m	£m
Paragon Mortgages	599.5	976.6	8,768.0	9,221.7
Idem Capital	24.0	104.4	283.3	451.0
Paragon Bank	1,024.4	409.1	1,686.2	407.8
	1,647.9	1,490.1	10,737.5	10,080.5

A3.2.1 Paragon Mortgages

Paragon Mortgages is one of the longest established lending brands in the buy-to-let mortgage market. Alongside its sister brand, Mortgage Trust, Paragon Mortgages maintains a significant presence in this sector of the UK mortgage market. Total loan assets of the Paragon Mortgages segment at 30 September 2016 were £8,768.0 million, 4.9% lower than the £9,221.7 million a year earlier. This reflects the trend to focus an increasing share of the Group's new buy-to-let lending through Paragon Bank and also for the Bank to purchase previously securitised buy-to-let loans, moving the balances between divisions.

Of the total Paragon Mortgages loan balance £8,601.0 million were buy-to-let mortgage assets (30 September 2015: £8,999.1 million), with £167.0 million of other assets (30 September 2015: £222.6 million).

Buy-to-let

Market overview

The UK buy-to-let sector has experienced significant levels of disruption since the government signalled the phased reduction of the tax relief available to landlords on mortgage interest to the basic rate of income tax in its budget in the summer of 2015. The phased reduction of the available tax relief to landlords commences in April 2017.

Since that point there have been further regulatory and fiscal interventions in the sector, including increases in the level of Stamp Duty Land Tax ('SDLT') payable by investors in property and a more interventionist approach to the regulation of buy-to-let lending announced by the PRA.

Against this, however, the demand for rental property remains high, with rents remaining strong and expected to rise by many commentators.

The new PRA standards establish minimum levels for lenders' affordability assessments for buy-to-let loans and also set out requirements governing the underwriting process required for lending to portfolio landlords (those with four or more buy-to-let funded properties). Although these standards are similar to those operated by the Group, they are significantly more demanding than those applied to date by some other lenders in the market. Whilst this increase in regulation may act as a further constraint on market growth, the Group is well placed to benefit from any realignment this may cause among participants in the sector. Early evidence of this is seen in the growth of the proportion of the Group's pipeline relating to complex buy-to-let. This was 61.8% going in to 2017 compared to 45.5% twelve months earlier.

The monthly flow of UK housing transactions over the year was severely distorted by the changes to SDLT announced in the 2015 Autumn Statement which became effective in April 2016. This caused transactions to spike in March at 171,000 before dropping to just 73,000 in April. Recovery in transaction numbers, driven largely by a resurgent owner-occupied market, was swift with transaction numbers by August 2016 at similar levels to August 2015. Continuing constraints on the supply of properties for sale have helped maintain stable house prices and whilst the Royal Institute of Chartered Surveyors ('RICS') have scaled back their expectations for house price growth in their most recent projections, they still expect house price rises over the next five years of approximately 4.0% per annum.

Regardless of the changes in regulation and housing policy, the primary characteristic of the housing market more generally remains a shortage of supply. As the demand for housing increases due to population growth, inward migration and household formation, the imbalance between supply and demand continues to increase, supporting house price inflation and reducing affordability. This constrains the potential for growth in the owner-occupied sector, whilst limits on public finances limit the ability of the social sector to respond to increasing demand from those in housing need. As a result, demand for private rented property has continued to increase which, in turn, has supported landlord demand for finance for property investment.

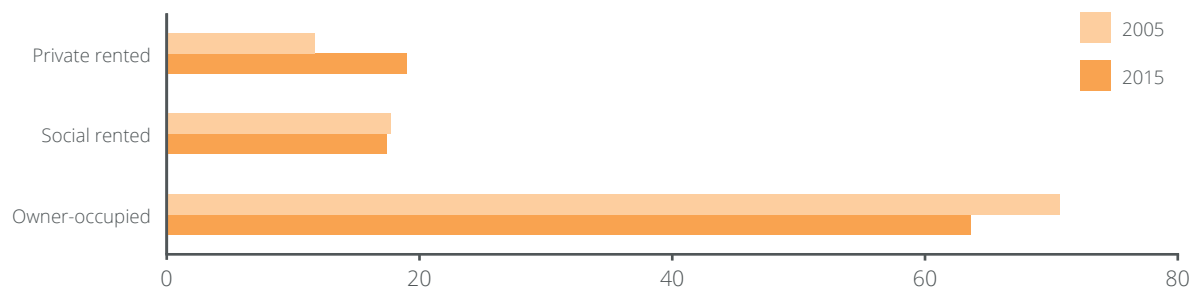
Rental demand remains high across the country, which in turn is driving up rents. Research by Savills published in October 2016 suggests that the outlook for rents over the next five years is both stronger and more stable than that for house prices. Savills suggest that whilst rent increases may slow next year due to the ongoing uncertainties around Brexit and tightening affordability, the barriers to home ownership described above will continue to drive demand. As a consequence, they forecast that over the next five years rents will grow by 19% across the UK as a whole, with 25% growth in London.

The PRS remains the second largest form of tenure according to data in the annual English Housing Survey for 2014-2015 released by the Department of Communities and Local Government in February 2016. This showed that 4.3 million households rented privately compared to 3.9 million in the social sector. This represented 19.0% of all households compared to 17.4% renting in the social sector and 63.6% in owner-occupation. A key feature of the sector in recent years has been the increase in the number of families with children that rely on the PRS for a home, which has increased from 30.0% to 37.4% of households over the last ten years. This is also reflected in the increase in the age of first time buyers who were, on average, 32.5 years old according to the latest data, compared with 31.1 years old ten years earlier.

This change in tenure is illustrated in the chart below, comparing the distribution of tenure in England in 2015 with the position ten years earlier.

Change in percentage share of housing tenure 2005 – 2015

English Housing Survey 2014-15

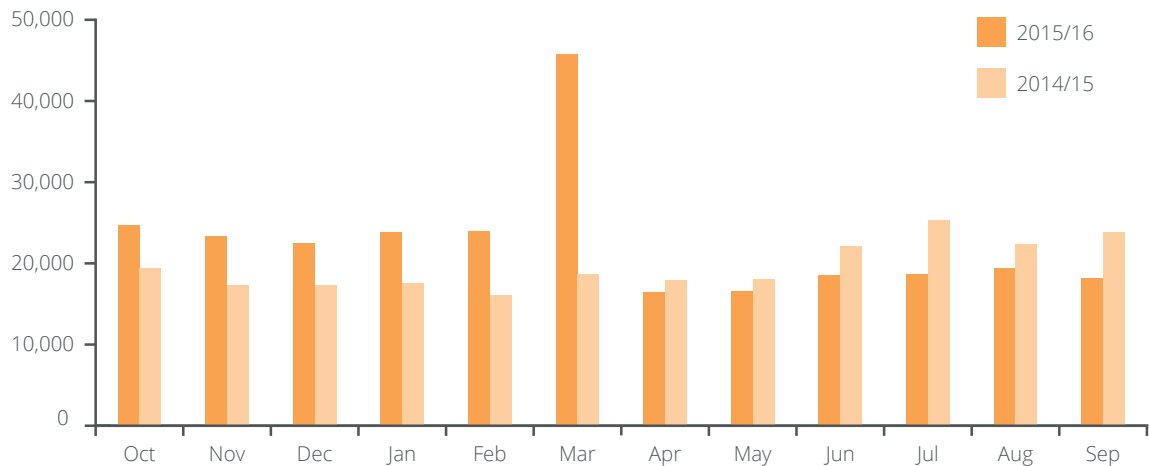


Whilst buy-to-let lending at an overall market level in 2016 is likely to be similar to 2015, the phasing of lending across the year will have been similar to the Group's experience, with activity concentrated in the period between January and March 2016. Lending after that quarter has been below the levels for the same period in 2015 across the market, reflecting both the acceleration of transactions prior to the SDLT deadline and the lower levels of landlord confidence, particularly impacting the purchase market.

This is demonstrated by the month-to-month buy-to-let lending data published by the Council of Mortgage Lenders ("CML").

Number of buy-to-let transactions – 2015/16 compared with 2014/15

Council of Mortgage Lenders



Whilst the year ended 30 September 2016 has been a period of disruption in the market, the fiscal and regulatory changes made in the period are expected to restructure supply towards the more complex professional landlords. The overall rate of growth, as a result, is expected to slow, but, with demand from tenants remaining strong, rents are likely to rise and the private rented sector is expected to remain an attractive area for investment. The Group's long established capabilities in this sector are expected to result in it taking an increased share of its target markets as these broader influences play out over the coming years.

Group performance

Group buy-to-let completions totalled £1,161.0 million in the year compared to £1,326.6 million in 2015. The credit quality of the new lending business written in the year has remained excellent. With retail deposit funding representing the core of the Group's financing strategy, Paragon Bank has made an increasingly important contribution to funding the Group's buy-to-let lending volumes. Paragon Bank funded buy-to-let originations rose from 26.4% of lending in 2015 to 48.4% of lending in 2016 and the Bank now represents the larger of the two funding streams employed by the Group for new loans.

The Group's buy-to-let completions are set out below.

	Completions in year		Pipeline at year end	
	2016	2015	2016	2015
	£m	£m	£m	£m
Paragon Mortgages	599.5	976.6	123.8	404.2
Paragon Bank	561.5	350.0	197.3	309.5
	1,161.0	1,326.6	321.1	713.7

The flow of new applications has stabilised in the second half of the year, albeit at a lower level than in recent periods, resulting in a pipeline of new business (live cases between application and completion), of £321.1 million at the period end (2015: £713.7 million), of which £197.3 million, representing 61.4% of the total, was in Paragon Bank, exceeding the pipeline in the Paragon Mortgages division.

The level of the pipeline reflects both the market disruption of recent months and the timing of credit tightening by competitors to reflect the impact of changes to interest tax deductibility and in anticipation of PRA mandated minimum underwriting standards. The Group changed its minimum hurdles in January 2016, ahead of some competitors and as these changes are made across the market, the Group's relative competitive position is expected to improve. There has been some early evidence of this, with the buy-to-let pipeline increasing after the year end.

The Group's approach to underwriting remains robust. The focus on the credit quality and financial capability of our customers is underpinned by a detailed and thorough assessment of the value and suitability of the property as a security. This was enhanced in the period by the adoption of the stricter Interest Cover Ratio ('ICR') requirements.

The average ICR of the Group's pipeline cases, and the average reference rate against which it is measured, at the last four half year ends is shown below.

	30 September 2016	31 March 2016	30 September 2015	31 March 2015
ICR	148.9%	144.6%	142.4%	145.2%
Reference rate	5.46%	5.47%	5.15%	5.21%
Stressed interest rate	8.13%	7.91%	7.33%	7.56%

The stressed rate represents the yield available to the customer on the mortgaged element of their property to cover interest payments and running costs.

The quality of new lending remains high, with a good affordability profile, low average loan-to-value ratios and strong customer credit profiles.

Over the year the Group has expanded its capacity to deal with the more complex requirements of portfolio landlords. This has included the refocusing of staff resource in this area of our lending, the development of more sophisticated online application processing for complex cases and the introduction of a dedicated service proposition for specialist intermediaries who work with these portfolio landlords. The strategic objective of this approach has been to enhance the Group's capability in this part of the buy-to-let market, both in anticipation of the changes that are expected to result from the PRA's new regulations and to address a rapid increase in demand from incorporated landlords responding to the fiscal changes that come into effect in the next tax year.

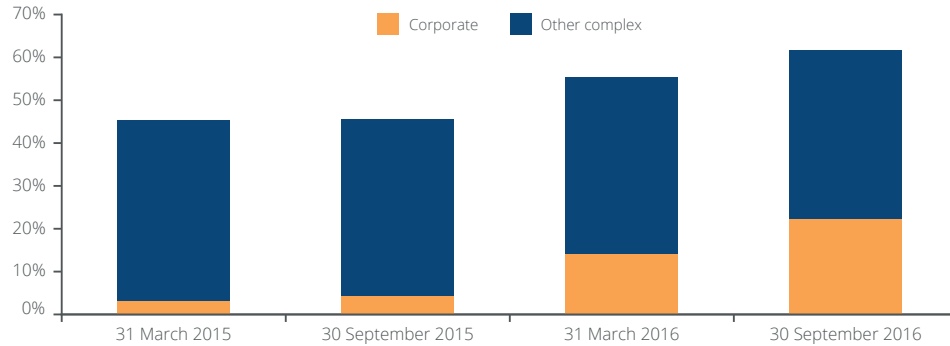
Complex cases include incorporated landlords and larger portfolios, but also those involving more specialist property types such as houses in multiple occupation ('HMOs'), multi-unit properties, local authority leases and student lets.

The Group's lending on more complex buy-to-let cases has increased over the year and represents over 60% of the pipeline at 30 September 2016, compared with 44.5% at 30 September 2015. Lending to incorporated landlords has been a significant element of this increase with applications from these customers increasing four-fold over the year, representing over 20% of the total number of pipeline cases at the year end.

This trend over the last year can be seen in the analysis of the Group's buy-to-let pipeline application numbers over the last two years.

Percentage of complex pipeline cases

Number outstanding at date



The Group's outstanding buy-to-let balances are analysed below:

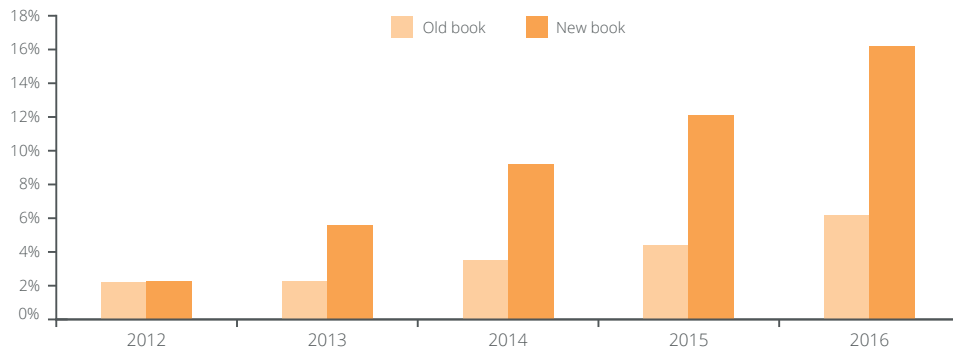
	Balance outstanding	
	2016	2015
	£m	£m
Paragon Mortgages	8,601.0	8,999.1
Idem Capital	13.7	14.5
Paragon Bank	1,006.5	349.6
	9,621.2	9,363.2

At 30 September 2016 the Group's buy-to-let portfolio stood at £9,621.2 million, 2.8% higher than the £9,363.2 million reported a year earlier. The redemption rate on the overall buy-to-let book, although higher than the 5.8% reported for 2015, still remains low at 9.1%, despite the increasing numbers of post-credit crisis accounts included in the portfolio, which would be expected to redeem more quickly than the extant book. The annualised redemption rate on these loans, at 16.2% (2015: 12.1%), is, as expected, approaching the levels seen before the credit crisis as the book matures. The annualised redemption rate on pre-crisis lending, at 6.2%, has increased from the 4.4% seen in the year ended 30 September 2015. This included an uplift in March 2016 related to the market disruption from the SDLT changes but remained comparatively low and has since fallen back from the annualised 6.7% reported at the half year.

The table below shows the redemption rates for the buy-to-let book reported on an annual basis over the last five years.

Annual redemption rates

2012 - 2016

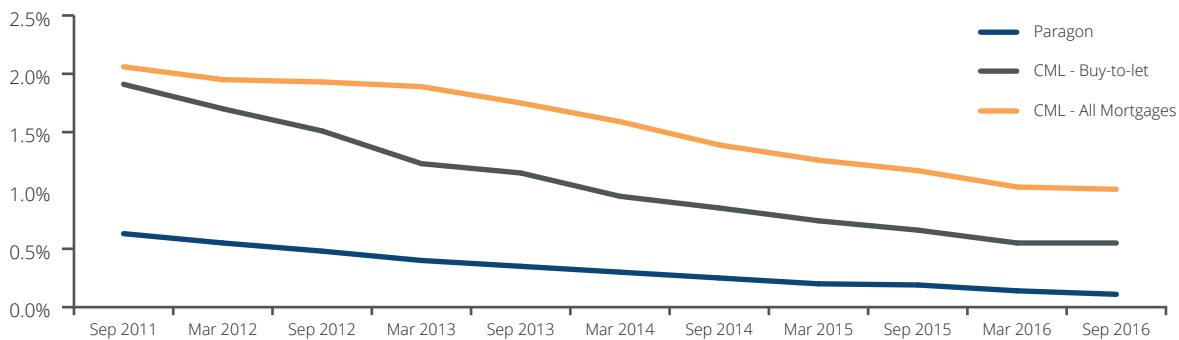


The Group enjoys the reputation of being a highly prudent lender, with the strong underwriting, customer servicing and collection skills, systems and experience required to advance loans effectively to landlord customers with complex requirements. This is demonstrated by its long-term delivery of market leading buy-to-let credit performance. Despite the regulatory and fiscal changes in the buy-to-let market and, more recently, uncertainties surrounding the Brexit referendum result in the summer, the credit performance of the portfolio over the year continued to be exemplary, maintaining the Group's long-term outperformance of the sector in buy-to-let arrears level. The percentage of loans more than three months in arrears as at 30 September 2016 (note 7) stood at 0.11% (30 September 2015: 0.19%) and remained considerably better than the CML's comparable market average of 0.55% at that date (30 September 2015: 0.67%).

The graph below shows movements in the Group's buy-to-let arrears rate against the CML market data, for buy-to-let and for all mortgages, at each half year period end in the last five years.

Buy-to-let arrears

At 31 March and 30 September

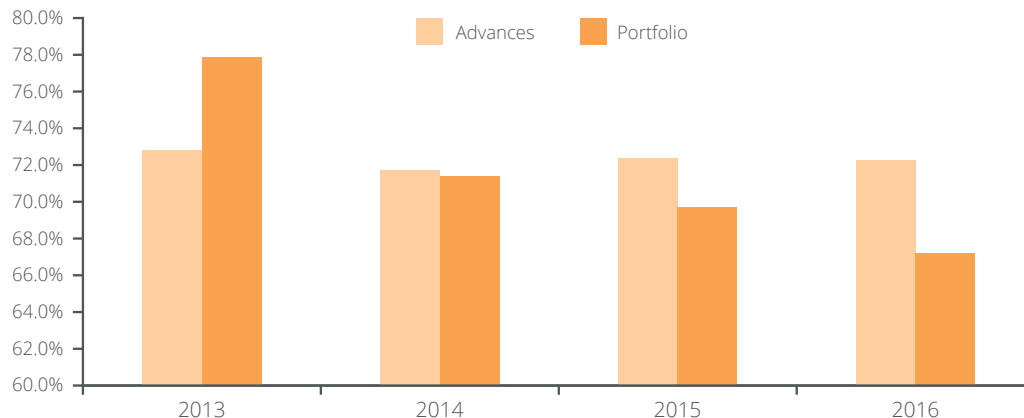


Security values have also benefitted from increasing house prices. The Nationwide House Price Index showed appreciation in residential property values of 5.3% over the year (2015: 3.8%), while the indexed loan-to-value ratio of the buy-to-let portfolio at 30 September 2016, at 67.2%, had improved from 69.7% a year earlier. The increase in average prices, however, is part of a more volatile picture, with marked variations at the local and regional level.

Movements in the Group's average loan to value ratios for the buy-to-let portfolio and for new advances in each period are shown below, with the average loan-to-value ratio in the portfolio decreasing over time as the book seasons, while loan-to-value at advance remains stable, demonstrating a consistent approach to underwriting.

Average loan-to-value - buy-to-let lending

Year ended (advances) or at year end date (portfolio)



The Group maintains a specialist team of in-house surveyors to maximise its understanding of particular markets, both from a valuation and a lettings standpoint. In a potentially less benign economic environment, this capability also enables the Group to closely monitor developments in the residential property market, regionally, nationally and by type of property.

The number of properties with an appointed receiver of rent reduced by 10.9% to 946 at 30 September 2016 (30 September 2015: 1,062), and 97.4% of the properties available for letting in the receiver of rent portfolio were let at that date (30 September 2015: 96.9%).

Yields on the Group's buy-to-let lending balances, based on average monthly balances outstanding are set out below. These are analysed between the post credit crisis lending and the legacy assets, which enjoy the benefit of cheaper dedicated funding through securitisation structures.

	Average balance		Average yield	
	2016	2015	2016	2015
	£m	£m	%	%
New lending	2,786.0	1,655.5	4.71%	5.17%
Legacy assets	6,814.4	7,211.9	2.23%	2.27%

The distribution of yields on buy-to-let mortgages may vary between Paragon Mortgages and Paragon Bank, dependent on product mix from time to time.

Other assets

These include legacy owner-occupied mortgages, car loans, secured consumer loans and unsecured consumer loans originated before 2009. These assets form a very small part of the division's results, when compared to buy-to-let assets and performed in line with our expectations during the year.

	Balance outstanding	
	2016	2015
	£m	£m
Owner-occupied mortgages	19.4	47.6
Secured loans	143.8	170.0
Unsecured loans	3.8	5.0
	167.0	222.6

The monthly average balance of these assets in the year was £188.2m (2015: £244.6m) and the yield was 9.16% (2015: 8.46%). The legacy secured loan book, which forms the largest part of the balance, recorded arrears of 16.1% (2015: 15.9%), consistent with the industry average of 12.5% given the age and seasoning in the portfolio.

The Group has returned to lending in the car finance and secured loan markets through Paragon Bank. This activity is reported within that division's results.

A3.2.2 Idem Capital

Idem Capital is one of the UK's principal consumer debt buyers and is a servicer of loans for third parties and co-investment partners.

Activity in the debt purchase market remains high with UK based financial institutions continuing to dispose of both paying and non-paying consumer loans either as business-as-usual sales or through de-leveraging requirements. The market has historically been lumpy in its nature but did suffer a decline in activity at the time of the Brexit referendum. The majority of expected transactions had been put on hold over the summer; however, a number of these have since appeared, with Idem Capital having invested over £65.0 million since the year end. There is also evidence of a strong pipeline of transactions expected to reach the market over the coming months.

UK financial institutions have reduced the size of their purchaser panels in recent years, for operational efficiency and to facilitate compliance with regulatory obligations. Idem Capital has maintained its position as an active panel member for the major UK based debt sellers and has participated in several transactions during the course of the financial year.

Idem Capital, working in partnership with Paragon Bank, invested £208.8 million in loan portfolio acquisitions in the year ended 30 September 2016 (30 September 2015: £104.4 million). This included purchases of loan assets in which Idem Capital had previously had an interest under servicing and co-investment arrangements. The analysis of this balance between the divisions is shown below, together with the outstanding balances at the year end.

	Investment in the year		Balance outstanding at year end	
	2016	2015	2016	2015
	£m	£m	£m	£m
Idem Capital portfolios	24.0	104.4	283.3	432.9
Co-investments	-	-	-	18.1
Idem Capital division assets	24.0	104.4	283.3	451.0
Paragon Bank division assets	184.8	-	250.6	-
	208.8	104.4	533.9	451.0

The outstanding value of the Group's debt purchase investments at 30 September 2016 totalled £533.9 million (30 September 2015: £451.0 million). Of this balance, 64.2% related to loans secured on property (30 September 2015: 51.9%).

During the period balances to the value of £102.0 million were sold by Idem Capital to Paragon Bank, replacing the division's funding with cheaper retail deposit funded debt.

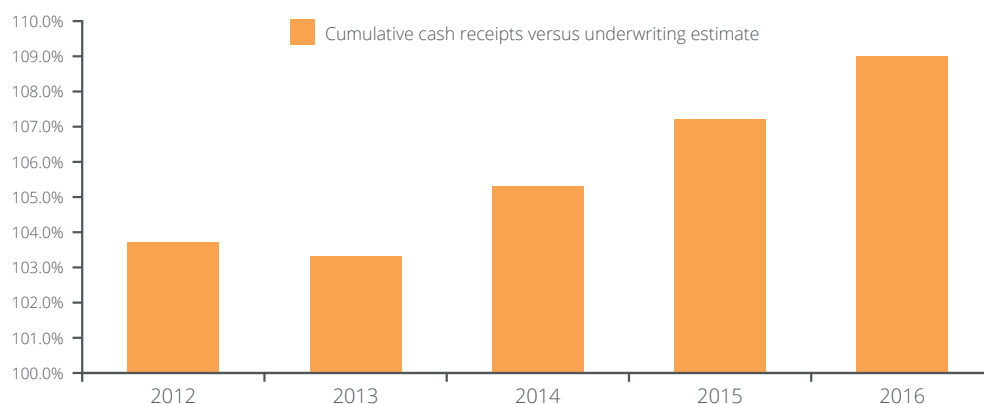
At 30 September 2016, the 120 month gross (undiscounted) estimated remaining collections ('ERC') for the Group's acquired assets stood at £740.7 million (30 September 2015: £677.7 million), while those for the division's portfolio stood at £454.3 million (30 September 2015: £677.7 million) (note 7). This reduction in the division was primarily attributable to the intra-group sale of assets into Paragon Bank, where the 120 month ERC for purchased assets totalled £286.4 million at 30 September 2016 (30 September 2015: £nil). ERC is a common measure of scale in the debt purchase industry reflecting likely future cash flows from the acquired assets over the next ten years, which will reduce over time as balances are collected.

Asset performance continues to be strong. As at 30 September 2016 cumulative cash receipts in the Idem Capital portfolios totalled 109.0% of the values predicted at the point the loans were acquired (30 September 2015: 107.2%).

The movements in this cumulative performance against plan in each of the last five years are shown below.

Cumulative performance of Idem Capital purchased portfolios to date

Year ended position



Yields on the Group's acquired consumer finance balances, based on average monthly balances outstanding are set out below. These are analysed between secured and unsecured balances.

	Average balance		Average yield	
	2016 £m	2015 £m	2016 %	2015 %
Secured loans	291.7	235.1	18.22%	17.60%
Unsecured assets	207.7	172.1	15.99%	18.15%

The allocation of yields may vary between Idem Capital and Paragon Bank, dependent on their relative participation in transactions from time to time.

After taking into account portfolio run-off, acquired accounts under Idem Capital management, including those owned by Paragon Bank, increased by 5.1%. Total accounts under Idem Capital management (including third-party serviced assets) decreased by 10.4% in the year, principally due to the reduction in third party administration activity, partly as a result of Idem Capital acquiring previously administered loan portfolios.

The number of purchased loan assets managed by Idem Capital is shown below.

	2016 Number	2015 Number
Idem Capital owned	279,877	277,063
Paragon Bank owned	13,193	-
	293,070	277,063
Third party	53,742	109,806
Idem Capital managed	346,812	386,869

During the period, Idem Capital successfully raised external finance for both its secured and unsecured portfolios, optimising leverage against these portfolios on more favourable terms. In addition, a partial sale of Idem Capital's secured loan portfolio to Paragon Bank contributed to improving the capital efficiency and funding terms across the Group's acquired portfolios. This is discussed further in the funding review in Section A3.3.

Idem Capital utilises the Group's highly developed loan servicing and collection capability which is used for its own purchases and for co-investment and third party assets. The Group has invested heavily in its control and compliance oversight infrastructures and is well placed to continue to deliver robust operational and conduct standards for customers as required by the UK regulatory authorities, portfolio vendors and co-investment partners.

As described under 'Regulation' (section A3.5.3), Paragon Finance PLC, the principal entity within the Group responsible for servicing loan accounts, received the appropriate permissions under the FCA's consumer credit regime ('CONC') and Mortgages: Conduct of Business' ('MCOB') regime during the course of the year.

A3.2.3 Paragon Bank

Paragon Bank continues to provide the Group with diversification of both income streams and funding sources. It saw strong development in the year with total assets rising to £1,686.2 million (2015: £407.8 million). That growth has been driven by the strategically important acquisition of PBAF, portfolio purchases and ongoing origination activity. It has materially diversified the Group's funding profile, both through raising significant amounts of retail deposit monies and in gaining access to the FLS to support lending to SME customers.

Paragon Bank funds its new lending advances and pipeline through savings deposits. The Bank's funding position at 30 September 2016 is summarised below.

	2016	2015
	£m	£m
Loans to customers (note 32)	1,686.2	407.8
Retail deposits (note 54)	1,873.9	708.7
Loan to deposit ratio	90.0%	57.5%

The scale now achieved by Paragon Bank reduces the inefficiencies seen during its start-up phase when deposit levels were dictated by pipeline requirements as well as income generating asset balances. This more efficient liquidity profile enhances profitability and creates a more normal relationship between deposit levels and the size of the loan portfolio.

The Group provided capital of £167.0 million to Paragon Bank during the period (2015: £33.0 million), including amounts required to support acquisitions, and its policy is to provide the Bank with sufficient capital to cover its planned requirements over each twelve-month period.

In addition to Paragon Bank providing a diversified funding base for the Group, its second strategic objective is to diversify the Group's income flows. An analysis of the Bank's loan portfolio is presented below:

	Current year advances and external investment		Outstanding balance	
	2016	2015	2016	2015
	£m	£m	£m	£m
Buy-to-let mortgages	561.5	350.0	1,006.5	349.6
Car finance	79.8	43.9	95.2	43.2
Personal finance	229.7	15.2	304.8	15.0
Asset finance	144.3	-	250.4	-
Development finance	9.1	-	9.1	-
Other loans	-	-	20.2	-
	1,024.4	409.1	1,686.2	407.8

As well as entering the asset finance market through acquisitions, Paragon Bank also launched a property development finance offering during the year. It continues to investigate further opportunities to broaden its range of products, both organically and by acquisition, where these match its risk appetite. The next scheduled development is the launch of a specialist residential mortgage operation, serving currently undersupplied areas of that market, expected in the first half of the new financial year.

Yields on the Bank's loan assets, based on average monthly balances outstanding are set out below, analysed between product lines.

	Average balance		Average yield	
	2016	2015	2016	2015
	£m	£m	%	%
Buy-to-let mortgages	718.8	114.9	4.49%	3.85%
Acquired balances	234.3	-	4.26%	-
Originated personal finance	36.1	4.8	4.87%	4.23%
Car finance	71.9	21.2	5.40%	5.40%
Development finance	2.2	-	8.99%	-
Asset finance	247.8	-	10.46%	-

As the Bank's investments in buy-to-let mortgages and acquired assets are part of the wider group position, the yields above will differ from the overall yields for these activities, dependent on the mix of business.

Buy-to-let

Paragon Bank continues to increase its buy-to-let lending, with £561.5 million of advances in the year (2015: £350.0 million), representing 48.4% of the Group's total buy-to-let advances (2015: 26.4%). At the end of the period the Bank's buy-to-let pipeline stood at £197.3 million (2015: £309.5 million). There have been no accounts over three months in arrears on business written by the Bank up to 30 September 2016 (2015: none). The buy-to-let market is discussed in more detail under 'Paragon Mortgages' above. The products originated by the Bank are complementary to those offered by Paragon Mortgages.

In addition to newly originated assets, Paragon Bank acquired the portfolio of buy-to-let loans previously financed in the Group's Paragon Mortgages (No. 17) PLC securitisation. This portfolio, which stood at £99.2 million at 30 September 2016, contained well-seasoned loans which formed part of the Bank's rolling programme of pre-positioning buy-to-let assets with the Bank of England. At the year end £620.3 million of assets had been pre-positioned in this way (2015: £nil).

The Bank is expected to continue to acquire previously securitised assets, where the use of deposit funding can achieve cost and capital optimisation benefits for the Group while conforming to the Bank's risk profile.

Car finance

The UK car market has continued to grow during the year ended 30 September 2016. During September 2016, according to data published by the Society of Motor Manufacturers and Traders, 470,000 new cars were registered (2015: 463,000) which was the highest number ever recorded for September. Calendar year-to-date registrations were 2,150,000 which is a 2.6% increase on the comparable period in 2015 (2015: 2,097,000).

The UK car finance market has also experienced considerable growth, with total finance for the year ended September 2016 reported by the Finance and Leasing Association ('FLA') up 11.9% at £40.4 billion (2015: £36.1 billion), with similar percentage increases seen for both new and used car funding at £26.2 billion and £14.2 billion respectively (2015: £23.7 billion and £12.4 billion).

Car finance volumes have continued to build, with total advances increased by 81.8% in the year to £79.8 million (2015: £43.9 million). Paragon Bank's car finance loan book was 120.6% higher than at the start of the period at £95.2 million (2015: £43.2 million). The quality of these loans remains high and the percentage of the Bank's car finance accounts which were more than two months in arrears at 30 September 2016 was 0.09% (2015: none).

The Bank's underwriting standards ensure that car finance loans enjoy significant security from the financed vehicle. At 30 September 2016 external valuations from CAP, the motor vehicle market analysts, were available for vehicles representing £75.0 million of the loan book (excluding light commercial vehicles, motorhomes or vehicles 10 years past the last production date which are not included in the published data). These assets had a total security value of £88.1 million, resulting in headroom of £13.1 million or 16.6%. In the event of a 10% depreciation in vehicle values, the security valuation reduces to £79.3 million, with £4.3 million of headroom still remaining (5.6% of the asset value).

Personal finance

The second charge mortgage market has continued to experience growth over the year with FLA data for new business volumes in September 2016 showing a year-on-year increase by value of 4.1% to £77 million (September 2015: £74 million). In contrast, the number of new second charge mortgages fell by 1.2% to 1,719 over the same period (September 2015: 1,740). The average second charge mortgage advance in September was therefore £44,700, a year-on-year increase of 5.2% (September 2015: £42,500). The total size of the second charge mortgage market reported by the FLA had increased in the year ended 30 September 2016 by 14.7% to £892 million (2015: £778 million).

The personal finance balances shown below comprise second charge mortgage assets originated by Paragon Bank or purchased by it from third parties or other Group entities:

	Current year advances and external investment		Outstanding balance	
	2016	2015	2016	2015
	£m	£m	£m	£m
Originations	44.9	15.2	54.2	15.0
Acquired loans	184.8	-	250.6	-
	229.7	15.2	304.8	15.0

Paragon Bank's advances in the year were £44.9 million (30 September 2015: £15.2 million), increasing its originated loan book by 361.3% in the year, and the pipeline of new business at the period end was £11.5 million (30 September 2015: £4.4 million). The average loan size in the year was just over £57,000 and the average loan-to-value ratio in the portfolio at 30 September 2016 was 68.8%. None of the Bank's originated second charge mortgage accounts were in arrears at 30 September 2016 (30 September 2015: none).

Debt purchase opportunities are sourced through the Group's Idem Capital debt purchase operation, when potential asset purchases fit with the Bank's risk appetite and business model. The use of Idem Capital's expertise and resources combined with funding through the Bank broadens the range of potential acquisitions for the Group. During the period the Bank has also purchased certain personal finance balances, formerly disclosed in the Idem Capital segment. The UK debt purchase market is discussed further under 'Idem Capital' above.

Paragon Bank's purchased second charge mortgage assets were of high quality at the acquisition date and at 30 September 2016 only 5.04% of these accounts were two months or more in arrears, compared to an industry average of 12.5% reported by the FLA.

Second charge mortgages became regulated under the FCA's MCOB regime on 21 March 2016. Paragon Personal Finance completed the required systems enhancements, procedural developments and employee training during the year. Whilst these changes disrupted market volumes at the time, they generate further opportunities for product development and broaden the available distribution options for the Group's second charge mortgage products.

Development finance

The development finance balance represents the initial advances from the Bank's new operation to provide funding for small scale property developments. The proposition launched during the year and has developed a strong network of relationships within the market that are expected to drive sustained growth, based on a robust credit assessment and risk proposition.

Paragon Bank's focus in this area is to provide access to finance for smaller builders who are not being supported by the clearing banks, but who have an important part to play in increasing the supply of new properties in the UK. The business delivers attractive returns and operates within the Bank's risk appetite. The operation made loans of £9.1 million in the year (2015: £nil) and had an investment balance of £9.1 million at year end (2015: £nil). The pipeline of the new business at the year end was £63.7 million (30 September 2015: £nil).

Asset finance

The Group acquired its asset finance business on 3 November 2015. This represents a significant strategic broadening of Paragon Bank's scope into the SME asset finance market and provides an attractive opportunity to deliver growth, addressing a different market to its existing offerings. During the year this business has added £9.4 million to the Bank's profits, before acquisition related costs of £2.8 million (note 9).

PBAF was formed, as Five Arrows Leasing Group, in 1988 and was owned by Rothschild & Co from 1996 until its sale to the Group. It offers a range of asset finance products through its subsidiaries to UK SMEs, including equipment, vehicle and construction equipment finance and is also a provider of lease servicing.

The FLA reports the total market for asset finance for businesses at 30 September 2016 covered £70.3 billion of outstanding balances, an increase of 7.0% over the preceding twelve months (30 September 2015: £65.7 billion). Advances in that market in the year ended 30 September 2016 were £30.2 billion, an increase of 7.9% on the £28.0 billion recorded in the previous year. The market is addressed by a range of companies, many operating within specialist niches.

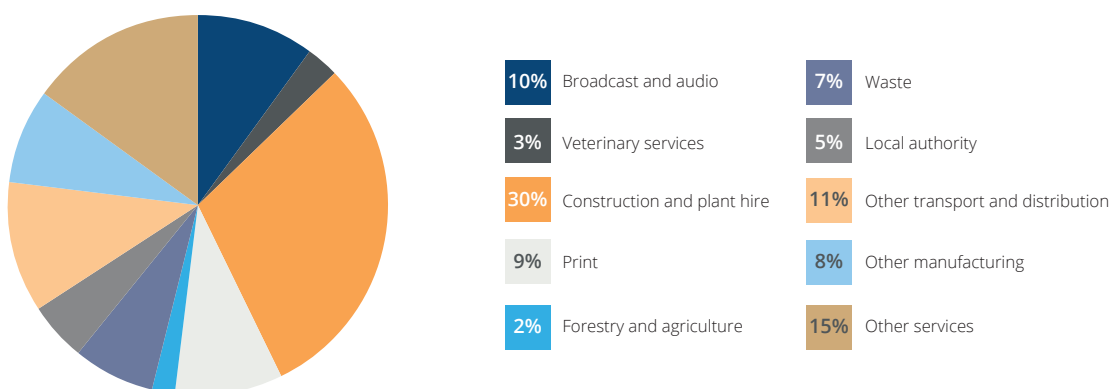
The finance lease assets acquired with the business were £203.6 million (note 9), which had risen to £250.4 million by the year end, an increase of 23.0%, as a result of new advances in the period since acquisition of £144.3 million. These finance lease assets generated interest income of £19.3 million in the period. The number of loan accounts more than two months in arrears at 30 September 2016 at 0.82% remained very low (0.94% at acquisition), in line with the FLA figure for business finance leasing of 0.7% (2015: 0.8%).

PBAF generates operating lease income from a fleet of vehicles with a book value of £11.4 million at the end of the period (£7.6 million at acquisition), with £6.1 million of new contracts initiated in the period. It also operates a spot hire fleet with a net book value of £4.5 million at the year end (£3.1 million at acquisition). Operating lease activities generated £3.0 million in the year, net of direct costs. The business also has invoice factoring and discounting operations which generated income of £3.0 million in the period.

The asset finance team is highly regarded in the marketplace, has a strong credit ethos and has a good cultural fit within the Group's wider business. The development of the current team and infrastructure will be guided by Paragon Bank and will provide the building blocks for further SME finance development, organically and, potentially, by further acquisitions. The current product suite delivers a broad asset finance sector coverage, in addition to servicing certain distinct specialist niche segments of the SME market.

The principal industries supplied by the asset finance business in the period are shown in the chart below:

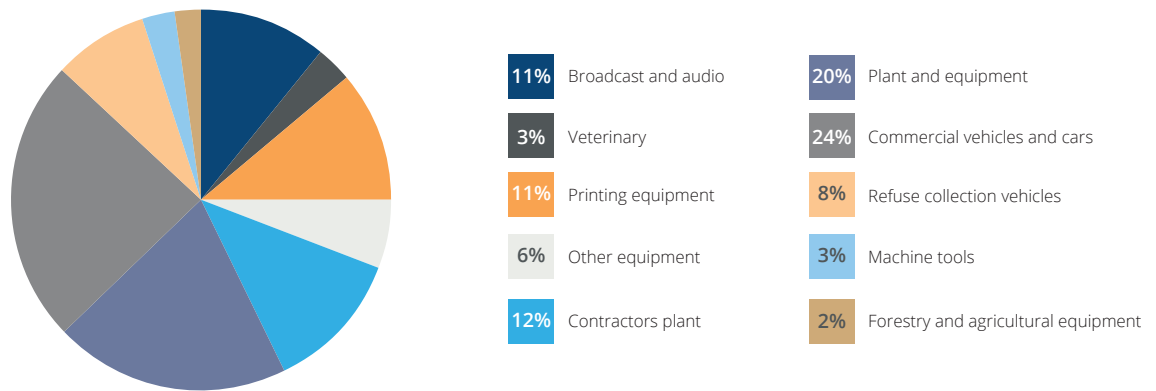
Paragon Bank Asset Finance – Balances by industry
30 September 2016



The nature of the assets supplied is summarised in the chart below.

Paragon Bank Asset Finance – Balances by type of equipment

30 September 2016



The asset finance business was further expanded by the acquisition of Premier Asset Finance on 30 September 2016. Premier is one of the UK's leading asset finance brokerages, sourcing in excess of £100.0 million of lending per annum for a range of SME customers. The business, which is based in Edinburgh, has a national presence, and was voted as Hard Assets Broker of the Year in Leasing World's 2016 awards. The new acquisition will complement the existing asset finance operation and reflects the Group's ongoing commitment to delivering a more material presence in this market to develop its diversification strategy, both by organic growth and, potentially, through further acquisitions.

Other asset finance loan assets

The other loan assets included in the asset finance operation are set out below.

	2016	2015
	£m	£m
Commercial mortgages	2.9	-
Factoring and discounting	16.9	-
Other loans	0.4	-
	20.2	-

The factoring business supports the customers of the asset finance business as well as servicing its own customer base and is well positioned to trade successfully and to expand to new customers. The other loan balances above represent legacy portfolios of the acquired business.

Factoring balances are agreed on a revolving basis and therefore it is not appropriate to quote an advances figure alongside those for other loan types.

A3.3 Funding Review

A3.3.1 Debt Funding

During the year the Group has continued to pursue its strategy of diversifying its funding base, in particular by making increased use of its retail savings capability through Paragon Bank. The Group's present medium term strategic funding objective is focussed predominantly on retail deposits, with the use of securitisation on a tactical basis if market conditions are favourable.

The Group's funding at 30 September 2016 is summarised as follows:

	2016	2015	2014
	£m	£m	£m
Paragon Mortgages (securitised and warehouse funding)	9,812.8	9,597.1	9,367.8
Idem Capital (non-recourse asset backed funding)	136.8	102.9	145.1
Paragon Bank (retail deposit balances)	1,873.9	708.7	60.1
Business specific funding	11,823.5	10,408.7	9,573.0
Corporate borrowings	553.0	404.9	293.2
	12,376.5	10,813.6	9,866.2

During the year Paragon Bank accessed the facilities within the Sterling Monetary Framework and drew £108.8 million to support lending to SMEs. This access has created a platform for future funding under the TFS, which the Bank intends to utilise in the coming year.

Retail funding

The UK savings market continues to grow strongly, with household savings balances reported by the Bank of England increasing by 7.4% in the year to 30 September 2016 to £1,106.1 billion (30 September 2015: £1,030.2 billion). This strong supply has helped to maintain the recent trend for low savings rates with the average annual interest on two year fixed interest bonds, reported by the Bank of England, having declined from 1.54% in September 2015 to 1.00% in September 2016.

The Group initially used retail funding to finance its entry into the car finance market, extending this to secured lending and buy-to-let. Retail deposits are at the core of the Group's funding strategy, being a reliable, cost-effective and scalable source of finance. As a consequence, the volume of retail deposit balances has grown significantly during the year, with retail deposits at 30 September 2016 reaching £1,873.9 million (30 September 2015: £708.7 million).

The Bank's savings proposition provides customers with a range of transparent deposit options, offering value for money. This also provides the Bank with a stable funding platform, with a focus on attracting term funding to manage interest rate risk and often limiting product availability for short periods of time.

The Group's straightforward approach and consistently competitive products have been recognised in the industry and by customers and Paragon Bank was nominated as a finalist for the Best Online Savings Provider award by Moneyfacts for the second consecutive year in October 2015.

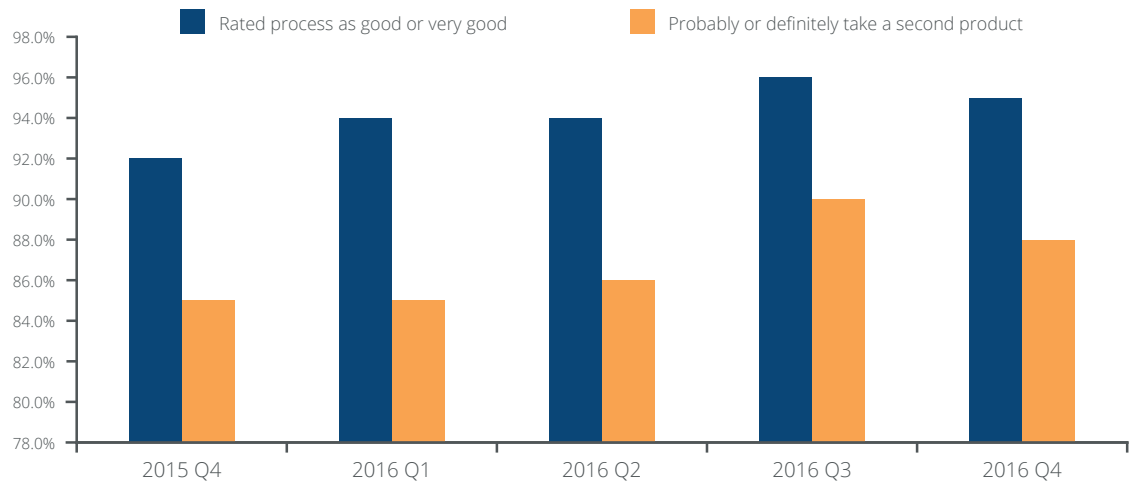
During the second half of the year the Bank launched its first ISA product, initially to existing customers. This represents a significant broadening of the Group's offering into a key part of the UK savings market, with ISA accounts representing £271.6 billion, or 24.6%, of the savings balances reported in the Bank of England data at 30 September 2016.

In customer feedback 95% of those opening a savings account with Paragon Bank in the year, who provided data, rated the overall savings process as 'good' or 'very good', while 87% stated that they would 'probably' or 'definitely' take a second product with the Bank.

Quarterly responses to these survey questions are shown below.

Paragon Bank – Satisfaction surveys

Percentage of customers opening accounts responding to survey



Savings balances at the year end are analysed below.

	Average interest rate		Average initial balance		Proportion of deposits	
	2016	2015	2016	2015	2016	2015
	%	%	£000	£000	%	%
Fixed rate deposits	2.11%	2.33%	28	34	71.0%	71.7%
Variable rate deposits	1.65%	1.62%	15	16	29.0%	28.3%
All balances	1.98%	2.13%	25	28	100.0%	100.0%

The average initial term of fixed rate deposits was 26 months (2015: 29 months).

With the Bank expected to contribute increasingly to the Group's originations, the scale of its deposit-taking activities is expected to expand materially over the next few years.

Securitisation funding

Sentiment within the capital markets was dominated by the build-up to and result of the Brexit referendum, with significant volatility before and immediately after the event, in addition to a series of other macro-economic concerns troubling investors. The increased volatility produced unattractive conditions for issuance. Given the Group's strategic focus on retail deposit funding, securitisations will only be undertaken on a tactical basis when market conditions support effective execution. With pricing unattractive and demand volatile the Group has not accessed the securitisation market since November 2015.

Buy-to-let mortgage originations outside Paragon Bank are initially funded through three revolving warehouse facilities which totalled £850.0 million at 30 September 2016 (30 September 2015: £950.0 million). Following a review of the available funding one facility, for £100.0 million, was closed in the period, having become redundant through the increased focus on retail deposit funding. Further rationalisation of warehouse capacity is expected as facilities fall due for renewal given the Group's present focus on more cost-effective retail deposit funding opportunities through the Bank.

In the longer term these mortgage loans may be funded through the securitisation markets, subject to favourable market conditions or may be sold to Paragon Bank. The Group's 62nd transaction, Paragon Mortgages (No. 24) PLC ('PM24'), for £350.1 million, was completed during November 2015. It priced in difficult market conditions, reflecting an anticipation of increased issuance resulting from several very large portfolio acquisition transactions expected to be refinanced through the securitisation market. This expectation led to higher margins being demanded by investors on new issues.

The Group's public securitisations issued in the current and previous years are summarised below.

Securitisation	Amount raised £m	Date	Average funding margin over LIBOR (basis points)
Paragon Mortgages (No. 24) PLC	350.1	November 2015	175
Paragon Mortgages (No. 23) PLC	292.5	July 2015	123
Paragon Mortgages (No. 22) PLC	292.5	March 2015	95
Paragon Mortgages (No. 21) PLC	243.7	November 2014	88

During the period the mortgage assets held by Paragon Mortgages (No. 17) PLC were sold to Paragon Bank and are now financed with retail deposits.

Following the issue of PM24, conditions in the securitisation markets deteriorated further through the early part of the financial year and then recovered somewhat towards the year end, resulting in issuance being at its lowest level in recent years. Conditions remain volatile and with the availability of the alternative retail deposit funding route, the Group has not returned to the securitisation market. The Group continues to keep developments in the securitisation market under review and will continue to use it as a funding source on a tactical basis.

Due to the lack of securitisation issues, the amounts drawn on the warehouse facilities at 30 September 2016 had increased to £489.0 million (2015: £254.0 million). The warehouse balances will either be securitised during 2017 or will be acquired by Paragon Bank to be pre-positioned with the Bank of England, for use in the TFS or other such arrangements. This funding scheme, announced on 4 August 2016, gives Paragon Bank access to cost effective funding, in the form of central bank reserves, against eligible collateral during a four-year period. The availability of the TFS is likely to reduce further the Group's reliance on the securitisation market during 2017.

Funding for purchased assets

Idem Capital has continued its funding strategy of financing smaller scale acquisitions from the Group's equity while keeping under review the opportunities to introduce external funding when asset volumes make that economically appropriate.

In October 2015, an Idem Capital special purpose vehicle company ("SPV") entered into an agreement to issue £117.3 million of sterling floating rate notes to Citibank NA. These notes bear interest at a rate of one month LIBOR plus 3.5% and the funds raised were used to re-finance existing Idem Capital unsecured loan assets, previously funded intra-group and through an existing SPV, and are secured on those assets. The transaction raised net new funding of £65.5 million. This agreement was extended by £74.9 million in the year.

During the year other Idem Capital borrowings were repaid following the sale of the underlying assets to Paragon Bank, reducing funding costs, and the Bank joined with Idem Capital in a portfolio purchase transaction. As a result of these transactions, at 30 September 2016 the funding of the Group's debt purchase assets was distributed as shown below.

	2016	2015	2014
	£m	£m	£m
Purchased assets by funding source			
Externally funded	269.1	275.6	324.4
Retail deposit funded	250.6	-	-
Funded through Group resources	14.1	157.3	82.8
	533.8	432.9	407.2

This demonstrates the increased flexibility in the Group's funding for its debt purchase activities, broadening its sources of finance and demonstrating its ability to access third party funding on a more regular basis. The participation of Paragon Bank in debt purchase transactions offers greater flexibility in terms of deal size and asset class, where increasingly the focus will move to more strongly performing portfolios.

Corporate funding

While the Group's working capital has primarily been provided by equity since 2008, in recent years it has expanded its use of corporate debt funding, allowing it to diversify its funding base and extend the tenor of its borrowings.

During September 2016, the tone of capital markets improved for a short period, as UK economic activity experienced less of an immediate downturn than expected following the outcome of the Brexit referendum. The improved conditions allowed the Company to issue £150.0 million of Subordinated Tier 2 Notes due September 2026, the proceeds of which will be used, in part, to repay the £110.0 million Subordinated Notes due April 2017 as well as for general corporate purposes. The transaction was rated BB+ by Fitch and subscribed for by over 70 investors. This is the first issue of its kind by the Group and demonstrates the continuing broadening of its corporate funding.

The Group is rated by Fitch Ratings, and maintains its BBB- senior debt rating, with Fitch confirming this rating with a stable outlook on 5 May 2016. With a strategy to increase holding company leverage levels over time, the rating will support long dated corporate debt issuance in both scale and pricing terms.

The Group's £1.0 billion Euro Medium Term Note Programme announced in January 2013 remains in place and while no issuance was made in the period the programme was renewed in January 2016 to allow further issuance and continues to form part of the Group's long-term funding strategy.

Further information on all of the above borrowings is given in note 50.

A3.3.2 Capital Management

The Group has continued to enjoy strong cash generation during the year. Free cash balances were £366.5 million at the year-end (30 September 2015: £199.9 million) (note 38) after investments to support the asset finance acquisitions and other organic growth within Paragon Bank, new buy-to-let originations and acquisitions by Idem Capital. The free cash balance also includes the proceeds of the £150.0 million Tier 2 Bond issue, £110.0 million of which will be required to repay existing corporate debt maturing in April 2017. The Company sees opportunities to deploy capital to support organic growth and invest in portfolio purchases and potentially in further M&A opportunities.

Dividend and dividend policy

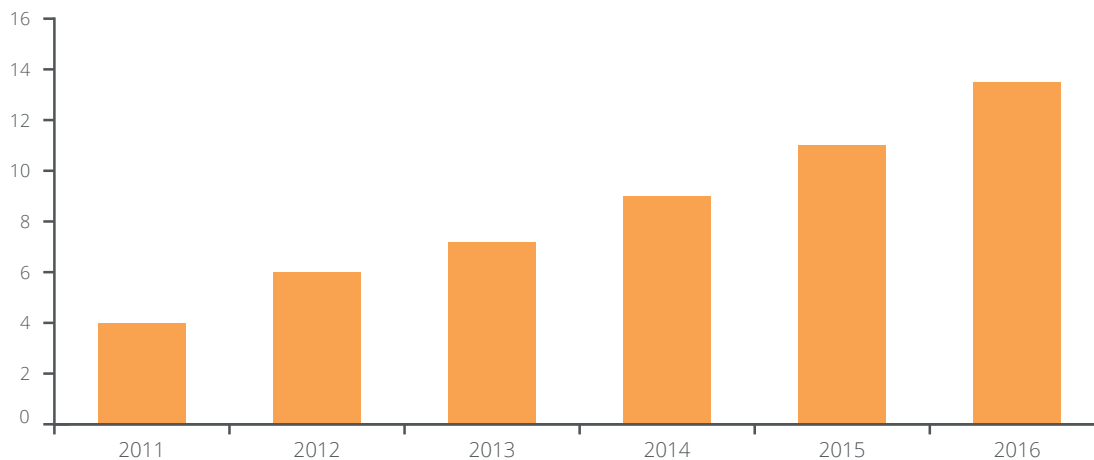
In view of the strong position of the Group and its confidence in the prospects for the business, the Board is proposing, subject to approval at the Annual General Meeting ('AGM'), on 9 February 2017, a final dividend of 9.2 pence per share which, when added to the interim dividend of 4.3 pence, gives a total dividend of 13.5 pence per share for the year. This represents an increase of 22.7% from 2015, bringing the dividend cover to 3.0 times (2015: 3.2 times) (note 6).

This level of dividend cover is in line with the Company's stated policy, established in 2012, to target a cover ratio of 3.0 to 3.5 times by the financial year ended 30 September 2016. Annual dividend per share has grown at a compound rate of 27.5% from the 4.0 pence per share for the year ended 30 September 2011, the last year before the policy was adopted, to the 13.5 pence per share proposed for the current year.

The progress of the dividend for the year over this period is shown in the chart below.

Dividend for the year (pence)

In respect of the years 2011 - 2016



The Company intends to pursue a progressive dividend policy, maintaining its dividend cover ratio at three times.

Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator 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 Group is required to hold relative to its risk weighted assets in order to safeguard depositors against the risk of losses being incurred by the Group.

The Group maintains extremely strong capital and leverage ratios, with a CET1 ratio of 15.9% at 30 September 2016 (2015: 19.1%) and a leverage ratio at 6.2% (2015: 7.7%) (note 6) leaving the Group's capital at 30 September 2016 comfortably in excess of the regulatory requirement. The reduction in the CET1 ratio in the year results principally from the effect of the PBAF acquisition on risk weighted assets and the impact of the asset finance acquisitions, the share buy-back programme and the deficit on the Group's pension plan on regulatory capital.

The Group notes the consultation paper issued by the BCBS on 15 December 2015 regarding the proposed amendments to the Standardised Approach ('SA') for assessing the capital adequacy of institutions. The most material proposal for the Group relates to a potential increase in the risk weightings applicable to buy-to-let lending assets. The Group considers that the proposed risk weightings do not properly reflect the strong credit performance of the asset class in the UK and has engaged with both the PRA and the BCBS as part of the consultation process. The BCBS has also issued a consultation paper in March 2016, proposing revisions to the Internal Ratings Basis ('IRB') for assessing capital, which is based on firms' own internal calculations and subject to supervisory approval. The proposals may serve to limit the comparative advantage available to IRB users over SA users through the use of floors.

Notwithstanding the outcome of these consultations, the Group has substantial performance data and excellent credit metrics to support the adoption of an IRB approach for determining appropriate risk weightings for its buy-to-let mortgage assets. Other UK institutions that currently use the IRB approach for their buy-to-let portfolios achieve materially lower risk weightings than the 35% required by the present SA, with figures reported by the PRA in July 2015 as being typically in the low to mid-teen percentages.

In addition to the potential capital advantages from adopting the IRB approach, the Group sees broader business benefits from adopting the disciplines required by IRB as a core part of its risk management structure. Additional resources have been dedicated to this project.

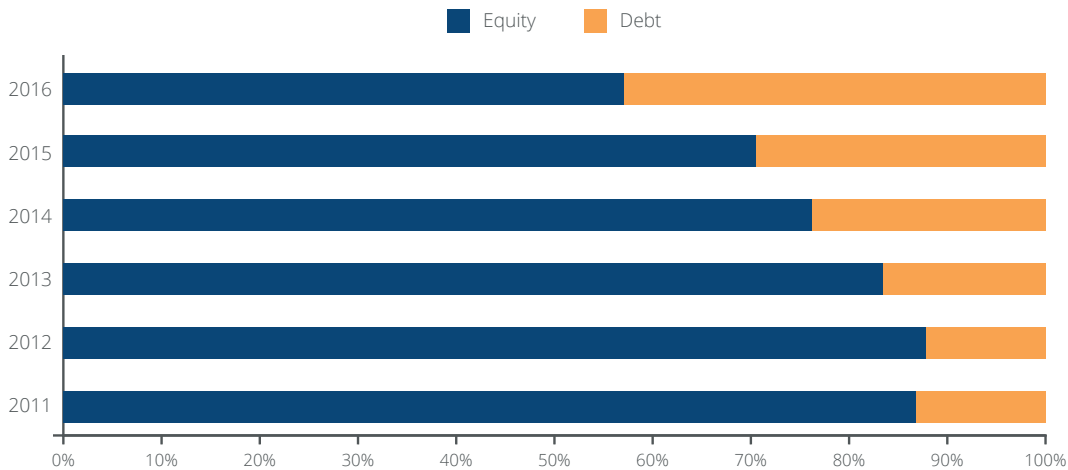
The Group will be closely monitoring developments in both of these consultations as they progress and has commenced a project to prepare an application to the PRA to adopt the IRB in future, which will build on the Group's existing core competencies in credit risk and data handling and should lead to further enhancements in the internal risk governance framework.

Gearing and share buy-backs

An analysis of the Group's central funding between corporate debt and equity (note 6) is shown below:

Balance of central funding resources

At 30 September



Given the strong capital base and low leverage in the Company's balance sheet, the Board has determined that the Group should seek to utilise greater levels of debt to support growth and reduce its over-reliance on equity capital, improving returns for shareholders. In pursuit of this strategy the Group issued £150.0 million of Tier 2 Corporate Bonds in the period and will continue to review the opportunities available to it to access the sterling senior unsecured debt market and the UK retail bond market to add further incremental long-dated debt to the Group balance sheet.

In November 2014 the Group announced a share buy-back programme, initially for up to £50.0 million and extended to £100.0 million in November 2015, to be reviewed periodically to take account of anticipated investment opportunities and the balance of the Group's debt and equity capital resources. During the year the Group bought back 16.6 million of its ordinary shares at a cost of £51.0 million, (note 47), these shares being held in treasury. The Board intends to extend the programme by up to £50.0 million in the financial year ending 30 September 2017. These shares will also be initially held in treasury, but may be cancelled subsequently.

The Company currently has the necessary shareholder approval to undertake such share buy-backs and will propose the appropriate renewal of the relevant authority at its 2017 AGM, when a special resolution seeking authority for the Company to purchase up to 28.0 million of its own shares (10% of the issued share capital excluding treasury shares) will be put to shareholders.

The Board keeps under review the appropriate level of capital for the business to meet its operational requirements and strategic development objectives. The strength of the Paragon Mortgages and Idem Capital businesses, the diversification which has been achieved in the funding base in recent years and the further opportunities for growth and sustainability provided by Paragon Bank, have now created the foundations upon which to develop the Group's next phase of growth.

A3.4 Financial Review

The financial year ended 30 September 2016 saw the Group's underlying profit (appendix C) increase by 9.1% to £146.9 million (30 September 2015: £134.7 million) while on the statutory basis profit before tax increased by 6.7% to £143.2 million (30 September 2015: £134.2 million). Earnings per share increased by 14.1% to 40.5p (30 September 2015: 35.5p).

A3.4.1 Results for the Year

Consolidated Results

For the year ended 30 September 2016

	2016 Acquisition £m	2016 Extant £m	2016 Total £m	2015 £m
Interest receivable	22.4	389.0	411.4	341.0
Interest payable and similar charges	(5.3)	(182.9)	(188.2)	(143.6)
Net interest income	17.1	206.1	223.2	197.4
Other leasing income	13.0	-	13.0	-
Related costs	(10.0)	-	(10.0)	-
Net leasing income	3.0	-	3.0	-
Other income	4.8	13.0	17.8	14.1
Other operating income	7.8	13.0	20.8	14.1
Total operating income	24.9	219.1	244.0	211.5
Operating expenses	(18.2)	(74.3)	(92.5)	(71.2)
Provisions for losses	(0.4)	(7.3)	(7.7)	(5.6)
	6.3	137.5	143.8	134.7
Fair value net (losses)	-	(0.6)	(0.6)	(0.5)
Operating profit being profit on ordinary activities before taxation	6.3	136.9	143.2	134.2
Tax charge on profit on ordinary activities			(27.2)	(27.1)
Profit on ordinary activities after taxation			116.0	107.1
			2016	2015
Dividend – rate per share for the year			13.5p	11.0p
Basic earnings per share			40.5p	35.5p
Diluted earnings per share			39.7p	34.8p

The acquisition of PBAF took place on 3 November 2015. To aid comparison the Group's results for the year are analysed above between the acquisition and extant business. The acquisition results include transaction costs of £1.7 million and other consequential costs of £1.1 million.

The acquisition of Premier took place on 30 September 2016 and hence no trading results from this business are included in the Group's results for the year. However, transaction costs of £0.3 million are included in the acquisition result above.

Total operating income increased by 15.4% to £244.0 million (2015: £211.5 million). This represents a 3.6% organic increase combined with the £24.9 million of net income arising from the acquisition.

Within this, net interest income increased to £223.2 million from the £197.4 million recorded in the year ended 30 September 2015. The increase reflects improving margins and growth in the size of the average loan book, which rose by 7.7% to £10,400.0 million (2015: £9,659.2 million) (appendix A).

Net interest margins in the year ended 30 September 2016 increased to 2.15% compared to the 2.04% in the previous year (appendix A), driven by new originations and portfolio purchases having higher margins than those assets redeeming in the period.

Other operating income was £20.8 million for the year, compared with £14.1 million in 2015. The increase principally results from the acquisition which contributed £3.0 million of net leasing income and £3.4 million of third party servicing fees. The decrease in the extant business reflects a lower level of third party fee income earned in Idem Capital with formerly administered third party assets being purchased by the Group.

Operating expenses excluding the acquired business increased by 4.4% to £74.3 million from £71.2 million reported in the previous year, partly reflecting the increase in the average number of employees outside the acquired businesses to 1,040, a 2.0% rise (2015: 1,020).

Costs in the acquired business were £18.2 million, including those relating to the acquisition. The asset finance business naturally operates with a higher cost:income ratio than the rest of the Group, in particular with respect to maintenance and specialist servicing options offered alongside the provision of asset finance, resulting in it accounting for 19.0% of the Group's headcount at the year end. This resulted in the overall underlying cost:income ratio (excluding acquisition related costs) increasing to 36.7% from 33.7% for the corresponding period last year (appendix B), although it remains significantly below the industry average. The unadjusted cost:income ratio for the year was 37.9% (2015: 33.7%) (appendix B).

The cost:income ratio excluding the acquired business was broadly similar to that in the preceding year at 33.9%. The Board remains focused on controlling operating costs through the application of rigorous budgeting and monitoring procedures, and expects the overall cost:income ratio for the asset finance business to improve as it is integrated into the Group and starts to see the benefits of income growth from its expanded operations.

The charge of £7.7 million for loan impairment has increased from that for 2015 (2015: £5.6 million), partly as a result of provisions arising in the acquired business. As a percentage of average loans to customers (appendix A) the impairment charge remains broadly stable at 0.07% compared to 0.06% in 2015. The Group has seen favourable trends in arrears performance over the period, both in terms of new cases reducing and customers correcting past arrears, whilst increasing property values have served to reduce overall exposure to losses on enforcement of security. The loan books continue to be carefully managed and the credit performance of the buy-to-let book remains exemplary.

Yield curve movements during the period resulted in hedging instrument fair value net losses of £0.6 million (2015: £0.5 million net losses), which do not affect cash flow. The fair value movements of hedged assets or liabilities are expected to trend to zero over time, as such this item represents a timing difference. The Group remains economically and appropriately hedged.

Corporation tax has been charged at the rate of 19.0%, compared with 20.2% for the last year; the decrease principally resulting from the impact of reductions in the UK Corporation Tax rate on both current year results and deferred tax liabilities.

Profits after taxation of £116.0 million (2015: £107.1 million) have been transferred to shareholders' funds, which totalled £969.5 million at the year end (2015: £969.5 million), representing a tangible net asset value of £3.12 per share (2015: £3.26) and an unadjusted net asset value of £3.50 per share (2015: £3.28).

A3.4.2 Segmental Results

The Group analyses its results between three segments, which are the principal divisions for which performance is monitored:

- Paragon Mortgages includes revenue, in the form of interest and ancillary income, from the Group's first mortgage operations, other than the buy-to-let lending of Paragon Bank, and from other assets remaining in legacy consumer portfolios
- Idem Capital includes revenue generated from assets purchased by the Group's debt investment business, Idem Capital Holdings Limited, other than those financed by Paragon Bank and from third party consumer loan administration activity; and
- Paragon Bank includes revenue generated from the Group's regulated banking business, Paragon Bank PLC and its subsidiaries including the acquired asset finance companies

The underlying operating profits of these business segments are detailed fully in appendix C to the annual report and are summarised below.

	2016	2015
	£m	£m
Underlying operating profit / (loss)		
Paragon Mortgages	89.9	94.0
Idem Capital	45.4	49.3
Paragon Bank	11.6	(8.6)
	146.9	134.7

Paragon Mortgages

Trading activity during the year in the Paragon Mortgages division was very strong, with the segment contributing £89.9 million to underlying Group profit (2015: £94.0 million). The division's reduced profit level resulted from its underlying growth from net new lending being broadly counterbalanced by the sale of seasoned assets to Paragon Bank in the year, together with the higher funding costs allocated to the segment following the Group's retail bond issue in August 2015.

Idem Capital

The Idem Capital division's portfolios performed strongly in the year to 30 September 2016 and, while the division benefitted from new investments made during the year and a firm control of costs, the transfer of previously acquired assets to the Paragon Bank division reduced Idem Capital's underlying profit contribution to £45.4 million (30 September 2015: £49.3 million).

Paragon Bank

The increasing maturity of Paragon Bank and the acquisition of the PBAF asset finance business towards the start of the year have resulted in this segment achieving an underlying profit of £11.6 million (2015: loss of £8.6 million), excluding acquisition costs of £3.1 million. This includes £9.4 million of profit arising in the acquired business. Paragon Bank has invested heavily both in the development of the risk and compliance structure required for regulatory purposes and to provide the foundations for organic growth across its product lines. As these product lines grow the Bank will naturally increase the utilisation of the present fixed cost base improving its overall cost effectiveness.

A3.4.3 Assets and Liabilities

Summary Balance Sheet

30 September 2016

	2016	2015
	£m	£m
Intangible assets	105.5	7.7
Investment in customer loans	10,737.5	10,062.4
Derivative financial assets	1,366.4	660.1
Free cash	366.5	199.9
Other cash	871.1	856.1
Other assets	71.4	92.7
Total assets	13,518.4	11,878.9
Equity	969.5	969.5
Retail deposits	1,873.9	708.7
Borrowings	10,502.6	10,105.6
Pension deficit	58.4	21.5
Other liabilities	114.0	73.6
Total equity and liabilities	13,518.4	11,878.9

The increase in intangible assets reflects the goodwill and intangible assets recognised on the acquisitions of PBAF (£80.1 million) and Premier (£17.8 million) which are carried on the balance sheet in accordance with the requirements of International Financial Reporting Standards ('IFRS') 3. The carrying amount was reviewed at the year end and was not found to be impaired.

The Group's loan assets include:

- First mortgage assets, with new originations and legacy assets in Paragon Mortgages, new originations in Paragon Bank and purchased assets in Idem Capital
- Second mortgages, with new originations in Paragon Bank, legacy assets in Paragon Mortgages and purchased assets in Idem Capital
- Car finance loans, with new originations in Paragon Bank and legacy assets in Paragon Mortgages
- Asset finance loans, originated by the acquired PBAF business and included in the Paragon Bank segment
- Other unsecured consumer lending with purchased assets in Idem Capital and legacy assets in Paragon Mortgages

An analysis of the Group's financial assets by type is shown in note 32.

Movements in the Group's loan asset balances are discussed in the lending review section (Section A3.2).

Movements in derivative financial assets arise principally as a result of the effect of changes in exchange rates on instruments forming cash flow hedges for the Group's floating rate notes. These movements do not impact on the Group's results.

Cash flows from the Group's securitisation vehicle companies and the acquired portfolios remain strong. These, together with debt raisings, financed further investments in loan portfolios, the capital requirements of Paragon Bank and credit enhancement for mortgage originations. Cash was also utilised in the share buy-back programme, which commenced during December 2014 and where £100.7 million (including costs) had been deployed by 30 September 2016. Free cash balances were £366.5 million at 30 September 2016 (2015: £199.9 million) following the receipt of cash from the Group's £150.0 million Tier 2 Corporate Bond issue in September (note 42).

Movements in the Group's funding are discussed in the funding review section.

Decreasing gilt yields have increased the accounting value placed on the liabilities of the Group's defined benefit pension plan over the year ended 30 September 2016, leading to the deficit under International Accounting Standard ('IAS') 19 increasing to £58.4 million (2015: £21.5 million). This resulted in an actuarial loss in other comprehensive income of £37.2 million before tax (2015: £4.3 million).

A3.5 Operational Review

A3.5.1 Management and People

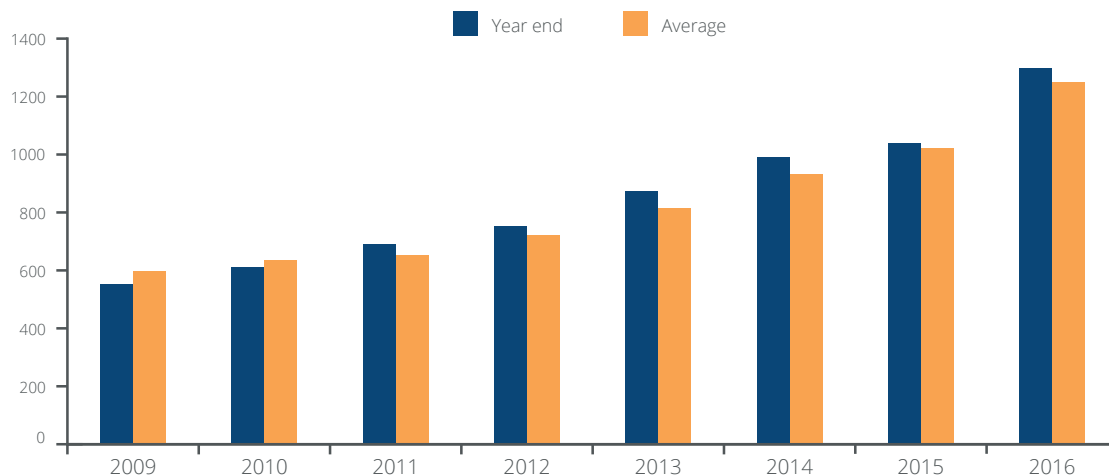
The Group has always recognised that its people are its most important asset and are key to its future growth and development. The learning and development of its employees, together with a rigorous recruitment process are a key part of the Group's organic growth strategy and underpin the strong progress it has made. It retains its Gold Investor in People status, reflecting the quality of its internal processes and during the year has continued to act, by invitation, as an Investor in People Champion, sharing its experience with other businesses. This places it in the top 1% of companies in the UK for people development.

The Group is proud to have signed the Women in Finance Charter, sponsored by HM Treasury, during the year. The Charter's objectives reflect the Group's own aspirations in the field of gender diversity and the Group will be responding to its requirements in future periods.

The Group prides itself on the fact that its people remain with it for a long time. Its annual employee attrition rate of 6.5% is below the national average and 28.7% of its people have been with Paragon for more than ten years, with 8.3% having achieved over 20 years with the Group. We believe this is due to providing quality development opportunities and creating a place where people want to work, which has meant that knowledge and experience have been retained in each of our specialist areas. We have continued to add to the team over the past year with excellent people at all levels of the organisation, increasing numbers by 24.9% over the year, which includes the acquisition of Five Arrows Leasing Group. We believe our people are well positioned to support the Group's future growth strategy.

Employee numbers

At 30 September and average for the year



During 2017 the Board, initially through the Nomination Committee, will give in depth consideration to the appointment of an additional non-executive director, particularly one who has retail and SME banking experience.

The Group's succession planning strategy has been an important area of focus during the year, with key roles in the Group identified from a leadership and specialist perspective. Immediate successors are in place for these roles for the short term to provide business continuity and longer term succession plans are being developed for those with career aspirations and strong potential. This area will remain a priority for the Board, with the assistance of the Nomination Committee, during the forthcoming year.

A3.5.2 Risk

The Group's risk governance framework is based upon a formal three lines of defence model. Within this framework the Credit, Asset and Liability and Operational Risk and Compliance Committees, formed of senior management, report to the board level Risk and Compliance Committee. This committee comprises the Chairman and the independent non-executive directors of the Company.

In the last year the Group has strengthened its risk resource in areas such as operational risk and credit risk. These appointments have been made to ensure that subject matter experts are in place ahead of planned future growth to help shape policy and process. They will also ensure that the Risk and Compliance function has sufficient capability and capacity to provide effective oversight of the Group's expanding activities, including the acquired asset finance business.

The Group's governance structure therefore provides an effective basis for the management of risk within which:

- The **first line of defence**, comprising executive directors, managers and employees, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The **second line of defence** is provided by the Risk and Compliance division, the board Risk and Compliance Committee and its supporting sub-committees
- The **third line of defence** is provided by the Group Internal Audit function and the board Audit Committee which are responsible for reviewing the effectiveness of the first and second lines of defence

The principal changes in the risk environment faced by the Group during the year include:

- Impact of the Brexit referendum result on the UK economy and capital markets
- Execution risk on the asset finance transaction as the business is integrated into the Group
- Transitional risks arising from the acquired operations
- Increasing cyber-security risks, through the increased scope of the retail deposit operation and the increasing sophistication of cyber-attacks on the financial sector
- Potential impact of changes in the regulatory and fiscal environment for buy-to-let mortgages in the UK, in particular for the Group's future advances and redemption levels
- Impact of new proposals on capital regulation from the BCBS

The Group is carefully monitoring these risks as they develop and considers itself well placed to mitigate their impact.

Further details regarding the governance model, together with the principal risks faced by the Group, the ways in which they are managed and mitigated and the extent to which these have changed in the year are detailed within section B6 of this annual report.

A3.5.3 Regulation

The Mortgage Credit Directive Order took effect on 21 March 2016 and was arguably the largest change to the structure of consumer credit since the introduction of the Consumer Credit Act in 1974. The Directive's implementation in the UK resulted in second charge residential mortgages moving from the FCA's CONC regime to its residential mortgage regime ('MCOB'). It also resulted in the introduction of regulation to a limited area of the buy-to-let segment through specific consumer buy-to-let requirements ('CBTL').

In anticipation of these changes, the Group commenced a formal programme of work in 2015 to ensure that any necessary operational changes were made and regulatory permissions obtained by March 2016. Whilst the programme of work was extensive, it is pleasing to note that it was delivered on time, with no adverse impact for our customers nor any material impact on the operation of our businesses.

All relevant Group companies now hold the required permissions from the FCA under the CONC, MCOB for second mortgage and CBTL regimes as appropriate. As part of a wider strategy to enter the first charge residential mortgage market, the Group's principal servicing business, Paragon Finance PLC, now holds the requisite permission from the FCA to administer both second and first charge residential mortgages. Following the year end, Paragon Bank has received the FCA / PRA permissions required to undertake first charge residential lending.

The Financial Policy Committee of the Bank of England ('FPC') has powers to regulate owner-occupied mortgage lending and these powers were extended to buy-to-let lending by HM Treasury on 16 November 2016. This will mean that from early 2017, the FPC will be able to direct the PRA and FCA to require regulated lenders to place limits on buy-to-let mortgage lending in relation to LTV and ICR ratios.

In March 2016, the PRA issued a Consultation Paper setting out proposals to enhance underwriting standards in the buy-to-let sector to support the FPC's ability to act from a macro-prudential perspective. In September 2016, the PRA published its resulting Policy Statement which was broadly in line with the proposals within the original Consultation Paper. The Group's historically conservative approach to the underwriting of buy-to-let lending is entirely consistent with the PRA's objective of ensuring that lenders conduct their buy-to-let business in a prudent manner, avoiding inappropriate lending and the potential for excessive credit losses. As a result, whilst a formal programme of work is already in place to ensure the Group meets the detailed PRA requirements, these changes are not expected to have a material impact on the operation of our business.

Paragon Bank is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, the current and projected rate of regulatory change, driven by domestic and European policy, is significant, particularly as additional aspects of the Basel III supervisory regime are rolled out and the BCBS consults on further changes. The governance and control structure within Paragon Bank and the wider Group has therefore been established and developed to ensure that the impacts of all new regulatory requirements on the business are clearly understood and planned for. Regular reports on key regulatory developments are received at both executive and board risk committees. Current BCBS consultations on regulatory capital requirements and their potential impact on the Group are discussed under 'Capital Management' above.

Paragon Bank provided the required submissions to the PRA and FCA in relation to the Senior Managers Regime and Certification Regime during the year. Steps are well advanced within the Bank to ensure it complies with all the requirements of the regimes by the relevant dates. In addition, the Group is conscious of the extension of these regimes to other Financial Services and Markets Act firms with effect from 2018 and is taking appropriate steps to ensure it is able to comply with the requirements.

A3.6 Conclusion

I am pleased to report a strong set of results in which we significantly increased revenue, strengthened net interest margins and improved return on equity, whilst maintaining pricing and credit discipline. Whilst the year has been disrupted by fiscal and regulatory changes, as well as political and macro-economic factors, our customers' performance has been exemplary and new business activity has seen encouraging growth recently.

The Group's operating model is undergoing significant change, as it transitions from a non-bank, securitised, monoline lender into a retail funded banking group. Paragon Bank is increasingly at the heart of the Group's development, with its deposit book now exceeding £2 billion and its franchise firmly established. This has facilitated further progress in our diversification strategy, notably through the acquisition of Five Arrows Leasing Group and, more recently, Premier Asset Finance, which together have given Paragon a strong platform to build on the significant growth potential in the UK SME finance market.

We have put in place the foundations for strong and sustainable growth. The business is well funded and well capitalised with a robust operating model and an exemplary track record. We continue to believe that over the medium term the banking markets will undergo structural change which will favour specialist lending institutions such as Paragon and we are well positioned to take advantage of the opportunities that will arise.

Nigel S Terrington

Chief Executive

23 November 2016

A4 FUTURE PROSPECTS

The Code requires the directors to consider and report on the future prospects of the Group. In particular it requires that they:

- Explain how they have assessed the prospects of the Group and whether, on this basis, they have a reasonable expectation that the Group will be able to continue in operation (the 'viability statement')
- State whether they consider it is appropriate for the Group to adopt the going concern basis of accounting in the preparation of the financial statements presented in section D (the 'going concern statement')

In addition Listing Rule LR9.8.6 R(3) requires the directors to make these statements and to prepare the viability statement in accordance with the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council ('FRC') in September 2014.

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are set out in the Chairman's Statement in section A1 and Chief Executive's review in section A3. The principal risks and uncertainties affecting the Group, and the steps taken to mitigate these risks are described in section B6.5.

Section B6 of this annual report describes the Group's risk management system and the three lines of defence model it is based upon.

Note 6 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while note 7 includes a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting estimates affecting the results and financial position disclosed in this annual report are discussed in note 5.

Financial forecasts

As described under 'Accountability' in section B3.1, the Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed plans are produced for a rolling 24 month period with longer term forecasts covering a five year period. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short term and strategic basis.

The plans for the period commencing on 1 October 2016 have been approved by the Board and have been compiled taking into consideration the Group's cash flow, dividend cover, liquidity and capital requirements as well as other key financial ratios throughout the period.

Current economic and market conditions are reflected at the start of the plan with consideration given to how these will evolve over the plan period and affect the business model. The plan is compiled by consolidating separate income forecasts for each business segment and securitisation vehicle to form the top level projection for the Group. This allows full visibility of the basis of compilation and enables detailed variance analysis to identify anomalies or unrealistic movements. Cost forecasts and new business volumes are agreed with the managers of the various business areas to ensure that targets are realistic and operationally viable.

During this process, sensitivity analysis is also carried out on a number of key assumptions that underpin the forecast to evaluate the impacts of the Group's principal risks on profit, cash flow and other key metrics. This is further stress tested as part of the Group's Internal Capital Adequacy Assessment Process ('ICAAP'), using a number of severe downside scenarios.

Risk assessment

During the year, the directors, as members or attendees of the Risk and Compliance Committee undertook reviews on a quarterly basis which included:

- Consideration and challenge of the ratings applied to the various risk categories to which the Group is exposed
- Consideration of the principal risks facing the Group
- Consideration of key regulatory developments

At the year end the directors reviewed this on-going work and the most recent risk information available to confirm the position of the Group at the balance sheet date.

The directors concluded that this process constituted a robust assessment of all of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. These principal risks are set out in section B6.5 of the Risk Management Report.

Availability of funding

The Group's securitisation funding structures described in note 7 ensure that both a substantial proportion of its originated loan portfolio and a significant amount of its acquired Idem Capital assets are match-funded. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations utilising the Group's available warehouse facilities described in note 7 are refinanced through securitisation or retail deposits from time to time.

The Group's retail deposits of £1,873.9 million (note 54), accepted through Paragon Bank are repayable within five years, with 54.3% of this balance (£1,017.1 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is monitored; a process supervised by the Asset and Liability Committees of the Group and Paragon Bank. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2016 Paragon Bank held £322.1 million in liquid assets, £7.1 million of short term investments (note 41) and £315.0 million of cash (note 42). A further £108.8 million of liquidity was provided by the Bank of England FLS, bringing the total to £430.9 million.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Bank's approved Individual Liquidity Adequacy Assessment Process ('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 an additional £428.1 million has been pre-positioned.

The earliest maturity of any of the Group's working capital debt is in April 2017, when the £110.0 million corporate bond is repayable. The issue of the £150.0 million Tier-2 bond in September 2016 is intended to replace this borrowing in the Group's capital structure and has raised the necessary cash to make the repayment on the due date.

The outstanding principal balance of the Group's retail bonds at 30 September 2016 was £297.5 million, none of which is repayable before December 2020.

The Group's cash analysis continues to show strong free cash balances, even after allowing for significant discretionary cash flows, and its securitisation investments produce significant cash flows.

As well as its Tier-2 bond issue, the Group has demonstrated in the past its ability to raise retail bond debt under the programme renewed in January 2016, and it has a history of raising new corporate debt when required through this and other programmes. The Group's access to debt is also enhanced by its corporate BBB- rating, reaffirmed by Fitch Ratings in the year, and its status as an issuer is evidenced by the BB+ rating granted to the Tier-2 bond issue.

At 30 September 2016 the Group had free cash balances of £366.5 million immediately available for use (note 42) and would still have £256.5 million available after setting aside cash for the corporate bond repayment.

As described in note 6 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2016 was in excess of regulatory requirements and its forecasts show this continuing to be the case.

Viability statement

In considering making the viability statement the directors considered the three-year period commencing on 1 October 2016. This aligns with the horizons used in the Group's analysis of risk and only includes one year of the less detailed forecasting period.

The directors considered:

- The Group's financial and business position at the year end, described in section A3
- The Group forecasts, and the assumptions on which they were based
- The Group's debt issuance in the year and its prospective access to future funding
- Stress testing carried out as part of the Group's ICAAP process
- The activities of the Group's risk management process throughout the period
- Risk monitoring activities carried out by the Risk and Compliance Committee
- Internal audit activities in the year

Having considered all the factors described above the directors believe that the Group is well placed to manage its business risks, including solvency and liquidity risks, successfully.

On this basis, the directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period commencing on 1 October 2016.

While this statement is given in respect of the three-year period specified above, the directors have no reason to believe that the Group will not be viable over the longer term. However, given the inherent uncertainties involved in forecasting over longer periods, the shorter period has been adopted.

Going concern statement

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

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them.

After performing this assessment, the directors concluded that it was appropriate for them to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

A5 CORPORATE RESPONSIBILITY

The Group believes that the long-term interests of shareholders, employees, customers and other stakeholders are best served by acting in a socially responsible manner. As such, the Group's aim is to ensure that a high standard of corporate governance and corporate responsibility is maintained in all areas of its business and operations.

A5.1 Employees

The welfare, development and engagement of the Group's employees are central to developing a strong culture, with employee capability and motivation acknowledged as being central to the delivery of the Group's strategy. Engagement levels are monitored through an annual employee survey. The March 2016 exercise received a response rate of 91% (2015: 89%) and an overall engagement score of 86% (2015: 85%).

Remuneration packages across the business are compliant with the UK's national minimum wage rates. In addition, we are an accredited employer with the Living Wage Foundation and met this standard in June 2016. The independent Living Wage Foundation sets an hourly rate calculated according to the cost of living in the UK which is updated annually. This is a higher rate than the government's National Living Wage. The Group supports the Living Wage Foundation's principle of a living wage being good for business, good for the individual and good for society and we see this as an important part of our values and our people strategy.

Flexible working is actively encouraged across all areas, to promote a work-life balance for individuals and to ensure that the Group retains the skills and experience of its people. The Group monitors working practices to ensure that it complies with the Working Time Regulations to ensure no one is forced to work more than a 48 hour week over an average 17 week period. This includes the monitoring of any second jobs.

When responding to changes in its business, the Group always seeks to minimise the requirement for compulsory redundancy, retraining and redeploying employees wherever possible.

The Human Resources department actively works alongside the Group's management to recruit, develop and retain capable people.

Equality and diversity

The Group is committed to providing a working environment in which employees feel valued and respected and are able to contribute to the success of the business, and to employing a workforce that recognises the diversity of its customers. The Group has invested not only in management training to ensure managers are equipped to support fair working practices, but also in educating all employees to ensure the policy is fully embedded.

The Group's aim is that its employees should be able to work in an environment free from discrimination, harassment and bullying, and that employees, job applicants, customers, retailers, business introducers and suppliers should be treated fairly regardless of:

- Race, colour, nationality (including citizenship), ethnic or national origins
- Gender, sexual orientation, marital or family status
- Religious or political beliefs or affiliations
- Disability, impairment or age
- Real or suspected infection with HIV/AIDS; or
- Membership of a trade union

and that they should not be disadvantaged by unjust or unfair conditions or requirements.

The Group aims to ensure that applications for employment from people with disabilities and other under-represented groups are given full and fair consideration and that all employees have access to the same training, development and job opportunities. Every effort is also made to retrain and support employees who suffer from disabilities during their employment, including the provision of flexible working to assist their return to work.

Our people are at the heart of everything we do and we understand the significance and value of building strong and diverse teams, with leaders from all backgrounds. Gender diversity is an important element of our people strategy and we are proud to have signed the Women in Finance Charter this year.

The Women in Finance Charter, which is sponsored by HM Treasury, is an initiative amongst financial services companies in the UK, aimed at promoting equality of opportunity in the workplace. The Group's responsibilities under the Charter include designating a member of the senior executive team to be responsible for gender diversity and inclusion, setting targets for diversity in senior management and making public information on those targets.

The Group is presently working towards fulfilling the requirements of the Charter and is also putting in place systems to report on its gender pay gap in line with the legislative requirements currently being introduced.

Composition of the workforce

During the year the workforce has grown by 24.9% to 1,299 people (2015: 1,040). Information on the composition of the workforce at the year end is summarised below:

		2016	2016	2015	2015
		Females	Males	Females	Males
Employees	<i>(Number)</i>	680	619	579	461
	<i>(Percentage)</i>	52.3%	47.7%	55.7%	44.3%
Management grade employees	<i>(Number)</i>	100	170	82	109
	<i>(Percentage)</i>	37.0%	63.0%	42.9%	57.1%
Senior managers	<i>(Number)</i>	5	21	4	17
	<i>(Percentage)</i>	19.2%	80.8%	19.0%	81.0%
Directors	<i>(Number)</i>	1	7	1	7
	<i>(Percentage)</i>	12.5%	87.5%	12.5%	87.5%

Of these employees, ethnic minority employees comprised 11.2% of the workforce (2015: 9.7%) and 4.3% of management grade employees (2015: 6.3%). The change in the balance of management grades reflects principally the impact of the gender balance of the acquired PBAF operation at acquisition.

Employees on temporary or short-term contracts accounted for 0.6% of the workforce (2015: 3%).

The Group's annual employee turnover for the year was 6.5% (2015: 11%).

Composition of the workforce is reviewed on an annual basis and employee satisfaction with equality of opportunity is monitored as part of the regular employee surveys. Human Resources policies are reviewed regularly to ensure that they are non-discriminatory and promote equality of opportunity. In particular, recruitment, selection, promotion, training and development policies and practices are monitored to ensure that all employees have the opportunity to learn and develop according to their abilities.

In March 2016 an externally facilitated and benchmarked employee survey was carried out. The Group's overall engagement indicator at that time being 86% (2015: 85%), which was higher than the financial services sector average of 81% (2015: 66%). In addition, 91% of our employees stated that they were proud to work for the Group (2015: 90%) and 96% said they shared its values (2015: 95%).

Training and development

The Group has been accredited under the 'Investors in People' scheme since 1997 and its Gold status was confirmed once again in February 2016. This demonstrates the Group's commitment to the training and development of all its employees.

In addition, we were also invited by Investors in People to receive Champion Status in May 2014, which is given to organisations who are seen as pioneers in people management practices and role models in strategic leadership and is currently held by only 1% of companies in the UK. This involves the Group in active networking with other organisations and offering mentoring support to smaller organisations that are working towards gaining the Investors in People accolade.

All employees receive an appraisal at least annually. These reviews are designed to assist employees in developing their careers and to identify and provide appropriate training opportunities. Appraisals also provide a method to track individual's progress and identify opportunities to develop them into further roles, thereby supporting the Group's overall succession planning objectives.

The Group's in-house development team deliver leadership development programmes, externally accredited by the Chartered Management Institute ('CMI'), to support managers. This year eight senior managers completed our first formal mentoring programme to become CMI accredited mentors.

The corporate training and development strategy focuses on providing opportunities to develop all employees and is central to the achievement of the Group's business objectives. On average employees received 8.5 days training in the year (2015: 11.4 days), which is significantly higher than the average figure quoted by the Chartered Institute of Personnel and Development ('CIPD') of between 2.8 and 3.3 days for the private sector.

Recruitment

We remain committed to employing individuals from the communities in which we are based and hold open days three times per year to publicise our vacancies. We also run a successful 'refer a friend' scheme whereby employees are rewarded with a referral fee if an individual they refer for a role passes probation. This year 72 individuals were successfully recruited through this scheme (2015: 38).

We also engage with local schools and colleges in the Solihull area through careers fairs to offer 'employability workshops' and to promote ourselves as a local employer. In addition, we have offered eleven work experience placements to local students this year.

Employees' involvement

The directors recognise the benefit of keeping employees informed of the progress of the business. The Group operates a People Forum, attended by employee representatives from each area of the business, which exists primarily to facilitate communication and dissemination of information throughout the Group and provides a means by which employees can be consulted on matters affecting them.

Employees are provided with regular information on the performance and plans of the Group, and the financial and economic factors affecting it, through electronic information and presentations.

The Company operates a Sharesave share option scheme and a profit sharing scheme, both of which enable eligible employees to benefit from the performance of the business.

The directors encourage employee involvement at all levels through the appraisal process and communication between directors, managers, teams and individual employees.

Company involvement in industry initiatives on employment standards

This year the business has provided support to external working groups focussing on employment standards organised by industry bodies such as the British Bankers' Association and, in particular, contributed to the Banking Standards Board's survey on culture.

The Group's membership of the Investors in People Gold Club involves sharing best practice with other Gold Standard employers and it hosts one networking event each year.

Health and Safety policy

It is the Group's policy to comply with the terms of the Health and Safety at Work Act 1974, and subsequent legislation, to provide and maintain a healthy and safe working environment. Health and safety objectives have been set to minimise the number of instances of occupational accidents and illnesses, while monitoring performance, providing training, raising employee awareness and ultimately achieving an accident-free workplace.

The Group recognises and accepts its duty to protect the health, safety and welfare of all visitors to its premises, including contractors and temporary workers, as well as any members of the public who might be affected by our operations.

While the management of the Group will do all within its power to ensure the health and safety of its employees, it is recognised by all employees that health and safety at work is the responsibility of each and every individual associated with the Group. It is the duty of each employee to take reasonable care of their own and other people's welfare and to report any situation which may pose a threat to the well-being of any other person.

Health and safety policies and procedures are managed by the Group Services Division which liaises with senior management and Human Resources as necessary. A health and safety co-ordinator is employed within Group Services to manage all health and safety matters, including policies, procedures, risk assessments and training records. Following the acquisition of PBAF, a programme is currently under way to ensure that all applicable policies and procedures are implemented to maintain statutory compliance and instil consistency and best practice across the expanded group.

All employees regardless of any residual risk are provided with such equipment, information, training and supervision as is necessary to implement the policy in order to achieve the above stated objectives. The Group makes available such finances and resources deemed reasonable to mitigate any risks identified.

All injuries, however small, sustained by a person at work are reported internally with the appropriate level of investigation assigned, based on the incident. Accident records are crucial to the effective monitoring and revision of the policy and must therefore be accurate and comprehensive. Trend analysis is undertaken where appropriate to determine if there are any gaps in the occupational health and safety management system that require closing.

The Group recognises the need to ensure that all employees adhere to this health and safety policy and is prepared to invoke the disciplinary process in case of any deliberate disregard for health and safety policies and procedures.

The Group's health and safety policy is continually monitored and updated, particularly when changes in the scale or nature of its operations occur. The policy is reviewed every two years, with interim amendments being made when required by changes in legislation or industry standards. Live issues and risks are recorded and monthly management information is issued to the ORCC and the Occupational Health and Safety Working Group.

BS18001:2007 (The British Standard for Occupational Health and Safety) was obtained during 2013 and the Group is now acknowledged by its third party auditor to have a mature management system. This was re-emphasised during the Group's recertification audit in June 2016 where the auditor evidenced ongoing process improvements and documentation reviews relating to the Group's day-to-day management of risk.

During the year ended 30 September 2016 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters. This is in keeping with the Group's record throughout its 30-year history. A notification for a single minor incident under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 was made in March 2016. This is the Group's first notification since October 2014.

A5.2 Environmental Policy

The Group is mainly engaged in mortgage and consumer finance and therefore its overall environmental impact is considered to be low. The main environmental impacts of most of the Group's operations are limited to universal environmental issues such as resource use, procurement in offices and business travel.

Specialist Fleet Services ('SFS'), a division of PBAF, leases refuse collection vehicles to local authorities throughout the UK. SFS undertake additional aftersales activities that include servicing, maintenance and breakdown support.

SFS operates from several workshops around the UK and has exposure to several waste streams (oils, vehicle parts etc) that come from their own workshop activities. These are effectively managed under an environmental management system that is certificated to an International Standard – ISO14001:2015. SFS has a dedicated Health and Safety Manager with direct responsibility for all of its sites.

The Group's environmental commitment is included within the Health, Safety and Environmental policy that is approved by the Chief Executive and the People Director and which is publicly displayed in its buildings. Data is collected by the Facilities Team which monitors consumption figures and reports this to the business upwards to board level.

The Group complies with the Energy Savings and Opportunities Scheme ('ESOS'). This is a UK Government initiative, under an EU Directive, and requires the Group to identify and reduce its energy consumption. The Group is already in the data collection phase of the process to benchmark its current energy consumption to allow it to set achievable targets for reduction. The Group has implemented an Energy Working Group which reports to the Property Steering Group to prioritise and drive forward key recommendations for the more efficient use of energy.

The Group complies with all applicable laws and regulations relating to the environment. It operates a Green Charter to raise employees' awareness of recycling and campaigns are also run to reduce various forms of waste such as food, consumables or energy. The Group's Green Charter:

- Ensures all buildings occupied by the Group are managed efficiently by its Facilities Team
- Encourages employees to conserve energy
- Promotes recycling by negotiating contracts and providing facilities to enable employees to re-cycle office waste and other used products
- Controls business travel by promoting video conferencing between sites when appropriate and provides opportunities for employees to travel to work in various ways; such as providing cycle racks
- Ensures liaison with the local community
- Ensures that redundant IT equipment is disposed of within current directives / regulations (WEEE - Waste Electrical and Electronic Equipment)
- Ensures that all fluorescent light tubes are disposed of in a safe manner, compliant with appropriate regulations
- Arranges for paper waste products to be recycled, securely, by third parties

The Green Charter is kept under continuous review by the Facilities Team.

The Group's paper based stationery is procured from Forest Stewardship Council ('FSC') certified suppliers.

All of the Group's redundant IT equipment is collected by an accredited third party company who achieve the maximum amount of plastic and metals recycling possible for this WEEE waste.

The Group operates a Cycle to Work scheme, enabling employees to obtain cycles at preferential rates for commuting purposes, thereby reducing the carbon footprint of travel to work on the local community.

The Group has been involved in no prosecutions, accidents or similar non-compliances in respect of environmental matters.

Performance indicators

The environmental key performance indicators for the Group, determined having regard to the Reporting Guidelines published by the Department for Environment Food and Rural Affairs ('DEFRA') in June 2013, are set out below.

The Group does not consider it has significant environmental impacts under the headings 'Resource Efficiency and Materials', 'Emissions to Land, Air and Water' or 'Biodiversity and Ecosystem Services' set out in the Guidelines, due to the nature of its business activities.

This information is presented for the 12 months ended 30 September in each year and includes all entities included in the Group's financial statements. Information for acquired entities is included from the acquisition date. Normalised data is based on total operating income of £244.0 million (2015: £211.5 million).

Greenhouse gas ('GHG') emissions

	2016	2015
	Tonnes	Tonnes
	CO ₂	CO ₂
Scope 1 (Direct emissions)		
Combustion of fuel:		
Operation of gas heating boilers	520	689
Petrol and diesel used by company cars	229	120
Operation of facilities:		
Air conditioning systems	42	32
	791	841
Scope 2 (Energy indirect emissions)		
Directly purchased electricity	1,892	1,893
Total scope 1 and 2	2,683	2,734
Normalised tonnes - scope 1 and 2 CO ₂ per £m income	11.0	12.9
Scope 3 (Other indirect emissions)		
Fuel and energy related activities not included in scope 1 or 2	294	285
Water consumption	11	8
Waste generated in operations	39	7
Total scope 3	344	300
Total scopes 1, 2 and 3	3,027	3,034
Normalised tonnes scope 1,2 and 3 CO ₂ per £m income	12.4	14.3

Despite the increase in the Group's operational footprint following the acquisitions in the year, GHG emissions have not increased materially, due to lower levels of gas consumption for heating purposes.

A project is in progress to align the building management systems within the Group's premises, which should increase efficiency in the future. The Group has also retained the services of external energy consultants in order to further address issues of consumption and efficiency.

Vehicle fuel usage is based upon expense claims and recorded mileage.

CO₂ values above are calculated based on the DEFRA / Department of Energy and Climate Change ('DECC') guidelines published in June 2016. CO₂ values for the year ended 30 September 2015 have been restated for the revised conversion factors published by DEFRA / DECC.

The amounts shown above for total scope 1 and scope 2 emissions are those required to be reported under the Companies Act (Strategic Report and Directors Reports) Regulations 2013. Other scope 3 emissions not reported above are not considered to be significant.

Power usage

The Group uses mains electricity and natural gas from the UK grid to provide heat, light and power to its office buildings. The amount of power used in the year ended 30 September 2016 is shown below.

	2016	2015
	MWh	MWh
Electricity	4014.8	3,564.0
Natural gas	2,829.2	3,736.1
	6,844.0	7,300.1
Normalised MWh per £m income	28.0	34.5

Gas and electricity usage is based on consumption recorded on purchase invoices.

Water usage

The Group's water usage is limited to the consumption of piped water in the UK and no water is extracted directly. Water usage in the year ended 30 September 2016 was 10,588m³ (2015: 7,973m³), based upon consumption recorded on purchase invoices, a normalised amount of 43.4m³ per £m income (2015: 37.7m³ per £m income). This is a result of the increased size of the Group's operations. A water saving initiative is being introduced to reduce year on year water usage across the sites where the Group has full responsibility for the premises occupied.

Waste

The Group's waste output, outside SFS, consists of general office waste which includes a mixture of principally paper and cardboard with some wood, plastics and metal. All the Group's waste is either recycled or sent to landfill.

Wastes created by SFS are collected under contract with the supporting consignment notes and disposed of appropriately.

Amounts of waste generated in the year ended 30 September 2016 together with the methods of disposal are shown below.

	2016	2015
	Tonnes	Tonnes
Recycled	225	85
Landfill	174	52
	399	137
Normalised tonnes per £m income	1.64	0.65

Waste generation data is based upon volumes reported on disposal invoices. The Group provides facilities in its offices for recycling paper, cardboard, newspapers, glass, plastics and aluminium and steel cans. Batteries, printer and photocopier cartridges are collected and sent for recycling.

The increase in waste generation is a result of the acquisition of SFS, described above.

A5.3 Social, Community and Human Rights

The Group's activities are based wholly within the United Kingdom. It operates within the legal and regulatory framework of the UK, acknowledging the importance of corporate responsibility and citizenship in its relationships with its customers, the wider community and other stakeholders.

Commitment to our customers

The Group places the needs of customers at the heart of its day-to-day operations. With a commitment from the Board, fairness to our customers is a key consideration and objective at all stages of the lifetime of a loan or savings product.

Our vision is to become the UK's most highly regarded specialist provider of finance for people. Putting the interests of our customers at the heart of what we do is an integral part of achieving that objective and we want our customers to have confidence that we will always treat them fairly. The Group therefore strives to ensure that:

- products and services are designed to meet our customers' needs
- customers are given clear, jargon free information
- products perform as customers have been led to expect
- customers do not face unreasonable post-sale barriers to change a product, switch provider, submit a claim or make a complaint
- high quality customer service is provided

We believe our desire to achieve positive outcomes for our customers is an important commercial differentiator which has helped us build strong and positive relationships over many years.

This pro-active approach accords with the FCA's Principles for Business, particularly with regard to treating customers fairly and ensuring the way in which we communicate is clear, fair and not misleading. We ensure that we know how well we are performing in respect of these requirements, regularly adjusting what we do to deliver better customer solutions.

The Board and executive management are committed to maintaining and developing this culture across the Group.

Complaint handling

We understand that we do not always get things right first time and all complaints from our customers are taken very seriously. We acknowledge each complaint promptly and then work with customers to understand their feedback, investigating fully and responding swiftly in a fair and open manner.

Where possible we aim to resolve complaints at the first point of contact, but acknowledge some complaints will require further specialist investigation and time to resolve. Where further investigation is needed, we will stay in regular contact with the customer to keep them informed of what is happening with their complaint. If we need to contact previous service providers we have established contacts within these companies to ensure any complaint is resolved at the earliest possible opportunity.

Where applicable, we provide 'Alternative Dispute Resolution' information to customers to allow them to appeal to independent parties if they are not satisfied with our response. These include the Financial Ombudsman, the FLA and the Credit Services Association. Where customers feel the need to appeal we co-operate fully and promptly with any settlements and awards made by these parties.

We genuinely view every complaint as an opportunity to improve our business, an opportunity to identify where we are going wrong and, most importantly, an opportunity to put things right for our customers. We complete root cause analysis on our complaints to ensure appropriate corrective actions are taken to address the issue and minimise the risk of re-occurrence for other customers.

Supporting the community

The Group contributes to registered charities relating to financial services or serving the local communities in which it operates. Contributions of £1,443,000 (2015: £1,045,000) were made by the Group during the year to the work of the Foundation for Credit Counselling which operates the StepChange Debt Charity. The Group also contributed to charities throughout the year by way of single donations.

Other charitable contributions made in the year totalled £32,000 (2015: £19,000). The Group's main objective is to support children's and local charities, although no charity request is overlooked. During the last year the Group has helped many and varied charities and causes such as: Age UK Solihull, Rotary Club St Alphege, Children with Cancer, NSPCC Birmingham, Ward 19 – Heartlands Hospital, the Lily Mae Foundation, County Air Ambulance Birmingham, Macmillan, Well Child, Brainwave and Kids in Action.

Employees have been making a difference to the local community in many ways. This year employees have:

- delivered workshops in local schools and colleges focussing on financial awareness and employability skills
- donated over 100 shoeboxes for local Samaritan project 'Operation Christmas purse'; and
- made regular contributions to local food banks

The Group also supports Paragon's Charity Committee, consisting of volunteer employees, which organises a variety of fundraising activities throughout the year. In the calendar year 2015, £12,348 was raised for Help Harry Help Others, while in the first nine months of 2016 £10,462 has been raised for Birmingham Children's Hospital and the Alzheimer's Society. All employees are given the opportunity to nominate a charity each year and a vote is carried out to select the charity or charities to benefit from the following year's fundraising.

Taxation payments

The Group's tax strategy is to comply with all relevant tax obligations whilst cooperating fully with the tax authorities. The Group recognises that in generating profits which can be distributed to shareholders it benefits from resources provided by government and the payment of tax is a contribution towards the cost of those resources. The Group will only undertake tax planning that supports commercial activities and in the UK context is not contrary to the intention of Parliament.

As a group containing a bank the Group is subject to The Code of Practice on Taxation for Banks ('the Bank Tax Code') as published by Her Majesty's Revenue and Customs ('HMRC') in March 2013. During the year the Group confirmed to HMRC that it was unconditionally committed to complying with the Bank Tax Code, and formally re-approved the Group's tax governance policies and the tax strategy outlined above. Following the acquisition of PBAF and Premier the acquired companies have become subject to the Group's governance policies and tax strategy.

The Finance Act 2016 requires the Group to publish, prior to 30 September 2017, on its website a tax strategy covering the following matters:

- The approach of the Group to risk management and governance arrangements in relation to UK taxation
- The attitude of the Group towards tax planning (so far as affecting UK taxation)
- The level of risk in relation to UK taxation that the Group is prepared to accept
- The approach of the Group towards its dealings with HMRC

The published strategy will be owned by the Board collectively in accordance with HMRC's published expectations.

The Group has an open and positive relationship with HMRC, meeting with their representatives on a regular basis, and is committed to full disclosure and transparency in all matters.

The Group is resident and operates in the UK and its tax payments to the UK authorities include not only corporation tax but also substantial payroll taxes. The amounts of the Group's cash payments to UK national and local tax authorities in the year, including Pay As You Earn ('PAYE') and NI contributions deducted from employee wages and salaries were as follows:

	2016	2015
	£m	£m
Corporation tax	23.5	22.6
PAYE and National Insurance	21.0	20.0
VAT	1.4	0.3
Stamp duty	0.8	0.2
Total national taxation	46.7	43.1
Business rates	1.2	1.3
	47.9	44.4

Business practices

The Group carries out its business fairly, honestly and openly. It has an anti-bribery and corruption policy, endorsed by the directors and operated throughout the Group. It will not make bribes, nor will it condone the offering of bribes on its behalf. It will not accept bribes, nor will it agree to them being accepted on its behalf and will avoid doing business with those who do not accept its values and who may harm its reputation.

The Group has carried out the risk assessment required by the Bribery Act 2010 and concluded that it is not a company with a high risk of bribery. The Group conducts all of its business within the UK and its only significant outsourcing arrangement relates to the administration of its savings operations by the outsourcing arm of a major UK building society. However, the Group takes its responsibilities seriously and will not tolerate bribery on any scale and as such policies have been strengthened and new ones introduced where appropriate.

The Group's policies cover the conduct of its business, the Group's interaction with suppliers and contractors and the giving or receiving of gifts and corporate hospitality. It prohibits facilitation payments. Before new suppliers are approved, the Group's procedure requires that they must be assessed against the requirements of the anti-bribery and corruption policy.

All employees are required to read the Group's anti-bribery and corruption policy and sign to confirm their acknowledgement, understanding and acceptance of its requirements. The anti-bribery culture forms part of the induction course for all new employees and is reinforced at subsequent training sessions. Any employee found to be in breach of these policies will be subject to disciplinary action. No such disciplinary action has taken place in the year ended 30 September 2016.

The Group Chief Risk Officer, in conjunction with the Head of Financial Crime, who is part of the 'second line' Risk and Compliance function, is responsible for ensuring the Bribery Act risk assessment and resulting policies and procedures are in place and reviewed on a regular basis. They are also responsible for ensuring any changes in the law are noted and applied to the Group's policies and procedures, where appropriate.

The Head of Internal Audit is responsible for providing assurance that the business heads have the appropriate controls in place to ensure all employees adhere to the anti-bribery and corruption policies and procedures at all times.

The Group has not been involved in any incidents resulting in prosecutions, fines, or penalties or in similar incidents of non-compliance in respect of bribery and corruption.

Human rights

The Group operates exclusively in the UK and, as such, is subject to the European Convention on Human Rights and the UK Human Rights Act 1998.

The Group respects all human rights and in conducting its business the Group regards those rights relating to non-discrimination, fair treatment and respect for privacy to be the most relevant and to have the greatest potential impact on its key stakeholder groups of customers, employees and suppliers.

The Board and the Group Chief Risk Officer have overall responsibility for ensuring that all areas within the Group uphold and promote respect for human rights. The Group seeks to anticipate, prevent and mitigate any potential negative human rights impacts as well as enhance positive impacts through its policies and procedures and, in particular, through its policies regarding employment, equality and diversity, treating customers fairly and information security.

Group policies seek both to ensure that employees comply with the relevant legislation and regulations in place in the UK and to promote good practice. The Group's policies are formulated and kept up to date by the relevant business area, authorised in accordance with the Group's governance procedures and communicated to all employees through the Human Resources Policies Manual.

The Group supports the objective of the Modern Slavery Act 2015, in raising awareness of modern slavery and human trafficking and will be publishing the Modern Slavery Statement required, in accordance with government guidance, in early 2017.

The Group is committed to ensuring that there is no modern slavery or human trafficking in its supply chains or in any part of the business and to acting ethically and with integrity in all business relationships.

The full statement will be published on the Group's website www.paragon-group.co.uk.

The Group undertakes extensive monitoring of the implementation of all of its policies and has not been made aware of any incident in which the organisation's activities have resulted in an abuse of human rights.

A6 APPROVAL OF STRATEGIC REPORT

Section A of this Annual Report comprises a Strategic Report for the Group which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law, in particular Chapter 4A of the Companies Act 2006, and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

It should be noted that the Strategic Report has been prepared for the Group as a whole, and therefore gives greater emphasis to those matters which are significant to the Company and its subsidiaries when viewed as a whole.

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

Pandora Sharp

Company Secretary

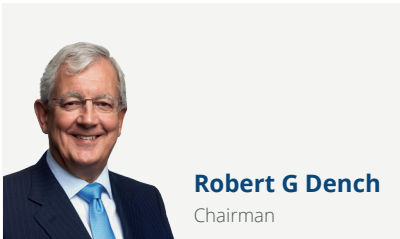
23 November 2016

B. CORPORATE GOVERNANCE

How the Group is run and how risk is managed

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B1 CHAIRMAN'S STATEMENT ON CORPORATE GOVERNANCE



Robert G Dench
Chairman

Dear Shareholder

As I noted earlier, governance is central to the operations and structure of the Paragon Group and corporate governance is an essential part of the ethos of the Board.

I am pleased to introduce the corporate governance report for the Group which is an important element in the operating methodology of the Board.

Governance is a very strong focus in the culture of the Group and I consider it important that this tone is endorsed and reflected by the Board.

This year saw our triennial external board evaluation, completed in September 2016, and I am very pleased to report that the outcome showed a Board that was clearly effective. This follows on from a positive report in our previous external evaluation. I would like to take this opportunity to thank my fellow directors for their ongoing work which has enabled this result to be achieved. There were a number of points that arose out of the board and committee evaluations that will be addressed during the forthcoming financial year and further information is provided on these later in the report.

During the year ended 30 September 2016 in addition to its regular business items the Board has:

- Overseen the development of the Group's new lending offerings through Paragon Bank
- Conducted an exercise reviewing the Group's operational structure to ensure that it is as effective and efficient as possible
- Discussed the implications of Brexit for the Group (both before and after the referendum result)
- Supervised the post-acquisition strategic review of PBAF and maintained oversight of the implementation of its results, while monitoring the integration of PBAF within the wider Group
- Considered and approved the acquisition of Premier Asset Finance Limited
- Reviewed developments in the Group's funding strategy and position in the light of changes in the business and market conditions; and
- Approved revisions to a number of the core governance documents including the Schedule of Matters Reserved for the Board and the Terms of Reference of the Audit and Remuneration Committees

In the financial year ending 30 September 2017 areas of focus for the Board will include the ongoing development of the asset finance business as well as new product developments across the Group. The Board will also continue to consider the emerging impact of the Brexit referendum on the UK economy and its impact on the Group's business, as well as other impacts from legal and regulatory changes across the Group's funding and lending activities either recently introduced or currently proposed.

I meet with shareholders regularly to discuss general matters and annually with the Chairman of the Remuneration Committee to discuss matters of governance and remuneration. These meetings assist in the development of governance within the organisation and I would like to thank shareholders for the challenges that they have raised.

As the Group develops over the next year and with the uncertainties in the current macro-economic climate it will be important that our strong corporate governance ethos at board level and on governance in general is maintained throughout the Group and I look forward to enabling this.

I have had the pleasure of engaging with various stakeholders during the year and I look forward to continuing to reflect on their views and challenges as part of the Board's ongoing commitment to corporate governance, as both the Group's operations and the corporate governance environment develop in the future.

Robert G Dench

Chairman

23 November 2016

B2 BOARD OF DIRECTORS

The Directors of the Company at the year end were:



Robert G Dench (Age 66)
Chairman



Nigel S Terrington (Age 56)
Chief Executive

Appointed to board:

Non-executive director: 2004
Chairman: 2007

Treasury Director: 1990
Finance Director: 1992
Chief Executive: 1995

Experience:

During an extended career with Barclays he held a number of senior positions in the UK and overseas, leaving in 2004

Nigel Terrington's early career began in investment banking, which included working for UBS. He joined Paragon Group in 1987, shortly becoming Treasurer, before being appointed as Finance Director and then Chief Executive. He has been Chairman of the CML, Chairman of the Intermediary Mortgage Lenders Association ('IMLA'), Chairman of the FLA Consumer Finance Division and a Board member of the FLA. Nigel is an associate of the Chartered Institute of Bankers

Committee membership:

Chairman: Nomination Committee
Member: Risk and Compliance, and Remuneration Committees

Member: Nomination Committee

Current external appointments:

Non-executive director of AXA UK PLC and Chairman of AXA Ireland Limited and other AXA Group companies

Member of HM Treasury's Home Finance Forum, the Bank of England's Residential Property Forum and the Chairman's and Executive Committees of the CML



Richard J Woodman (Age 51)
Group Finance Director



John A Heron (Age 57)
Managing Director, Paragon Mortgages

Director of Corporate Development: 2012
Group Finance Director: 2014

Director of Mortgages: 2003

Richard Woodman joined the Group in 1989 and has held various senior strategic and financial roles, including Director of Business Analysis and Planning and Managing Director of Idem Capital. He has taken a lead role in the Group's strategic development and, in particular, in the loan portfolio acquisition programme through Idem Capital. He is a member of the Chartered Institute of Management Accountants

John Heron joined the Group in January 1986 following a number of years in the building society industry and is the Group's longest serving employee. He played a pivotal role in re-establishing the Group's mortgage lending operations in 1994 as Managing Director of Paragon Mortgages and, in particular, the development of the Group's buy-to-let lending programme. He is a fellow of the Chartered Institute of Bankers

None

None

None

Chairman of the CML buy-to-let panel and a member of the IMLA board



Alan K Fletcher (Age 66)

Non-executive
director



Peter J N Hartill (Age 67)

Non-executive
director

Appointed to board:

2009 – Seven years served

2011 – Five years served

Experience:

Alan Fletcher has considerable experience in financial services, including pension fund trusteeship and investment fund management. He was Chairman of Neville James Holdings prior to its acquisition by Challenger International of Australia, following which he was Sales and Marketing Director of Challenger Group Services and a director of Challenger Life (UK) between 2002 and 2003. He was Chairman of the professional training company, Fresh Professional Development, between 2003 and 2010 and was a member of the General Synod of the Church of England between 2007 and 2010

Alan has also served as Director of Paragon Pension Trustees Limited, the Corporate Trustee of the Group's pension plan, since 2011

Peter Hartill spent 40 years with Deloitte, becoming a senior audit partner and a business advisor with experience across a wide range of industries and business issues. Specifically he has considerable experience in acquisitions and disposals, capital raising, risk control and corporate governance in the financial services sector

He is a Chartered Accountant and has been Chairman of the Audit Committee since 2011, meeting the requirement for an appropriately qualified person to fill that role

Committee membership:

Chairman: Remuneration Committee
Member: Audit, Risk and Compliance and Nomination Committees

Chairman: Audit Committee
Member: Risk and Compliance, Remuneration and Nomination Committees

Current external appointments:

Trustee of the Church of England Pensions Board since 2009, member of its Pensions Committee, Chairman of its Investment Committee and member of its Ethical Investment Advisory Group. Chairman of the Diocese of Leicester Investment Committee and member of the Finance Committee of Leicester Cathedral

Director of CEPB Mortgages Limited since February 2010

Chairman of Deeley Group Limited.

Non-executive director of A&J Mucklow Group PLC and Scott Bader Limited



Fiona J Clutterbuck (Age 58)

Non-executive director and Senior Independent Director



Hugo R Tudor (Age 53)

Non-executive director

2012 – Four years served

2014 – Two years served

Fiona Clutterbuck has many years of corporate finance experience at leading UK and international investment banks, specialising in financial institutions. During her career she has held the positions of Managing Director and Head of Financial Institutions Advisory at ABN AMRO Investment Bank, Managing Director and Global Co-Head of Financial Institutions Group at HSBC Investment Bank and was a director at Hill Samuel Bank Limited

Hugo Tudor spent 26 years in the fund management industry, originally with Schroders and most recently with BlackRock, covering a wide range of UK equities. He is a Chartered Financial Analyst and a Chartered Accountant and brings an investor perspective to the Board

Chairman: Risk and Compliance Committee
Member: Audit, Remuneration and Nomination Committees

Member: Audit, Risk and Compliance Remuneration and Nomination Committees

Head of Strategy, Corporate Development and Communications at Phoenix Group and director of other Phoenix Group companies. Senior independent director at WS Atkins PLC

Director of Damus Capital Limited

B3 CORPORATE GOVERNANCE

B3.1 Governance Framework

The Group's culture has a central role in the way the organisation operates. This culture is firmly reflected in the commitment of the Board of Directors to the principles of corporate governance contained in the Code issued by the FRC in September 2014 and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2016 the Company complied with the principles and provisions of the Code.

The Board notes that a new edition of the Code, published by the FRC in April 2016, will apply to the Company with effect from its year ending 30 September 2017. The Board has reviewed the new requirements and concluded that the Company is well placed to comply with the revised provisions.

The Board of Directors is responsible for overall Group strategy and for the delivery of that strategy within a robust corporate governance and corporate responsibility framework. That framework is described in the following pages.

Leadership

The schedule of matters reserved for the Board was reviewed during the year. This details key matters, for which the Board is responsible including:

- The Group's values and standards
- Its strategic aims and objectives
- Approval of major capital projects and material acquisitions and disposals
- Approval of annual operational and capital expenditure budgets
- Approval of the Company's dividend and corporate governance policies; and
- Agreeing the Group's risk appetite and determining the remuneration policy for the executive directors

All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings.

During the year the Board consisted of the Chairman, three executive directors and four non-executive directors. All the directors bring to the Company a broad and valuable range of experience and further detail of this together with additional biographical details are set out in section B2.

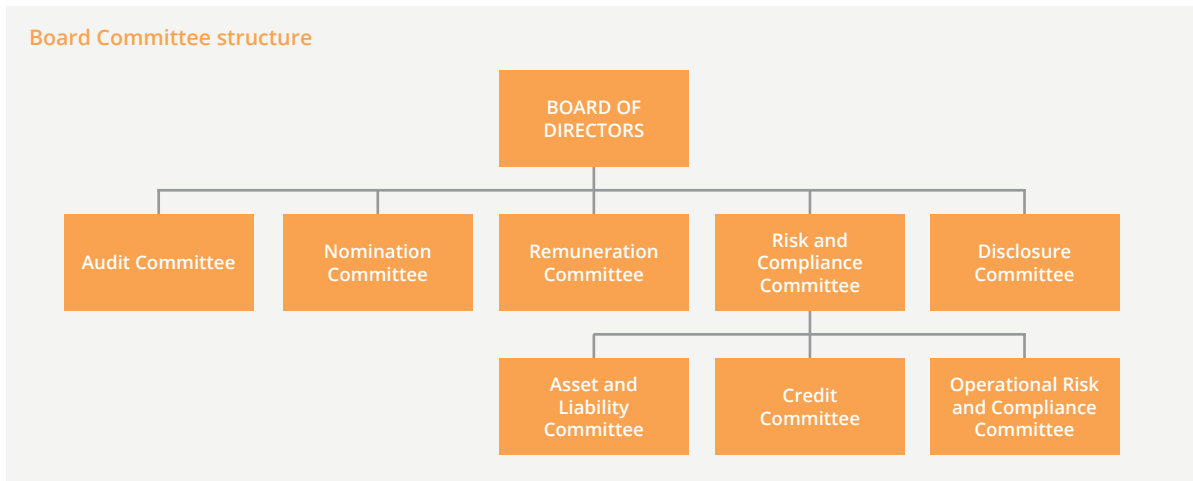
The division of responsibilities between the Chairman and Chief Executive is clearly established, set out in writing and agreed by the Board. This division was fully revised during the year to ensure that it was in line with best practice.

There is a strong non-executive representation on the Board, including the Senior Independent Director, Fiona Clutterbuck. This provides effective balance and challenge.

The Chairman's other business commitments are set out in the biographical details in section B2 and there have been no significant changes during the period to those commitments.

The Board has agreed a set of guiding principles on managing conflicts and a process to identify and authorise any conflicts which might arise, which was updated during the year. At each meeting of the Board and its committees actual or potential conflicts of interest in respect of any director are reviewed.

The Board also operates through a number of committees covering certain specific matters, illustrated in the chart below.



Board committees

- The Audit Committee, which during the year consisted of Peter Hartill (who chairs the Committee), Fiona Clutterbuck, Alan Fletcher and Hugo Tudor, all of whom were independent non-executive directors. The Board is satisfied that all members of the Committee have recent and relevant financial experience and that the Committee as a whole has competence relevant to the sector in which the Group operates. The Committee meets at least three times a year.

Further information on the work of the Audit Committee is given in section B4.

- The Nomination Committee, consisting of Robert Dench (who chairs the Committee), Nigel Terrington and all of the non-executive directors, ensuring that a majority of the Committee's members are independent non-executive directors. The Committee meets at least twice a year.

Further information on the work of the Nomination Committee is given in section B3.2.

- The Remuneration Committee, which during the year consisted of Alan Fletcher (who chairs the Committee), Fiona Clutterbuck, Peter Hartill and Hugo Tudor, all of whom were independent non-executive directors, and the Chairman of the Company, Robert Dench. The Committee meets at least three times a year.

Further information on the work of the Remuneration Committee is given in section B5.

- The Risk and Compliance Committee, which consisted of Fiona Clutterbuck (who chairs the Committee), Peter Hartill, Alan Fletcher and Hugo Tudor, all of whom were independent non-executive directors and the Chairman of the Company, Robert Dench. The Committee meets at least four times a year.

Further information on the work of the Risk and Compliance Committee is given in section B6.

In addition to the committees listed above a further standing committee, the Disclosure Committee was established during the year. The purpose of the Committee is to assist in the design, implementation and evaluation of disclosure controls and procedures; monitor compliance with the Company's disclosure controls, consider the requirements for announcement and overall determine the disclosure treatment of material market information. The Committee's members are Robert Dench, Nigel Terrington and Richard Woodman of which any two can form a quorum but that quorum should include either the Chief Executive Officer or Group Finance Director.

Executive committees

Three executive committees, the Asset and Liability Committee, the Credit Committee and the Operational Risk and Compliance Committee, consisting of executive directors and appropriate senior employees, report to the Risk and Compliance Committee and are described further in the Risk Management section, B6.

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

The attendance of individual directors at the regular meetings of the Board and its committees in the year is set out below, with the number of meetings each was eligible to attend shown in brackets. Directors who are unable to attend meetings will receive the papers and any comments will be reported to the relevant meeting. Directors have attended a number of ad hoc meetings during the year in addition to the regular Board meetings and have contributed to discussions outside of the regular meeting calendar.

Director	Board	Audit Committee	Risk and Compliance Committee	Remuneration Committee	Nomination Committee
Robert G Dench	11 (11)	-	5 (5)	5 (5)	3 (3)
Nigel S Terrington	11 (11)	-	-	-	3 (3)
Richard J Woodman	11 (11)	-	-	-	-
John A Heron	11 (11)	-	-	-	-
Alan K Fletcher	11 (11)	4 (4)	5 (5)	5 (5)	3 (3)
Peter J N Hartill	11 (11)	4 (4)	5 (5)	5 (5)	3 (3)
Fiona J Clutterbuck	11 (11)	4 (4)	5 (5)	5 (5)	3 (3)
Hugo R Tudor	11 (11)	4 (4)	5 (5)	5 (5)	3 (3)

Directors also attended an annual two-day strategy event, held off site, to enable further, more detailed, discussion of the Group's position and future development. This strategy event has been a regular fixture in the Group's governance calendar for a number of years and in recent years has also been attended by the Group's executive management group. This year invitations were also issued to the Bank's executive and non-executive directors reflecting the growing importance of retail deposit taking in the Group's funding and growth strategy.

The Board regularly receives, reviews and considers reports on the following matters:

- Strategic matters
- Potential acquisition opportunities
- Business performance
- Results, management accounts and financial commentary
- Operational reports from business areas
- Treasury and funding matters
- Legal and governance matters
- The work of the Board's committees
- Matters arising from subsidiary company boards, including that of Paragon Bank
- Investor relations and shareholder feedback

Subsidiary governance

A number of the corporate entities within the Group are regulated by either the PRA and the FCA or solely by the FCA. The Company has oversight of these entities as part of its overall responsibility for the management of the Group and also to ensure that the Group's values and standards in regulated spheres are met.

Effectiveness

All of the non-executive directors are independent of management and all are appointed for fixed terms. They are kept fully informed of all relevant operational and strategic issues and bring a strongly independent and experienced judgement to bear on these issues. The non-executive directors meet with the Chairman, from time to time, without the presence of the executive directors.

All of the directors holding office at 30 September 2016 had been reappointed at the Annual General Meeting on 11 February 2016 and all of them have submitted themselves for re-election at the forthcoming Annual General Meeting.

All directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that board procedures are complied with. Both the appointment and removal of the Company Secretary are matters for the Board as a whole.

All directors are able to take independent professional advice in the furtherance of their duties whenever it is considered appropriate to do so and have access to such continuing professional development opportunities as are identified as appropriate in the Board appraisal process.

The Board considers that each of the non-executive directors are independent of the Group and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

Alan Fletcher serves as a director of the corporate trustee of the Paragon Pension Plan (the 'Plan') and receives £10,000 per annum in respect of that appointment from Paragon Finance PLC, the sponsoring company of the Plan and a subsidiary of the Company. The Board considers that this does not impact on his independence because the Plan is a trust which is independent of the Company and, as a director of its corporate trustee, Mr Fletcher has a fiduciary duty to act in the best interests of the trust and the Plan's beneficiaries.

In determining that Hugo Tudor was independent, as defined by the Code, the Board considered his former role at BlackRock, where he was an active fund manager until 2013. BlackRock has been one of the Company's major shareholders for a number of years and the Company's dealings with it were, and remain, on the same basis as those with any other major shareholder, being limited to communication and consultation in accordance with normal market practice. This does not constitute a material business relationship and hence does not impact on Mr Tudor's independence.

The composition of the Board and its committees is kept under review, with the aim of ensuring that there is an appropriate balance of power and authority between executive and non-executive directors and that the directors collectively possess the skills and experience necessary to direct the Company and the Group's business activities. The directors review actual or potential conflicts of interest in respect of any director at each meeting of the Board and its committees.

There is an established process for external appointments through the Nomination Committee. Ultimately, the appointment of any new director is a matter for the Board. Executive director appointments are based upon merit and business need. Non-executive appointments are based upon the candidates' profiles matching those agreed by the Nomination Committee. In all cases the Board approves the appointment only after careful consideration.

Succession planning for the Board has been reviewed during the year and further detail is provided in the Nomination Committee section B3.2.

The Human Resources department has a wider succession development plan for senior management roles across the Group, prioritising those roles likely to require recruitment within the next five years. This data has been considered against internally identified individuals, with high potential and the capability to fulfil those roles as they become vacant, to ensure that succession requirements can be met. Internal individuals will be developed for future senior roles and this will be complemented with external recruitment at a senior level where necessary, to balance the required skills and experience of the senior management team and ensure continuing success in the future. This succession plan has received its biannual review during the year.

External board evaluation

The Board, individual directors and the Board's main committees are reviewed annually, with this year's review being the externally facilitated triennial review required by the Code.

The external evaluation considered the performance of the Board and its committees, all individual directors, including the Chairman and also the Company Secretary.

A number of alternative providers were considered to undertake this important review with Armstrong Bonham Carter LLP being appointed and the lead review work undertaken by Tom Bonham Carter. Neither Armstrong Bonham Carter LLP nor Tom Bonham Carter have undertaken any other work for the Group. The evaluation process consisted of meetings with all the directors, the Company Secretary and the People Director. These interviews were each scheduled for a minimum of two hours, with a wide ranging agenda across the breadth of strategy and governance matters including such topics as the Group's aims, the development of its strategy, plans and targets, the suitability of the composition of the Board and the executive team in light of the Group's aims and strategy, financial and operational resources, the Group's risk management systems, its communications with shareholders and employees, and the board processes operated.

Tom Bonham Carter also attended a directors' meeting day on which board, remuneration and risk and compliance committee meetings were held. His presentation of his results to the Board was received in September 2016. A schedule of follow up actions will be monitored over the next financial year.

The review concluded that there was clear evidence of the effectiveness of the Board and identified a small number of issues to be followed up in the next year. Few matters were identified for the long established Audit and Remuneration Committees and these have already been addressed, including the update of the Audit Committee's Terms of Reference to reflect the guidance published by the FRC in April 2016.

The Risk and Compliance Committee, which was only established in 2014, and the Nomination Committee whose role is developing have some points to be addressed over the next year.

Recommendations included the following:

Recommendation	Next steps
Board	
To ensure that the Group's strategy, as it evolves, is clearly articulated and defined over the short, medium and long term and that related risk appetite is fully documented	To review the ongoing documentation in respect of strategy and risk appetite to ensure clarity and to monitor this on a regular basis
To consider further enhancing the ongoing investor relations programme	To be reviewed in the second quarter of the new financial year
To consider the appointment of an additional non-executive director with more retail and SME banking experience	Conclusions of the Nomination Committee on this matter to be considered in the second quarter of the new financial year
Nomination Committee	
To consider the appointment of an additional non-executive director with more retail and SME banking experience	To be reviewed in the second quarter of the new financial year
Review the Terms of Reference and consider inclusion of best practice matters such as succession planning within the formal remit of the Committee	Completed
Risk and Compliance Committee	
To ensure the Committee has a robust process to check that the risk profile is in line with the approved risk appetite	To be reviewed in the second quarter of the new financial year
To ensure that the Committee has a robust risk review process in place for historic risk events	To be reviewed in the third quarter of the new financial year

Individual performance

Alongside the board evaluation process, feedback on individual directors and the Company Secretary was provided directly to the Chairman with the evaluation of the Chairman, arising from discussion with all other directors, the Company Secretary and the People Director, being provided to the Senior Independent Director. The Senior Independent Director then discussed the results of the evaluation with the non-executive directors. The evaluations of the other non-executive directors, the Chief Executive and the Company Secretary were discussed between those individuals and the Chairman with the Chief Executive discussing the executive director evaluations with those directors.

In addition, the performance of the Chief Executive is appraised by the Chairman. The performance of the other executive directors is appraised by the Chief Executive in conjunction with the Chairman. The results of these appraisals were presented to the Remuneration Committee in September 2016 for consideration and determination of remuneration.

Training

All of the non-executive directors have received presentations during the year on various aspects of the Group's activities. In addition, training has been provided by external advisers on topics such as the economy, and the markets and regulatory environments in which the Group operates or is considering operating in.

As part of its training programme the Board has agreed an additional commitment of one and half days for stand-alone training. These sessions took place in March 2016 and after the year end in October 2016. The March 2016 half day discussed the development of the Group's ICAAP with external advisers present. The October 2016 day included presentations from external economic advisers and banking analysts as well as in-house presenters.

The non-executive directors also completed a variety of the regular training modules that are mandatory for all employees. Subjects covered in the year included equality and diversity, money laundering, financial crime, whistleblowing, business continuity, information security and conduct risk. By the time of this report all board members had completed all 2015/16 continuing professional development topics.

Ongoing development opportunities for all directors will be provided, as required, during the forthcoming financial year. A training schedule is maintained by the Group's Human Resources department.

At the Annual General Meeting the Chairman will confirm to shareholders, when proposing the re-election of any non-executive director, that, following formal performance evaluation, the individual's performance continues to be effective and demonstrates commitment to the role. The letters of appointment of the non-executive directors will be available for inspection at the Annual General Meeting.

Accountability

Detailed reviews of the performance of the Group's main business lines are included within the Strategic Report. The Board uses this to present a fair, balanced and understandable assessment of the Company's position and prospects.

The directors' responsibility for the financial statements is described in section B8.

An on-going process for identifying, evaluating and managing the significant risks faced by the Group, which is regularly reviewed by the Board, was in place for the year ended 30 September 2016 and to the date of these financial statements. The directors confirm that they have reviewed the effectiveness of the Group's system of internal control for this period and that these procedures accord with the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the FRC.

The directors are responsible for the system of internal control throughout the Group, including the system of internal control over financial reporting, and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide reasonable, but not absolute, assurance against the risk of material misstatement or loss and that assets are safeguarded against unauthorised use or disposition. In assessing what constitutes reasonable assurance, the directors have regard to the relationship between the cost and benefits from particular aspects of the control system.

The system of internal control includes documented procedures covering accounting, compliance, risk management, personnel matters and operations, clear reporting lines, delegation of authority through a formal structure of mandates, a formalised budgeting, management reporting and review process, the use of key performance indicators throughout the Group and regular meetings of the Asset and Liability, Credit and Operational Risk and Compliance Committees and senior management.

Internal control over financial reporting within the Group is provided by a process designed, under the supervision of the Group Finance Director and senior financial management of the Group, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes, including the process of preparing the Group's consolidated financial statements.

Internal control over financial reporting includes policies and procedures intended to ensure that records are maintained that fairly, and in reasonable detail, reflect transactions and dispositions of assets, to provide reasonable assurance that transactions are recorded as necessary to permit the preparation of the financial statements, to ensure that receipts and expenditures are only being made in accordance with management authorisation and to provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Internal control systems, no matter how well designed, have inherent limitations and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that internal controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may reduce.

The Board receives regular reports setting out key performance and risk indicators. In addition the Board operates a formal risk management process, described in more detail in section B6, from which the key risks facing the business are identified. The process results in reports to the Board, through its Risk and Compliance Committee, on how these risks are being managed. The Board has a programme of regular presentations from senior management to enable the Board to review the operation of internal controls in relation to the risks associated with their specific areas.

The system of internal control is monitored by management and by an internal audit function that concentrates on the areas of greater risk and reports its conclusions regularly to management and the Audit Committee. The internal audit work plan is approved annually by the Audit Committee, which reviews the effectiveness of the system of internal control annually and reports its conclusions to the Board. Further details of the role and activities of the Audit Committee and its relationship with the internal and external auditors are set out in section B4. The Risk and Compliance Committee is responsible for reviewing the Group's risk management framework and the effectiveness of the Group's systems and controls. Further details of the role and activities of the Risk and Compliance Committee and the Group's risk management system are set out in section B6. There is some overlap between the work of the Audit Committee and that of the Risk and Compliance Committee and the Board monitors these areas to ensure that no gaps develop in the system of internal control.

Remuneration

Information on how the Group has applied the provisions of the Code relating to remuneration is set out in the Directors' Remuneration Report in section B5.

Relations with shareholders

The Board encourages communication with the Company's institutional and private investors. All shareholders have at least twenty working days' notice of the Annual General Meeting at which the directors and committee chairmen are available for questions. The Annual General Meeting is held in London during business hours and provides an opportunity for directors to report to investors on the Group's activities, to answer their questions and receive their views. At all general meetings shareholders have an opportunity to vote separately on each resolution and all proxy votes lodged are counted and the balances for, against and directed to be withheld in respect of each resolution are announced.

The Chairman, Chief Executive and Group Finance Director have a full programme of meetings with institutional investors during the course of the year and investors' comments are communicated to all members of the Board, enabling them to develop an understanding of the major shareholders' views of the Group. During the year ended 30 September 2016 meetings were held with investors from the UK, Europe and North America. From time to time other presentations are made to institutional investors and analysts to enable them to gain a greater understanding of important aspects of the Group's business.

The Chairman and the Chairman of the Remuneration Committee hold annual meetings with leading shareholders to discuss remuneration policies and other corporate governance matters and the comments received are reported to the Board and considered by the Remuneration Committee in determining or varying the Group's approach to executive compensation.

The results of all of these meetings are reported to the Board so that all directors are aware of shareholder views.

The Senior Independent Director is made aware of views expressed by shareholders to other members of the Board, via the Company's brokers or through the Investor Relations team and is available to meet with shareholders should they wish. Such meetings can be arranged via the Company Secretary.

The Company's website at www.paragon-group.co.uk provides access to information on the Company and its businesses.

B3.2 Nomination Committee

The Nomination Committee consists of the Chairman of the Company, Robert Dench (who chairs the Committee), Nigel Terrington and all of the non-executive directors, ensuring that a majority of the Committee's members are independent non-executive directors. The Committee has reviewed its terms of reference during the year (adopted by the Board in October 2016) and these are now more closely aligned to best practice. The Committee's purpose has been defined to include ensuring that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Board, to lead the process for Board appointments and to make recommendations to the Board on those appointments and assisting the Board in ensuring its composition is regularly reviewed and refreshed so that it is effective and able to operate in the best interests of shareholders. Ultimate responsibility for appointment rests with the Board.

In addition, the Committee will review the structure, size and composition (including the skills, experience, independence, knowledge and diversity) of the Board going forward and make any recommendations that it deems necessary. It also proposes, for Board approval, which candidates should sit on which committees and who should be considered for Board roles, such as committee chairmanships and the senior independent director position.

The Group recognises the importance of diversity, including gender diversity, at all levels of the organisation including the Board and the contribution which it can make to board effectiveness. The Group's diversity policies are described in section A5.1 of the Annual Report, where information on the composition of the workforce is also given. The Group recognises the importance of diversity on the Board, not only of gender, but also of experience and background, and the valuable contribution which such diversity can make towards achieving the appropriate balance of skills and knowledge which an effective board of directors requires.

Diversity quotas or targets have not, for a number of years, been considered appropriate by the Board. The Board has always believed and continues to believe in appointing the best person to the role regardless of gender or other points of diversity and this belief is reflected and operates across all appointments made by the Group. However, the Board recognises that measurement and publication of targets can assist in driving forward change and developing a talent pipeline in a sector where gender diversity has been difficult to achieve. For this reason, the Group has signed up to HM Treasury's Women in Finance Charter initiative and will be agreeing targets in respect of gender diversity amongst the Group's senior management. These targets will reflect the Board's commitment to ensuring that diversity considerations throughout the Group are wider than gender.

In considering a new external appointment to the Board, the Committee will review the board structure, size and composition. This leads to the identification of the skills required and consequently to the selection of potential candidates. The choice of appointee is based entirely on merit. The Committee ensures that prospective non-executive directors can devote sufficient time to the appointment. The Board recognises the benefits that can flow from non-executive directors holding other appointments but requires them to seek the agreement of the Chairman before entering into any commitments that might affect the time they can devote to the Company.

Early in the financial year the Committee, together with the Risk and Compliance Committee, undertook a full review of succession planning for executive director level positions at board level, for roles immediately below board level and for certain senior specialist roles across the Group including Paragon Bank PLC. In total approximately 100 roles were reviewed. The Committee was satisfied that plans were in place (and continue to be in place at year end) for immediate cover should unforeseen circumstances arise.

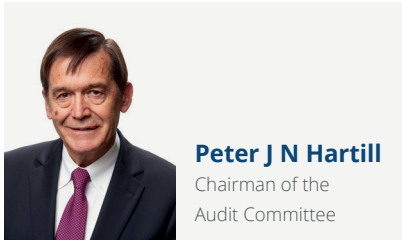
Following this review work, internal development has been undertaken to enhance succession planning with consideration given to possible 'at risk' roles as well as to the development of potential future senior management candidates. Risk mitigation will continue to include the ongoing development of employees as well as work to further validate potential candidates for senior positions. Development work on those potential candidates will occur with those employees remaining in their current roles as this training is undertaken so as to minimise business impact while ensuring that they are enabled to undertake a more senior role in due course. The Group's preference, where possible, is that internal candidates are developed and supported to undertake senior roles as this assists in the ongoing maintenance of its strong people centric culture.

The Committee monitors the tenure of non-executive directors and will develop succession planning, as far as practical and appropriate, in this area during the year ending 30 September 2017.

In addition to the matters noted above the Committee's revised Terms of Reference reflect its greater role in succession planning as well as additional responsibilities including assisting the Chairman with the annual board evaluation process, assessing the overall and individual performance and effectiveness of the Board and its committees. The Board, Committee and individual performance outputs of the external evaluation undertaken in the year ended 30 September 2016 will be reviewed and the actions arising monitored by the Committee in the new financial year. More detail on the external evaluation process can be found in section B3.1.

B4 AUDIT COMMITTEE

B4.1 Statement by the Chairman of the Audit Committee



Dear Shareholder

The year ended 30 September 2016 has seen continuing change, both in the Group's businesses and in the regulatory environment in which it operates, with the financial services industry as a whole being the subject of increased regulatory focus.

As a Committee our responsibility is to ensure that financial information published by the Group properly presents its activities to stakeholders in a changing landscape, as well as overseeing the effective delivery of both external and internal audit services.

During the year the Committee met four times and its principal activities were as follows:

- The review of the annual and half-yearly financial statements to ensure these properly present the Group's activities in accordance with accounting standards, law, regulations and market practice
- In particular, the consideration of the accounting for the acquisitions of PBAF and Premier in the year and the Group's accounting policies for the recognition of interest income and loan impairment amongst other significant accounting issues
- The supervision of the transfer of the Group's external audit to KPMG from Deloitte for the year ended 30 September 2016, following a formal tender process in the previous year
- The supervision of the internal audit function as it adapts to changes in the business and the wider implementation of the three lines of defence model during the year
- Overseeing the Group's preparations for the introduction of IFRS 9 and, with the Risk and Compliance Committee, the early stages of the Group's IRB project
- Considering the integration of the acquired PBAF and Premier operations into the Group's financial reporting and control framework
- Considering the Group's readiness to address other forthcoming accounting changes which will affect it

The Committee also considered a new policy on external audit independence, covering non-audit fees payable to the auditors and other aspects of the Group's relationship with the audit firm, and new terms of reference for the Committee.

In the financial year ending 30 September 2017 the Committee's main priorities will include:

- Continued monitoring of the Group's IFRS 9 implementation programme
- Overseeing the embedding of PBAF and Premier into the Group's financial control and reporting framework
- Ensuring that the Group's control processes develop alongside developments in the business
- Ensuring that the Internal Audit function is able to respond to the expected new guidance from the Chartered Institute of Internal Audit on internal audit in the financial services sector

I commend this report to shareholders and ask you to support the resolutions concerning the reappointment of KPMG as auditors and their remuneration at the Annual General Meeting in 2017.

Peter J N Hartill

Chairman of the Audit Committee

23 November 2016

B4.2 Operations of the Committee

The Audit Committee comprises all of the independent non-executive directors of the Company and its terms of reference include all matters indicated by Disclosure and Transparency Rule 7.1 and the Code.

The Committee's responsibilities include:

- Monitoring the integrity of the Group's financial reporting
- Reviewing the Group's internal control systems
- Monitoring and reviewing the effectiveness of the Group's internal audit function
- Monitoring the relationship between the Group and the external auditor

It also provides a forum through which the Group's external and internal audit functions report to the non executive directors.

The Committee noted the publication of the 2016 edition of the Code and considers that, as a whole, it possesses the competence relevant to the sector in which the Group operates that the Code requires and thus complies with the new edition of the Code which came into force on 1 October 2016.

The Committee meets at least three times a year and has an agenda linked to events in the Group's financial calendar. The Committee normally invites the Chairman, the executive directors, Group Financial Controller, Director of Internal Audit and a partner and other representatives from the external auditor to attend meetings of the Committee, although it reserves the right to request any of these individuals to withdraw.

For part of each meeting the Committee will meet separately with representatives of the external auditor and with the Director of Internal Audit without any other persons present.

At each meeting the Committee receives reports of reviews conducted throughout the Group by the Internal Audit and, from time to time, Compliance functions.

The Chairman of Paragon Bank's audit committee and its finance director are invited to meetings of the Committee when matters relating to the Bank are to be discussed.

B4.3 Significant issues addressed by the Committee in relation to the Financial Statements

The Committee considers whether the accounting policies adopted by the Group are suitable and whether significant estimates and judgements made by the management are appropriate. In evaluating the Group's financial statements for the year ended 30 September 2016 the Committee considered particularly:

- The accounting for the Group's acquisitions of PBAF and Premier in the period, including the amounts of goodwill arising on those transactions and its recoverability
- The calculation of interest receivable or payable under the Effective Interest Rate ('EIR') method for both internally originated and purchased loan assets and the Group's borrowings
- The levels of impairment provision against loan assets
- The valuation of the deficit in the Group's defined benefit pension scheme
- The viability statement which the Group is required to make under the Code
- The Group's capital and funding position and the Group forecasts for future periods

The Committee also considered whether this Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

In each of these areas the Committee was provided with papers discussing the position shown in the accounts, the underlying market conditions and assumptions and the methodology adopted for any calculations. The papers also detailed any changes in approach from previous periods. These were reviewed in detail and discussed with the relevant Group employees and the results of this work were considered, together with the results of testing by the external auditor. There were no material or significant disagreements between the management and the external auditor.

Particular matters which the Committee focused on in each of these areas were:

Matter	Particular areas of focus
Acquisition accounting and goodwill impairment	<p>During the year the Group completed the acquisitions of PBAF and Premier and was required, in accordance with IFRS 3, to determine fair values for all of the assets and liabilities acquired, including intangible assets and therefore to determine the amount of goodwill arising in each transaction.</p> <p>Further the Group is required to assess, at the end of the year, whether the carrying value of the goodwill balance is still appropriate or whether any impairment has occurred.</p> <p>In considering whether the fair values of assets and liabilities had been properly determined the Committee considered the nature of the assets acquired, their historic credit performance, the due diligence exercises carried out before acquisition, and in the case of PBAF the results of the Group's post acquisition strategic review.</p> <p>In considering whether any impairment of goodwill had occurred the Committee considered particularly the Group's forecasts for the cash flows to be generated by the acquired businesses and their reasonableness in the light of current trading performance and the strategic review exercise.</p> <p><i>Further information on these estimates and policies can be found in notes 12 and 13 to the accounts, and the potential impairment of goodwill is discussed in note 33.</i></p>

Matter	Particular areas of focus
Interest income and expense recognition	<p>As required by IAS 39, the Group recognises income from loan balances on an EIR basis, which is intended to produce a constant yield throughout the behavioural life of the loan, taking account of such matters as costs of procurement, and initially fixed or discounted interest rates. The calculation therefore rests on assumptions about the future behaviour of the Group's customers. A similar approach is taken to assessing interest on borrowings, where redemption profiles and anticipated refinancing dates influence expense recognition.</p> <p>The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications.</p> <p>Redemption profiles used in the modelling of mortgage books and the availability of alternative offerings in the market were areas of particular focus.</p> <p>The Committee also paid particular attention to the accounting for new Idem portfolio purchases, which are generally made at a discount to the gross balance owed by customers on the accounts purchased, and where portfolio performance is a major driver of the EIR calculation.</p> <p><i>Further information on these estimates can be found in note 5b to the accounts, and the interest income and expense recognised on this basis is shown in note 13 and 14.</i></p>
Impairment	<p>IAS 39 requires that companies provide for any financial assets, held at amortised cost, considered to be impaired at the balance sheet date, to the extent that the carrying value might not be recovered.</p> <p>The Group's calculation of impairment provision relies on assumptions to determine when an account might require provision and how large that provision would need to be.</p> <p>In order to satisfy itself that this calculation resulted in appropriate provisioning, the Committee considered actual out-turns against historical impairment provision amounts calculated by the Group's models and the continued relevance of historical cash flow experience to the current loan book, based on present economic conditions and account administration practices.</p> <p>This included an assessment of the impact of the Group's receiver of rent processes on cash flows and ultimate impairment levels, consideration of the likely effects of movements in property prices on security values and an examination of exposure on large portfolios.</p> <p><i>Further information on these estimates can be found in note 5a to the accounts, the impairment charge for the year is shown in note 22 and movements in provision for impairment are shown in note 36.</i></p> <p><i>The Group's exposure to credit risk is discussed in note 7.</i></p>

Matter	Particular areas of focus
<p>Pension deficit</p>	<p>The deficit on the Group's defined benefit pension plan is valued in accordance with IAS 19, which requires an actuarial valuation of the plan liabilities. Such a valuation is based on assumptions including market interest rates, inflation and mortality rates in the Plan.</p> <p>In order to satisfy itself as to the appropriateness of these assumptions, the Committee considered their derivation and the market data underlying them. These were compared to market benchmarks and advice from the Group's actuarial advisers. The Committee also considered benchmarking data provided by the external auditor.</p> <p><i>Further information on the Plan deficit, the basis of valuation and the assumptions underlying it can be found in note 56 to the accounts, along with an analysis of sensitivities to the more significant assumptions.</i></p>
<p>Viability statement</p>	<p>The Board are required by the Code and the Listing Rules to make a viability statement in the Annual Report. The Committee have been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered aspects of the work of the Board and its various committees which addressed the Group's business model, risk profile, access to funds and future strategy, they also considered guidance issued by the FRC and stress testing which had been carried out in the year.</p> <p><i>A fuller discussion of the directors' consideration of the viability statement is set out in section A4.</i></p>
<p>Capital and funding</p>	<p>The Board are required by the Code and the Listing Rules to make a going concern statement in the Annual Report. The Committee have been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered the Group's detailed forecasts and the implicit cash and capital requirements. The Committee discussed availability of funding, potential stress events and the impact of the economic environment.</p> <p><i>A fuller discussion of the directors' consideration of the going concern statement is set out in section A4.</i></p>
<p>Fair, balanced and understandable</p>	<p>The Board are required by the Code to state whether, in its view, the Annual Report is fair, balanced and understandable. The Committee have been asked to express an opinion to the Board as to whether this statement could properly be made.</p> <p>The Committee considered the draft Annual Report for the financial year, as a whole, satisfying itself that the process for the preparation and review of its various sections, was appropriate. The Committee especially focused on areas where disclosure requirements had changed or where new activities were to be reported on. Based on this exercise, and the Committee's own understanding of the business in the year, it determined whether the Annual Report, overall, portrayed the Group's activities, position and results properly.</p>

The Committee was able to reach satisfactory conclusions on all of these areas and therefore resolved to commend the Annual Report to the Board for approval, and to advise the Board that it can conclude that the Annual Report is fair, balanced and understandable.

Earlier in the year the Committee had considered each of these areas, where applicable, in the same manner in concluding that it could commend the Group's half-yearly financial report for the six months ended 31 March 2016 to the Board for approval.

B4.4 External Auditor

The Committee is responsible for assessing the effectiveness of the external audit process, for monitoring the independence and objectivity of the external auditor and for making recommendations to the Board in relation to the appointment of external auditors. The Committee is also responsible for developing and implementing the Group's policy on the provision of non-audit services by the external auditor.

Audit tendering

On 24 September 2014 the Competition and Markets Authority finalised its investigation into the audit market and published The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'Order'). The provisions of the Order are consistent with new requirements being introduced by European legislation.

The Order first applied to the Group from the beginning of the year ended 30 September 2016 and requires that only the Committee can agree the fees and terms of service of the external auditors, initiate and supervise a tendering process or recommend the appointment of an external auditor to the Board following a tender process.

The Committee, having considered the terms of the Order and the increasing frequency of audit tenders seen among comparable companies, concluded that the interests of good governance would be best served by putting the Group audit out to tender. As a result of this process KPMG LLP were appointed as auditors with effect from the year ended 30 September 2016 at the Annual General Meeting in February 2016. The financial year ended 30 September 2016 is the first reported on by KPMG.

The Group is therefore not subject to a legal requirement to undertake an audit tender until ten years have elapsed, and will report to shareholders no later than after the completion of the fifth year (the year ending 30 September 2020), and in each subsequent year thereafter, its conclusions on whether a further tender is in the Group's interest.

Before recommending the appointment of KPMG to the Board, the Committee engaged with them to ensure that they were able to provide the required quality of service and were independent of the Group. More specifically the Committee considered whether KPMG's understanding of the Group's business, their access to appropriate financial services and regulatory specialists within their firm, both locally and nationally, and their understanding of the sectors in which the Group operates were appropriate to the Group's needs.

Other than the legal requirements of the Order, the Committee has not identified any factors which might restrict its choice of external auditor.

Audit effectiveness

The Committee has considered the effectiveness of the external audit for the year ended 30 September 2016 and the Group's relationship with the external auditor, KPMG, on an on-going basis, and has conducted a formal review of the effectiveness of the annual audit before commending this Annual Report to the Board. This review consisted of the following steps:

- A list of relevant questions was considered by senior management who submitted their responses in writing to the Committee in advance of the meeting convened to consider the Annual Report
- The Committee members, with reference to the same questions considered their experience of the audit process in advance of that meeting
- At the meeting the Committee discussed the results of the exercise with the senior financial management of the Group, without the external auditor present
- The Committee then addressed the evaluation, as appropriate, with the external auditors

The Committee was able to conclude, on the basis of this exercise and its experience over the year, that the external audit process remained effective and that the auditor was independent and objective. A further review will be carried out following the completion of audit procedures on all Group companies and reported on in next year's Annual Report.

The effectiveness review addressing the conduct of the 2015 audit by Deloitte, undertaken at the time of approval of the 2015 Group accounts was updated once the external audit process for all Group companies had been completed and affirmed the original conclusion that the external audit was independent and objective and that the audit process was effective for that financial year.

Independence policy

Both the Committee and the external auditor have safeguards in place to avoid any compromise of the independence and objectivity of the external auditor. The Committee considers the independence of the external auditor annually and the Group has a formal policy for the engagement of its external auditor to supply non-audit services, which was reviewed during the year in the light of new guidance for Audit Committees from the FRC. The policy is designed to ensure that neither the nature of the service to be provided nor the level of reliance placed on the services could impact the objectivity of the external auditor's opinion on the Group's financial statements.

During the year the policy in place precluded the appointment of the external auditor to provide any service where there was involvement in management functions or decision making, or any service on which management might place primary reliance in determining the adequacy of internal controls, financial systems or financial reporting. The external auditor could provide corporate finance and similar services (provided there was no significant advocacy role) or tax services but, if the advice given or the position taken would have been material to the Group, the prior consent of the Committee would have been required. Internal audit services were not provided by the external auditor. Other services could be procured by management without the prior consent of the Committee, but reported to the Committee on an ongoing basis.

The new policy, in force from the financial year ending 30 September 2017, extends these provisions, and precludes the external auditor from providing tax or remuneration advice. The Committee now must approve any engagement of the external auditors for non-audit work, except where the fee involved is clearly trivial. It also sets out rules for the employment of former employees of the external auditor and procedures for monitoring such persons within the organisation.

The Committee review, on a regular basis, the levels of fees paid to all major accounting firms to identify any matters which might impact on those firms' ability to tender for the group audit at any future date.

Fees paid to external auditors

Fees paid to the external auditor are shown in note 21 to the Accounts. Other than services required to be provided by external auditors by legislation or regulation, non-audit services provided by Deloitte prior to their resignation related to taxation, securitisation reporting and regulatory advice. Other fees paid to KPMG after their appointment related to accounting and regulatory advisory work in respect of the Group's preparation for the introduction of IFRS 9 and its IRB project (shown as 'other services' in note 21).

In respect of taxation services the Committee has considered the services provided and concluded that the understanding of the Group and the industry demonstrated by the advisers made them well placed to meet the Group's needs. The incoming auditors, KPMG, have not been instructed in respect of tax services.

In respect of the securitisation reporting services and regulatory advice, Deloitte was selected to provide these services as they were considered to offer the most appropriate skills and experience for the projects concerned in a cost-effective manner, given their existing knowledge of the Group's systems.

Overall the fees paid to KPMG, the Group's external auditor, for non-audit services (excluding VAT), were £103,000 (2015: £486,000 paid to Deloitte), which is equivalent to 11.3% of the total fees paid to them.

The Group actively considers other providers for the type of non-audit services provided by the external auditor's firm and has engaged with other audit firms in the period. When considering discrete projects, such as transaction support or specialist internal audit assistance in the year, the Group engaged with a number of firms, including some outside the 'big four' largest audit firms, assessing each firm's appropriateness for the particular assignment before an appointment was made. Fees paid to audit firms, excluding the Group audit and related fees can be analysed as shown below:

	2016	2015
	£000	£000
Auditors - KPMG	103	-
Auditors - Deloitte	161	486
Other big four firms	478	89
Other firms	367	18
	1,109	593

Fees paid to the outgoing auditors after their resignation and the incoming auditors before their appointment are included within 'other big four firms'.

It should be noted that the Group instructed a non-big four firm in connection with the acquisition of Five Arrows Leasing Group.

The audit tender process conducted in 2015 has helped to further relationships with all of the big four firms, not simply the incoming auditors, and each of the other three firms has been instructed by the Group during the year.

B4.5 Internal Audit

The Committee is responsible for considering and approving the remit of the internal audit function and ensuring it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee also ensures that the internal audit function has adequate standing and is free from management or other restrictions which may impair its independence.

An external quality assessment of the Internal Audit function, as it related to Paragon Bank, was undertaken in December 2014 by the Chartered Institute of Internal Auditors. This concluded that there was very clear commitment from the executive teams and the audit committees, of both the Bank and the Group, to establish a strong and appropriately qualified and experienced internal audit team; and plans were clearly in place to strengthen the Internal Audit framework which would enable appropriate conformance with the Standards and the Chartered Institute of Internal Auditors' Financial Services Code. The Internal Audit team was considered to be well placed and had the requisite skills, experience and resources to deliver the audit plan. This review will be repeated on a triennial basis going forward.

During the year the Committee has considered and approved the risk based three-year rolling Group internal audit plan, which is based on an assessment of the key risks faced by the Group. It has monitored progress of the internal audit function against that plan, ensuring that the internal audit function has sufficient resource to carry out its duties effectively.

The Group's internal audit plan in the period has been increasingly influenced by the demands of regulators, who are empowered to request specific review work from the function when they feel this is appropriate.

With effect from the 2015-16 audit plan a formal co-sourcing agreement has been entered into with a third party accounting firm. This provides the Group's internal audit function with access to subject matter expertise and specialist knowledge to support that of the internal team, especially in regulatory and specialist areas. The co-source also provides the opportunity to benchmark and measure the internal control maturity of the activity under review.

Reports on internal audit work have been received by the Committee and, where necessary, appropriate actions have been recommended to the Board. The Committee meets with the Group's Director of Internal Audit without the presence of management on a regular basis.

The results of this work, together with the Committee's engagement with the management information of the Group and the executive directors, have enabled them to conclude that the statements given in section B3 relating to the Group's systems of internal control and its management of risk are appropriate.

Following the acquisition of PBAF, a review of the Internal Audit departmental structure took place and a decision was taken to enhance financial audit with the recruitment of a further suitably qualified and experienced financial audit manager.

The Committee notes the ongoing work being carried out by the Chartered Institute of Internal Auditors to revise its guidance on effective internal audit in the financial services sector and will consider what impact any recommendations emerging from this process will have on the internal audit function.

B4.6 Whistleblowing

There is an established procedure whereby employees can make disclosures regarding malpractice within the Group on a confidential basis, in accordance with the Public Interest Disclosure Act 1998 ('PIDA'). The policy also makes provision to ensure that no employee making such a disclosure suffers any detriment by doing so. This process is supervised by the Committee and any amendments to the policy require the approval of the Chairman of the Committee. There is a right of appeal to the Chairman where the employee is dissatisfied with the outcome and his decision is final in all cases.

To ensure that the policy is embedded in the operations of the Group all employees received training on the requirements of PIDA and the Group's policy during the year and were tested to ensure their understanding.

During the year ended 30 September 2016 no reports were made through the Group's whistleblowing process which necessitated action being taken.

B5 DIRECTORS' REMUNERATION REPORT

This report covers the activities of the Remuneration Committee for the year ended 30 September 2016 and sets out the remuneration policy and remuneration details for the executive and non-executive directors of the Company. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2008, as amended in August 2013, and the principles of the UK Corporate Governance Code.

The report is split into three main areas: the Statement by the Chairman of the Committee (B5.1), the Annual Report on Remuneration (B5.2) and the Policy Report (B5.3), the content of each of which is prescribed by the Regulations.

The Directors' Remuneration Report (excluding the Policy Report) will be subject to an advisory shareholder vote at the Annual General Meeting. The directors' remuneration policy set out in the Policy Report is subject to a binding shareholder vote at the Annual General Meeting to be held on 9 February 2017 (policy originally approved in February 2014). This policy will apply until the Annual General Meeting in 2020, unless revised by a vote of shareholders ahead of that time.

The Companies Act 2006 requires the auditors to report to the shareholders on certain parts of the report and to state whether, in their opinion, those parts of the report have been properly prepared in accordance with the Regulations. The parts of the Annual Report on Remuneration that are subject to audit are indicated in that report. The Statement by the Chairman of the Remuneration Committee and the Policy Report are not subject to audit.

B5.1 Statement by the Chairman of the Remuneration Committee

The information provided in this part of the Directors' Remuneration Report is not subject to audit.



Alan K Fletcher
Chairman of the
Remuneration Committee

Dear Shareholder

The philosophy underpinning the Group's remuneration policy seeks to produce an outcome which is fair and appropriate to the Company, its shareholders, senior executives and employees. Company performance is central, with the focus being on short and long term qualitative and quantitative objectives with an emphasis on strong risk management.

Business performance

The Group has made strong progress against both its operational objectives for the ongoing business and its longer term strategic objectives, notwithstanding a year marked by disruptive fiscal and regulatory change.

The growth in the Group's loan books, up 6.7% to £10,737.5 million, contributed to an increase in underlying profit by 9.1% to £146.9 million (2015: £134.7 million). The Group's product range was expanded by the acquisition of the asset and development finance operations. At the year-end preparation for the Group's launch of specific niche residential mortgage market products was well advanced and regulatory approvals had been obtained.

Variable pay earned in the year

The Committee has reflected the positive performance in the year in applying the remuneration policy. Performance bonuses of 75% of maximum for Mr N S Terrington and Mr R J Woodman and 62.5% of maximum for Mr J A Heron have been awarded. In reaching this decision, the Committee has reviewed performance against a number of financial value and risk based targets and has taken individual performance into account. In particular, the executive team has delivered above plan in a year which was particularly challenging in the second half and has continued to focus on the successful delivery of our new businesses, whilst also embedding risk management across the Group. The objectives are detailed in section B5.2.2. Full retrospective disclosure of the target range for the year ended 30 September 2016 will be included in the 2017 Annual Report on Remuneration.

Long term incentive awards under the Paragon Performance Share Plan ('PSP') which were granted in December 2013 are due to mature in December 2016. These awards are subject to a Total Shareholder Return ('TSR') performance condition, measured against the FTSE-250 Index (50% of the award), and EPS growth (50% of the award) both conditions being measured over the three financial years ended 30 September 2016. The Company's TSR performance over the period ranked below median and EPS exceeded the upper target. The Committee will consider the financial underpin for these awards prior to vesting, however anticipate that based on these results, half of the award will vest.

Key changes to the remuneration structure for 2017

The current remuneration policy was approved by shareholders at the 2014 AGM to apply for a period of three years. Consequently, the Committee undertook a review of the policy during the year and, as a result, are proposing a few minor changes which are summarised below (and in more detail at the front of the policy). No significant changes have been made to the 2014 policy which was approved with over 94% of votes in favour. The changes proposed are to simplify the policy, aid administration and take account of how it has been operated. In setting our new policy the Committee has continued to take into account its key principles of ensuring that the executive directors are fairly rewarded for their individual performance, having regard to retention and motivation, whilst maintaining a clear link between rewards and company performance.

The key changes proposed to the 2014 policy are:

- The Matching Share Plan (which had not been used since 2010) has been removed from the Policy
- Shareholding guidelines have been formally included in the policy, in line with best practice
- We have formally included clawback on the cash element of the bonus (although as I stated last year, this has been introduced for bonus awards in respect of the year ended 30 September 2016)
- For new externally appointed executive directors, the maximum contribution which may be made in respect of pension (either as a contribution into a pension or as cash in lieu) is 25% of salary. This level of contribution will only be used in exceptional circumstances with the usual contribution level expected to be in the range of 10-15%
- For externally appointed executive directors, there will be a two year holding period applied to the PSP awards (this has not been adopted for the existing executive directors on the basis that they already hold high levels of personal shareholdings); and
- As described in the Notice of Annual General Meeting, we are proposing, subject to shareholder approval, to make minor administrative amendments to the PSP in accordance with which the number of shares subject to the awards will ordinarily be determined by reference to the share price following the announcement of the prior year's results and the awards will vest following the assessment of the performance conditions

In addition, the Committee has reviewed the performance metrics attaching to the PSP awards. Our awards over the last three years have been based on a combination of relative TSR against the FTSE-250 and EPS growth targets, with equal weighting attached to both.

As the business grows and becomes more diversified, while the level of regulation increases, the focus on effective risk management becomes of increasing importance to the long term wellbeing of the Group. The Committee is mindful that the PSP should reflect a balance of the key performance indicators for the business. In line with market practice in the sector and to reflect the regulatory environment and good governance for a regulated business, it has therefore been decided to introduce a risk-based element into the PSP. This is in order to maintain the balance of internal and external measures, meaning that the risk and EPS elements will in future constitute 50% of the award. Further details of how risk will be assessed for the PSP to be granted following the Group's results announcement are detailed in section B5.2.3.

Prior to 2011 the TSR performance metric for PSP awards was by reference to a bespoke comparator group as the Committee considered a sector specific group made a more appropriate means of measuring the Group's performance. This approach became unworkable because of the number of the group's constituents that subsequently delisted, and TSR was therefore measured against the FTSE-250 index instead. Over recent years the number of listed companies in the financial services sector has expanded allowing the Committee to consider using a bespoke group again.

Comparison to the peer group is one of the key ways the Group is benchmarked externally by analysts and internally by management in determining success and the Committee has therefore decided to reinstate the use of a bespoke group. This consists of 13 companies and details are in Section B5.2.3.

For the 2015 PSP award the EPS target for threshold was set at 3% above the rate of increase in the retail prices index ('RPI') and the EPS target for maximum vesting was increased from 7% to 13% taking into account market expectations at that time. For the 2016 PSP grant the EPS target for threshold vesting is being maintained at 3% above RPI and the EPS target for maximum vesting will be set at 7% above RPI which is in line with the EPS targets set for PSP awards up to 2014. This is consistent with the reduction in market expectations since the 2015 PSP awards were granted. The Remuneration Committee believes strongly that these EPS targets represent a high degree of stretch against the current landscape and headwinds facing the business without encouraging excessive risk.

Together with the Group Chairman, the Group's People Director and the Company Secretary, I consulted with major shareholders and shareholder advisory bodies prior to the Committee's finalisation of the decisions above and received broad support.

The most important challenge for the Committee will be to continue to ensure that the remuneration policy remains appropriately structured to retain and motivate executive directors, whilst providing alignment with shareholders and, most importantly, directly linking to the achievement of the Group's strategy.

I commend this report to shareholders and ask you to support the resolutions to approve the Company's Directors' Remuneration Report, the new Remuneration Policy, which, if passed by shareholders, will apply from the AGM in 2017, and the proposed amendments to the PSP at the AGM in 2017.

Alan K Fletcher

Chairman of the Remuneration Committee

23 November 2016

B5.2 Annual Report on Remuneration

The annual report on remuneration comprises:

- A description of how remuneration policy has been applied in the year (B5.2.1)
- Details of the remuneration of the directors for the year ending 30 September 2016 (B5.2.2)
- Details of remuneration of the directors in the year ending 30 September 2017 (B5.2.3)
- Other disclosures required by the Regulations (B5.2.4)

B5.2.1 Application of policy

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

Consideration by directors of matters relating to directors' remuneration

Remuneration Committee

During the year, the Committee consisted of Alan Fletcher (who chaired the Committee), Fiona Clutterbuck, Peter Hartill and Hugo Tudor, all of whom were independent non-executive directors, and the Chairman of the Company, Robert Dench.

The Board introduced a conflicts policy in 2015 which takes into account the requirements of the UK Code on Corporate Governance in recognising and managing conflicts at remuneration committees. None of the non-executive directors who sit on the Committee has any personal financial interest (other than as a shareholder or debt holder), conflict of interest arising from cross-directorships or day-to-day involvement in running the business. The Chairman of the Company does not participate in discussions on his own remuneration.

The Committee determines the Company's policy on executive remuneration and specific compensation packages for each of the executive directors and the Chairman. No director contributes to any discussion about his own remuneration.

The Committee also reviews the level and structure of remuneration of senior management.

The terms of reference for the Committee, which were revised during the year to better reflect current corporate governance practice, are available on request from the Company Secretary.

In determining the directors' remuneration for the year, the Committee consulted Mr N S Terrington (Chief Executive) and the Group's People Director about its proposals.

Remuneration advisers

The Committee retained the services of New Bridge Street ('NBS'), a brand of Aon Hewitt Limited, as its independent advisor on remuneration matters until February 2016. Deloitte LLP ('Deloitte') became advisors from the 2016 AGM following a review process.

Deloitte is a founder member of the Remuneration Consultants Group and as such voluntarily operates under its Code of Conduct in relation to executive remuneration in the UK. During the year the Chairman of the Committee reviewed the performance of Deloitte, in terms of the quality and independence of advice, the potential for conflicts of interest (which are actively managed within Deloitte) and its knowledge and understanding of market practice. Having reviewed these factors, the Committee chose to continue to retain Deloitte as its adviser in 2017.

The total fees paid to Deloitte for advice to the Remuneration Committee amounted to £68,410.

Deloitte stepped down as the Group's auditors at the AGM in 2016. Deloitte provided other professional services during the year including regulatory and tax advice, co-sourced internal audit services, and advice relating to the Group's structured finance business.

Remuneration policy for the Chairman and executive directors

The Company's policy is to ensure that the executive directors are fairly rewarded for their individual performance, having regard to the importance of retention and motivation. The performance measurement of the executive directors and the determination of their annual remuneration packages are undertaken by the Committee. The Committee also sets the salary for the Chairman, taking account of his performance and time commitment in the role.

In forming and reviewing remuneration policy the Committee has given full consideration to the Code and has complied with its provisions relating to directors' remuneration throughout the year. Moreover, the Committee has given due regard to the link between remuneration and strategy, seeking to ensure that the remuneration structures in place do not encourage excessive risk or activities that are not in line with the agreed strategy. Contractual commitments already made to directors will continue to be honoured as part of this policy.

The remuneration packages of the individual directors are assessed after a review of their individual performances and an assessment of comparable positions in the financial sector and within a group of pan-sectoral comparators comprising a number of FTSE-250 companies with market capitalisations similar to the Company's.

The Committee pays due regard to the levels of remuneration within the Group when determining the remuneration of executive directors and other senior employees. It also seeks to ensure that the incentive structure for directors and senior management does not raise environmental, social or governance risks by inadvertently motivating irresponsible behaviour.

Bank remuneration

Paragon Bank PLC has its own remuneration committee, reporting to the Bank's board of directors, which considers remuneration policy across the Bank including the application of the PRA's Remuneration Code ('Remuneration Code') which governs the compensation of senior personnel in the banking sector, referred to as 'Remuneration Code Staff'. The Bank's remuneration committee ensures that Paragon Bank complies with the Remuneration Code on an ongoing basis in respect of those employees. The Committee reviews the work undertaken by the Bank's remuneration committee through regular reports submitted to it.

At the 2015 Annual General Meeting, shareholders were asked to approve a limit of 200% on the ratio of fixed to variable components of total remuneration for individuals classified as Material Risk Takers (as defined in the Remuneration Part of the PRA Rulebook) and employed by Paragon Bank PLC.

In February 2016, the PRA and the Financial Conduct Authority confirmed in a joint statement that this requirement would not be imposed on smaller firms. As a result, Paragon Bank PLC is not required to impose a limit on variable remuneration for regulatory reasons.

The Group has therefore decided to seek shareholder approval at the 2017 AGM to remove the specific limit on variable pay. The Group wishes to be aligned with the prevailing regulatory environment and to have the flexibility in its remuneration arrangements to be able to respond to future developments. It is not currently proposing to make any changes to variable pay opportunity for Material Risk Takers, or for the Company's executive directors.

B5.2.2 Directors' remuneration for the year ended 30 September 2016

The information provided in this section has been audited

Single total figure of remuneration for each director

The following tables have been prepared using the measures prescribed by The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

Year ended 30 September 2016

	Fixed remuneration				Variable remuneration				Total
	Salaries and fees	Allowances and benefits	Pension allowance	Pension accrual	Cash bonus	Deferred bonus	Dividend on vested deferred bonus	Share awards	£000
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Chairman									
R G Dench	240	16	-	-	-	-	-	-	256
Executive directors									
N S Terrington	463	14	176	78	533	161	20	417	1,862
R J Woodman	291	12	145	9	340	97	15	222	1,131
J A Heron	247	12	94	44	244	64	7	222	934
Non-executive directors									
A K Fletcher	70	-	-	-	-	-	-	-	70
P J N Hartill	70	-	-	-	-	-	-	-	70
F J Clutterbuck	90	-	-	-	-	-	-	-	90
H R Tudor	50	-	-	-	-	-	-	-	50
Total	1,521	54	415	131	1,117	322	42	861	4,463

Year ended 30 September 2015

	Fixed remuneration				Variable remuneration				Total
	Salaries and fees	Allowances and benefits	Pension allowance	Pension accrual	Cash bonus	Deferred bonus	Dividend on vested deferred bonus	Share awards	
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Chairman									
R G Dench	211	12	-	-	-	-	-	-	223
Executive directors									
N S Terrington	452	14	172	29	691	214	20	954	2,546
R J Woodman	285	12	133	14	440	130	8	508	1,530
J A Heron	241	12	92	16	284	78	7	508	1,238
Non-executive directors									
A K Fletcher	70	-	-	-	-	-	-	-	70
P J N Hartill	70	-	-	-	-	-	-	-	70
F J Clutterbuck	75	-	-	-	-	-	-	-	75
H R Tudor	43	-	-	-	-	-	-	-	43
E A Tilly	53	-	-	-	-	-	-	-	53
Total	1,500	50	397	59	1,415	422	35	1,970	5,848

Mr H R Tudor was appointed to the Board on 24 November 2014. Ms F J Clutterbuck was appointed as Senior Independent Director on 1 July 2015. Mr E A Tilly resigned from the Board on 1 July 2015.

In addition to fees earned as a non-executive director, Mr A K Fletcher serves as a director of the Corporate Trustee of The Paragon Pension Plan (the 'Plan') and receives £10,000 per annum in respect of that appointment from Paragon Finance PLC, the sponsoring company of the Plan and a subsidiary of the Company. The Plan is a trust which is independent of the Company and, as a director of its corporate trustee, Mr Fletcher has a fiduciary duty to act in the best interests of the trust and the Plan's beneficiaries.

Allowances and benefits include private health cover, fuel benefit and company car provision. The company car allowance paid to executive directors and the Chairman (£10,000 - £12,000) is also included in allowances and benefits.

In accordance with the Regulations, the amounts shown in respect of pension accrual have been calculated by applying a factor of 20 to the increase in accrued pension, after adjusting for inflation.

In the single total figure of remuneration for the year ended 30 September 2016, the share award values are calculated by multiplying the number of shares expected to vest by the average share price over the last quarter of the year ended September 2016 (290.48 pence). In accordance with the rules of the PSP, participants are entitled on exercise to additional value equal to the dividends that would have been paid on vested shares in respect of dividend record dates between the grant date and vesting date. Accordingly, the share award values also include 29.1 pence per vested share in respect of dividend record dates between 10 December 2013 and 10 December 2016.

In the single total figure of remuneration for the year ended 30 September 2015, the share awards value has been restated to reflect the value of awards under the PSP that vested in respect of performance conditions with performance periods ending in that year, being the awards granted on 28 February 2013 which vested on 28 February 2016. The share award values are calculated by multiplying the number of vested shares by the share price on 28 February 2016 (308.7 pence). In accordance with the rules of the PSP, participants are entitled on exercise to additional value equal to the dividends that would have been paid on vested shares in respect of dividend record dates between the grant date and vesting date. Accordingly, the share award values also include 27.2 pence per vested share in respect of dividend record dates between 28 February 2013 and 28 February 2016.

Dividend on vested bonus is the accrued dividends to vesting paid on deferred bonuses which were exercised during the year.

The link between pay and performance

Annual bonus for the year ended 30 September 2016

The annual bonus for the year under review was based on performance against financial and risk measures; performance against each of these measures is then subject to individual scale factors according to performance against personal strategic objectives. The performance for the year, and the resulting accrual levels, were as follows:

	Measure	Weighting	Outcome	Award level*
Financial performance	Adjusted operating profit	33.33%	£146.9m	17%
Future value of new business	Projected profits from lending and investment activities in the year and projected residual cash flow from acquired portfolios	33.33%	Buy-to-let lending £1,161.0m	21%
			Debt purchase investments £208.8 m	
			Consumer lending £124.7m	
			PBAF and Premier acquired asset finance lending £144.3m	
Risk	The business having operated within the key risk tolerance levels agreed by the Board	33.33%	See below	24%
Totals		100.00%	Bonus achieved for 2016	62%

*Of maximum under scheme, subject to individual performance scale factors of 0.5 to 1.5 times.

Financial performance

Operating profit for the year was in line with the target level of £147.0 million and exceeded the consensus at 30 September 2016 of £146.2 million. Cash generation from both the originated and acquired portfolios was also strong. Tight control was maintained over costs, with the underlying cost:income ratio remaining broadly stable in the year.

Future value

Following the changes to stamp duty announced in the 2015 Autumn Statement, the Group's buy-to-let volume target for 2016 was adjusted to £1,268 million. In anticipation of regulatory changes to underwriting the Group tightened criteria in January 2016 and increasingly focused new business activities at the more complex end of the buy-to-let market, evidenced by the increased proportion of complex cases from 48% in September 2015 to 63% in September 2016. Despite absolute volume levels being 8.5% below the target level at £1,161 million, the margins are stronger in this part of the market, with the Group's embedded value analysis suggesting the second half of 2016's originations delivered an uplift of 6% over the average 2015 level, a position also reflected in the year end pipeline.

Debt purchase investments significantly exceeded the target of £100 million, at £208.8 million. Within this figure, £184.8 million was completed in Paragon Bank.

Organic car finance, development finance and secured lending advances grew by 126.4% from their 2015 level at £133.8 million, however this undershot the target for the division of £174.5 million.

The asset finance business acquired in November 2015 outperformed its plan, delivering £144.3 million of new business compared to the original plan of £131.9 million, despite the integration, re-branding and system development activities being undertaken in the post-acquisition period.

Risk

During the year the Group has operated within the risk tolerance levels set by the Board for capital ratios, liquidity positions, new business and operational and regulatory risk. It has also further developed its plans to mitigate longer-term strategic risk. Complaint levels in the year were below comparable industry levels.

We have provided target performance numbers for the financial elements of the bonus. Full disclosure of the threshold and maximum ranges will be provided for the bonus earned for the year ended 30 September 2016 in the Annual Report on Remuneration for the year ending 30 September 2017 which will be when it is anticipated that this information is no longer considered commercially sensitive.

The final level of each executive director's bonus is adjusted to reflect personal performance against strategic objectives related to each of the elements. These individual performance scale factors are between 0.5 and 1.5 times, according to performance. The Committee's assessment of performance and delivery on objectives is noted in the Chairman's letter and the objectives for the year ended 30 September 2016 are detailed below:

For N S Terrington, R J Woodman and J A Heron:

- To deliver strategic leadership working within the parameters of the Group's risk appetite. To deliver the planned financial performance for the year, whilst ensuring fair outcomes for customers, future profit streams and positioning the Group to meet its longer term strategic goals. To ensure the business as a whole meets all risk, compliance and regulatory changes

Additionally for R J Woodman

- To deliver operational improvements from regulatory and accounting changes to the Group; specifically, IRB and IFRS 9

Additionally for J A Heron

- In respect of the Paragon Mortgages division to:
 - achieve its target operating profit
 - achieve its target new origination volume at agreed return levels
 - improve application conversion rates and cost per application levels
 - manage resource levels to meet immediate and longer term strategic requirements
 - ensure the mortgage business operates within the key risk tolerance levels agreed by the Board
 - facilitate Paragon Bank buy-to-let lending originations
 - develop the product range
 - maintain a balanced and sustainable distribution profile
- Lead a strategic review of the acquired Asset Finance business

Performance against the objectives is assessed by the Committee at the end of the year (with input from the Chief Executive as appropriate). Each objective is scored from 0 to 4, with target scale factor being for a score of 2, equating to a scale factor of 1.0 times, as set out in the table below:

Scale factor	Average score	Performance
0.50	0	Poor
0.75	1	Below target
1.00	2	Target
1.25	3	Above target
1.50	4	Exceptionally good

The Committee, having considered individual performance against the objectives set at the beginning of the year, has agreed the following scale factors for the year ended 30 September 2016:

N S Terrington	1.2
R J Woodman	1.2
J A Heron	1.0

The resulting bonuses for 2016, after applying the scale factors to the award levels, were as follows:

Executive	Financial performance (max 33%)	Future value of new business (max 33%)	Risk (max 33%)	Scale factor times	Total (percentage of max capped at 100%)	Total £000	Cash £000	Share value £000
N S Terrington	17%	21%	24%	1.2	75.0%	694	533	161
R J Woodman	17%	21%	24%	1.2	75.0%	437	340	97
J A Heron	17%	21%	24%	1.0	62.5%	308	244	64

The maximum bonus entitlement is 200% of salary for the period.

25% of amounts awarded in excess of £50,000 are deferred, to be payable in shares after three years, net of any clawback applied (see below). No further performance conditions apply to the deferred shares.

The Committee is satisfied that the level of bonus earned by each director reflects both the performance of the individual and the Group during the year.

Directors' pensions

The total amount charged to the profit and loss account of the Group in respect of pension provision for directors was £414,000 (2015: £397,000).

Mr N S Terrington, Mr R J Woodman and Mr J A Heron were members of the Group defined benefit pension plan during the year. Their entitlements under the Plan are shown below.

Director	Description of entitlement	Accumulated total accrued annual pension at 30 September	
		2016 £000	2015 £000
N S Terrington	Entitled to 1/48.375th of final salary per year of service, payable from age 60. May take reduced early retirement from age 55. Ceased pension accrual on 6 April 2006 but retains final salary linkage.	178	174
R J Woodman	Entitled to 1/46.625th of final salary per year of service, payable from age 60. May take reduced early retirement from age 55. Ceased pension accrual on 9 October 2007 and opted out of final salary linkage from 1 April 2011.	62	61
J A Heron	Entitled to 1/49.125th of final salary per year of service, payable from age 60. May take reduced early retirement from age 55. Ceased pension accrual on 6 April 2006 but retains final salary linkage.	100	98

The pension accrual figure included in the single total figure of remuneration table represents the increase in the accrued pension, excluding the effect of CPI inflation, during the year multiplied by 20, in accordance with the methodology set out in the Regulations.

The entitlements shown above represent the weighted average of service years for which accrual was earned at 1/60 of final salary and those for which accrual was earned at 1/37.5.

The executive directors have each ceased pension accrual, as shown in the table above. This was in return for a cash supplement calculated to equate to the cost of the Company's contributions towards future service benefits had each individual stayed within the Plan for his future service accrual. These contributions in respect of further pension provision for each of the directors are shown as 'pension allowance' in the single total figure of remuneration table.

Share-based awards

Paragon Performance Share Plan

Vesting:

Awards granted in December 2013 under the Group's PSP which will vest in December 2016 are subject to performance conditions measured over three financial years ended 30 September 2016, with 50% based on comparing the Group's relative TSR performance against a comparator group of companies comprising the constituents of the FTSE-250 and 50% based on assessment against EPS growth targets. The vesting percentage will be reviewed by the Committee against a financial underpin. The Company was ranked below median for the TSR element, which will therefore not vest. EPS targets required growth to exceed RPI plus 7% over each of the three financial years for the full amount to vest and this has been achieved. Consequently, 50% of the awards will vest, subject to the Committee determining, prior to vesting, that such level of vesting is consistent with the Company's financial performance.

Grants:

The awards granted in December 2015 were calculated so as to have a face value of 200% of salary, using the average closing mid-market price of the Company's shares on each of the five dealing days up to and including the day before the grant date (£3.5634). Therefore, the face value of the awards granted during the year were £926,000 for Mr Terrington, £583,000 for Mr Woodman and £494,000 for Mr Heron.

Entitlements:

Details of individual entitlements of the directors under the PSP at 30 September 2015, and 30 September 2016 are:

Award date	Date from which exercisable	Expiry date	Market price at award date	N S	R J	J A Heron
				Terrington	Woodman	
				Number	Number	Number
<i>Awards outstanding at 30 September 2015</i>						
21/05/2009	21/05/2012	20/05/2019	70.00p	-	385,714	-
17/12/2010	17/12/2013	16/12/2020	182.00p	-	205,886	-
21/12/2011	21/12/2014§	20/12/2021	176.90p	299,083	219,943	-
28/02/2013	28/02/2016‡	27/02/2023	321.20p	278,757	148,595	148,595
10/12/2013	10/12/2016‡	09/12/2023	345.30p	260,838	139,051	139,051
18/12/2014	18/12/2017‡	17/12/2024	409.60p	228,766	144,085	121,967
				1,067,444	1,243,274	409,613
<i>Awards made in the year:</i>						
22/12/2015	22/12/2018‡	21/12/2025	362.70p	259,944	163,708	138,596
<i>Awards exercised in the year:</i>						
				-	-	-
<i>Awards lapsing in the year:</i>						
10/12/2013	10/12/2016‡	09/12/2023	345.30p	(130,419)	(69,525)	(69,525)
At 30 September 2016				1,196,969	1,337,457	478,684

§ These awards were subject to a performance condition comparing the rank of the Company's TSR against a comparator group of companies comprising the constituents of the FTSE-250, on the date of grant over the three years commencing on the date of grant. 25% of the awards would vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance.

‡ 50% of these awards are subject to the TSR test, as above, and 50% are subject to an EPS test. The EPS test provides that 25% of EPS tested awards will vest where EPS growth is equal to the increase in the retail price index plus a lower threshold, increasing on a straight line basis to full vesting for EPS growth equal to the increase in the retail price index plus an upper threshold or more.

For awards granted between February 2013 and December 2014 the lower threshold was 3% and the upper threshold 7%. For awards granted in December 2015 the lower threshold was 3% and the upper threshold was 13%. In each case the testing period is the three financial years commencing with the year of grant.

Sharesave Plan

Awards made under the Sharesave Plan are granted to directors on the same terms which are available to employees in general. Details of individual options held by the directors at 30 September 2015 and 30 September 2016 are:

Award date	Date from which exercisable	Expiry date	Option price	N S	R J	J A Heron
				Terrington	Woodman	
				Number	Number	Number
<i>Awards outstanding at 30 September 2015</i>						
11/06/2015	01/08/2018	01/02/2019	345.68p	-	-	5,207
11/06/2015	01/08/2020	01/02/2021	345.68p	8,678	8,678	-
				8,678	8,678	5,207
<i>Awards made in the year:</i>						
20/06/2016	01/08/2019	01/02/2020	249.44p	-	-	7,216
20/06/2016	01/08/2021	01/02/2022	249.44p	12,026	12,026	-
<i>Awards exercised in the year:</i>						
				-	-	-
<i>Awards lapsing in the year:</i>						
11/06/2015	01/08/2018	01/02/2019	345.68p	-	-	(5,207)
11/06/2015	01/08/2020	01/02/2021	345.68p	(8,678)	(8,678)	-
At 30 September 2016				12,026	12,026	7,216

Deferred Bonus Shares

Details of individual entitlements of the directors under the Paragon Deferred Share Bonus Plan ('DSBP') at 30 September 2015 and 30 September 2016 are:

Award date	Date from which exercisable	Expiry date	Market price at award date	N S	R J	J A Heron
				Terrington	Woodman	Number
<i>Awards outstanding at 30 September 2015</i>						
23/11/2012	01/10/2015	22/11/2016	248.40p	83,297	62,003	27,977
10/12/2013	10/12/2016	09/12/2023	345.30p	55,302	36,906	24,258
18/12/2014	18/12/2017	17/12/2024	409.60p	52,888	26,965	19,249
				191,487	125,874	71,484
<i>Awards made in the year:</i>						
22/12/2015	22/12/2018	21/12/2025	362.70p	60,042	36,517	21,901
<i>Awards exercised in the year:</i>						
<i>On 27 November 2015</i>						
23/11/2012	01/10/2015	22/11/2016	248.40p	-	(20,000)	-
<i>On 30 June 2016</i>						
23/11/2012	01/10/2015	22/11/2016	248.40p	(83,297)	(42,003)	(27,977)
<i>Awards lapsing in the year:</i>						
				-	-	-
At 30 September 2016				168,232	100,388	65,408

The face value of the awards granted during the year (being the number of shares in each case multiplied by £3.5634, that being the average of the closing prices of the Company's shares at the end of each of the five dealing days ending on the day before the grant date) were £214,000 for Mr Terrington, £130,000 for Mr Woodman and £78,000 for Mr Heron.

Rights to further shares under the DSBP are due to be granted in respect of the compulsory deferral of performance bonuses for the year ended 30 September 2016, shown in the single total figure of remuneration table above. The number of shares to be awarded will be determined based on the average market price of the Company's shares on the five dealing days before the awards are granted. The shares, less any clawback, which can be applied by the Remuneration Committee in certain circumstances, will be exercisable by the recipients from the third anniversary of the grant date, subject, in normal circumstances, to the recipient being employed by the Company at that time.

Directors' share ownership

Directors' interests in shares

The interests of the executive directors in the shares of the Company at 30 September 2016 were:

	N S Terrington Number	R J Woodman Number	J A Heron Number
Unvested awards subject to vesting conditions			
PSP	749,548	446,844	399,614
Sharesave	12,026	12,026	7,216
	761,574	458,870	406,830
Unvested awards not subject to vesting conditions			
DSBP	168,232	100,388	65,408
Total unvested awards	929,806	559,258	472,238
Vested awards			
PSP	577,840	960,138	148,595
DSBP	-	-	-
Total vested awards	577,840	960,138	148,595
Total outstanding awards	1,507,646	1,519,396	620,833
Shares beneficially held	781,269	151,051	267,507
Total interest in shares	2,288,915	1,670,447	888,340
Awards exercised in the year			
PSP	-	-	-
DSBP	83,297	62,003	27,977
	83,297	62,003	27,977

The interests of the Chairman and the non-executive directors at 30 September 2016, which consist entirely of ordinary shares, beneficially held, were as follows:

	Number
R G Dench	73,728
A K Fletcher	119,993
P J N Hartill	7,000
F J Clutterbuck	8,372
H R Tudor	460,000

Share ownership guidelines

All executive directors are encouraged to hold a minimum number of shares in the Company with a value of 200% of their salary, calculated at 31 December each year on the basis of the average price of the Company's shares over a rolling three-year period. For new appointments the guideline was 100% of salary by the fifth anniversary of their appointment, increasing to 200% by the seventh anniversary. The number, net of income tax and national insurance, of vested but unexercised shares granted under the DSBP and under the PSP count towards the aggregate shares held by each director in respect of the policy.

Guideline holdings and the actual shares held at 30 September 2016 are set out below:

	N S Terrington	R J Woodman		J A Heron
	200%	100%	200%	200%
Salary (£)	462,700	291,400	291,400	246,700
Average share price (p)†	373.01	373.01	373.01	373.01
Guideline holding (shares)	248,092	78,122	156,244	132,277
Beneficially owned shareholding	831,269	151,051		267,507
Vested PSP (net of tax)	306,255	508,873		78,755
Deferred Bonus Plan (net of tax)	-	-		-
Calculated holding at 30 September 2016	1,137,524	659,924		346,262
Surplus as a percentage of guidance	359%	745%	322%	162%

† average share price over a rolling three-year period.

At 30 September 2016, all of the executive directors' holdings were in accordance with guideline levels.

From 1 October 2016 onwards the Committee has amended its guidelines so that all directors, whenever appointed, are required to hold shares to a value of 200% of their salary and will be required to retain 50% (net) of a vested PSP or DSBP award until that level is reached. The guidelines applying from 1 October 2016 are set out in the Directors' Remuneration Policy in section B5.3.

The Committee has decided, for the present, not to mandate that executive directors hold awards granted under the PSP for an additional period after the vesting date given the level of personal shareholdings of the current executive directors and their commitment to the Company over many years. For new external appointments the Committee has introduced a holding period to encourage share participation applied to the PSP awards.

B5.2.3 Application of remuneration policy for the year ending 30 September 2017

The information provided in this section of the Directors' Remuneration Report is not subject to audit

Salary

The Chairman's fee and executive directors' salaries are determined by the Committee immediately prior to the start of each financial year. In deciding appropriate levels, the Committee considers remuneration levels within the Group as a whole, individual and business performance during the year and remuneration in comparable FTSE-250 companies.

The current Chairman's fee and the salaries of the executive directors with effect from 1 October 2016 are as follows:

Position	Director	Fee / salary with effect from	
		1 October 2016	1 October 2015
		£	£
Chairman	R G Dench	240,000	240,000
Chief Executive	N S Terrington	474,270	462,700
Group Finance Director	R J Woodman	298,685	291,400
Director - Mortgages	J A Heron	252,870	246,700

The Committee agreed that the salaries of Mr N S Terrington, Mr R J Woodman and Mr J A Heron would be increased by 2.5% from 1 October 2016. This is in line with the level of increases for the Group's wider workforce.

The non-executive directors' fees have been benchmarked against the wider market during the year and it was agreed that the present levels were appropriate. Consequently, from 1 October 2016 the fees remain as follows:

- Base fee £50,000 (2015: £50,000)
- Additional fee for Senior Independent Director £20,000 (2015: £20,000)
- Additional fee for chairmen of committees £20,000 (2015: £20,000)

The additional fee for chairmen of committees is currently payable to the Chairmen of the Remuneration, Audit and Risk and Compliance Committees, but would be payable for the chairmanship of such additional Committees as might be authorised by the Board.

The Company's Articles of Association include a limit on the total aggregate fees that can be paid to non-executive directors. The present limit of £400,000 was approved by the shareholders at the 2014 Annual General Meeting.

Pension contributions

There will be no change to the operation of the pension policy for the executive directors in the year ending 30 September 2017. However, the Committee will review the level of these benefits during the year.

Benefits

There will be no change to the benefit provision for the directors.

Performance bonuses

For the year ending 30 September 2017, the annual bonus will be based on performance against the following performance measures: (1) operational profit, (2) future value of new business and (3) risk, each with equal weightings together with each director's performance against strategic and personal objectives, which will determine the level of a scale factor to be applied of between 0.5 and 1.5 times.

The Committee has chosen not to disclose, in advance, the performance targets for the forthcoming year as these are felt to be commercially sensitive. Retrospective disclosure of the targets and performance against them will be set out in next year's Annual Report on Remuneration except to the extent that any measure/target remains commercially sensitive.

For the avoidance of doubt, there will be no change to the maximum potential bonus and executive directors will be required to defer 25% of amounts awarded in excess of £50,000 in shares. The Committee may require higher levels of deferment or the executive may elect to defer a greater proportion.

Share awards

For PSP awards in the year ending 30 September 2017, 50% of any award will be subject to a TSR test and 50% subject to a combination of EPS and risk based metrics.

The TSR test compares the rank of the Company's TSR against a comparator group of companies. Due to a lack of comparable companies over recent years, the Committee has used the FTSE-250 index as the comparator group since 2011, however, for awards to be made in respect of the year ending 30 September 2017, TSR will be compared against a group of specific companies in the financial services sector as the Committee considers that this is the best measure of performance. 25% of awards vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance. The comparator companies are as follows:

Aldermore Group PLC, Arrow Global Group PLC, Barclays PLC, Close Brothers Group PLC, CYBG PLC, Lloyds Banking Group PLC, Metro Bank PLC, OneSavings Bank PLC, Provident Financial PLC, Royal Bank of Scotland Group PLC, Secure Trust Bank PLC, Shawbrook Group PLC and Virgin Money Holdings (UK) PLC.

The EPS test will account for 25% of the overall PSP award and provides that 25% of EPS tested awards will vest where annual EPS growth is equal to the increase in the retail price index plus 3%, increasing on a straight line basis to full vesting for annual EPS growth equal to the increase in the retail price index plus 7% or more.

The risk element will account for 25% of the overall PSP award and will be based on a number of risk and compliance factors which will be taken into consideration by the Committee at the time of vesting. This will include assessing evidence of wider risk management performance and the application of a strong risk culture across the Group, taking into account the business's risk tolerance levels. Included will be broad risk appetite metrics, material regulatory breaches, customer service, management of liquidity and capital risk, credit losses against risk appetite and other material risk events over the performance period. Disclosure of the assessment against performance of the risk element will be made in the Annual Report on Remuneration when the awards vest.

In addition, prior to any awards vesting under any element, the Committee must be satisfied that the requirements of a financial underpin test have been met.

As described in the Notice of Annual General Meeting, we are proposing, subject to shareholder approval, to make minor administrative amendments to the Performance Share Plan in accordance with which the number of shares subject to the awards will ordinarily be determined by reference to the share price following the announcement of the 2016 results and the awards will vest following the assessment of the performance conditions. For the avoidance of doubt, no change is proposed to the award quantum for executive directors.

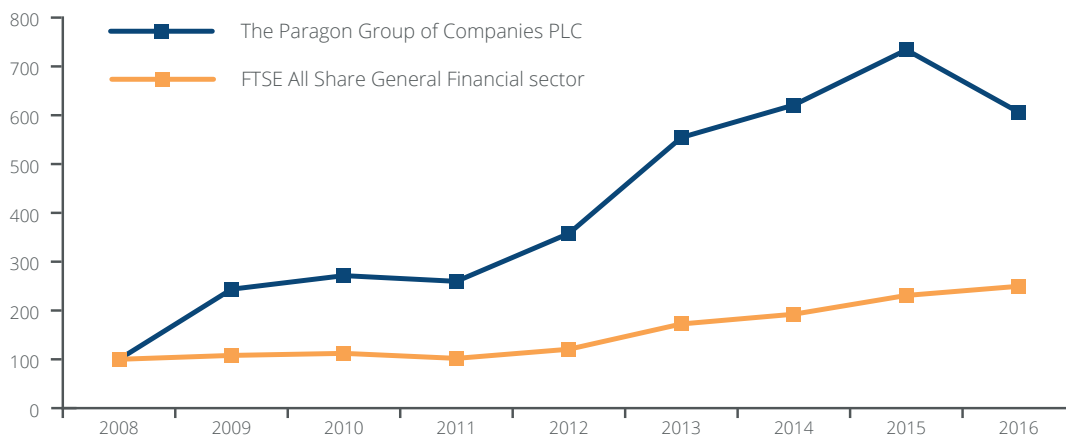
B5.2.4 Other information

The information provided in this section of the Directors' Remuneration Report is not subject to audit

Performance graph and table

The following graph shows the Company's TSR performance compared with the performance of the FTSE All Share General Financial sector index. The General Financial sector has been selected for this comparison because it is the sub-sector index that contains the Company's shares.

Eight Year Return Index for the FTSE All Share Financial sector
as at 30 September 2016



This graph shows the value, by 30 September 2016, of £100 invested in The Paragon Group of Companies PLC on 30 September 2008, compared with £100 invested in the FTSE General Financial sector index. The other points plotted are the values at the intervening financial year ends.

Remuneration of the Chief Executive

Historic data

The following table shows the total remuneration, as defined by the Regulations, and the amount vesting under short-term and long-term incentives as a percentage of the maximum that could have been achieved, in respect of Mr Terrington, the Chief Executive.

Year	Single figure of total remuneration	Annual bonus against maximum opportunity	Long-term incentive rates against maximum opportunity
	£000	%	%
2016	1,862	75.0	50.0
2015	2,546	100.0	100.0
2014	3,113	100.0	100.0
2013	2,655	85.0	100.0
2012	2,565	87.5	100.0
2011	2,382	87.5	58.6 and 85.1
2010	1,209	75.0	58.6
2009	932	50.0	-

Percentage change

The following table shows the change in certain aspects of the remuneration of Mr Terrington:

Component	2016	2015	Change
	£000	£000	%
Salary	463	452	2.4%
Benefits	14	14	-
Bonus	694	905	(23.3)%

The Group's pay review taking effect on 1 October 2015 awarded average percentage increases in wages and salaries to employees as a whole of 2.25%.

The nature and level of benefits available to employees in the year ended 30 September 2016 was broadly similar to that in the previous year.

The total amount of bonus paid to employees, excluding the directors in respect of the year ended 30 September 2016 was 6.0% higher than in 2015, while the amount of profit related pay distributed to employees other than directors and heads of function decreased by 1.3% between the two years due to the increase in overall headcount.

Relative importance of spend on pay

The Regulations require an illustration of the significance of the Group's expenditure on pay in the context of its operations. Set out below is a summary of the Group's levels of expenditure on pay and other significant cash outflows.

	<i>Note</i>	2016	2015	Change
		£m	£m	£m
Wages and salaries	18	47.8	35.9	11.9
Dividend paid	50	33.9	29.1	4.8
Loan advances and investment in portfolios		1,633.2	1,490.0	143.2
Corporation tax paid	61	23.6	22.6	1.0

Loan advances and investment in portfolios is shown above as this is the principal application of cash used to generate income for the Group. Corporation tax is contributed out of profit to the UK Government.

Current service contracts and terms of engagement

Chairman and executive directors

The current service contracts for the Chairman and executive directors are dated as follows:

- R G Dench - 8 February 2007 (amended 27 April 2015)
- N S Terrington - 1 September 1990 (amended 7 January 1993, 16 February 1993, 30 October 2001 and 10 March 2010)
- R J Woodman - 8 February 1996 (amended 10 March 2010)
- J A Heron - 1 September 1990 (amended 14 January 1993, 8 February 1993 and 10 March 2010)

Of the directors seeking re-election at the Annual General Meeting, Mr Dench, Mr Terrington, Mr Woodman and Mr Heron each has a service contract with the Company.

Executive directors may accept an external non-executive appointment with the approval of the Board. Any fees earned are retained by the executive. None of the executive directors currently earns remuneration from external non-executive appointments.

Non-executive directors

Current terms of engagement for the non-executive directors apply for the following periods:

A K Fletcher	-	25 February 2015 to 24 February 2018
P J N Hartill	-	11 February 2014 to 10 February 2017
F J Clutterbuck	-	12 September 2015 to 11 September 2018
H R Tudor	-	24 November 2014 to 23 November 2017

Non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company upon three months' notice.

Consultations with shareholders and AGM voting

At the AGM held on 11 February 2016, all resolutions were passed on a show of hands. Proxy votes lodged in respect of directors' remuneration were as follows:

Resolution	Votes for	% for	Votes against	% against	Discretion	Total votes cast	Votes withheld
Adopt remuneration report	188,944,432	98.2	3,419,635	1.8	36,188	192,400,255	1,504,128

At the AGM held on 6 February 2014, all resolutions were passed on a show of hands. Proxy votes lodged in respect of the remuneration policy were as follows:

Resolution	Votes for	% for	Votes against	% against	Discretion	Total votes cast	Votes withheld
Approve remuneration policy	198,421,454	94.6	11,266,393	5.4	55,906	209,743,753	7,498,568

Annual meetings take place between the Chairman of the Committee and the Chairman of the Company and major shareholders and their representative bodies. The views expressed in these meetings help the Committee in determining how to implement the Company's remuneration policy.

B5.3 Policy Report

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

Introduction

This part of the Directors' Remuneration Report sets out the directors' remuneration policy that it is proposed to apply from the close of the Annual General Meeting to be held on 9 February 2017. The policy, once approved, will apply until the Annual General Meeting in 2020, unless revised by a vote of shareholders ahead of that time.

Summary of proposed changes

The Company's directors' remuneration policy was first approved at the 2014 AGM with over 94% votes in favour, and took effect from the date of that meeting.

No significant changes have been made to the policy approved at the 2014 AGM. However, certain minor amendments have been made to simplify the policy, aid administration and take account of how it has been operated. In summary, the changes made to the proposed policy as compared to the policy approved at the 2014 AGM are as follows:

- The Matching Share Plan no longer forms part of the policy as there are no outstanding awards held by executive directors and no further awards will be made under the MSP to executive directors
- Reflecting best practice, we have formally incorporated our shareholding guidelines and the clawback provisions for the cash element of any bonus into the policy
- A maximum defined contribution (or cash equivalent) pension contribution for any new executive director appointed from outside the business has been set at up to 25% of salary. This level of contribution will only be used in exceptional circumstances with the usual contribution level expected to be in the range of 10-15%
- We have introduced an ability to grant tax qualifying PSP awards to provide potential savings for the Company and executives without increasing the pre-tax PSP opportunity
- Reflecting best practice, we have committed that dividend equivalents on DSBP awards will only be earned up to vesting in respect of the deferred share element of bonuses earned for the financial year ended 30 September 2016 and future years. Dividend equivalents may be paid up to exercise in respect of the deferred element of the bonuses in respect of the financial years ended 30 September 2013, 30 September 2014 and 30 September 2015; and
- Subject to shareholder approval at the AGM, to make minor administrative amendments to the PSP as described in the Notice of AGM

This policy report sets out policies in respect of:

- Remuneration for executive directors
- Remuneration of the Chairman and non-executive directors
- Choice of performance measures and target setting
- Recruitment and conditions of service
- Consideration of employment conditions elsewhere in the Group
- Consideration of shareholders' views; and
- Legacy arrangements

Elements of the remuneration policy for executive directors

The executive directors receive a combination of fixed and performance-related elements of remuneration. Fixed remuneration consists of salary, benefits and pension scheme contributions or alternative retirement benefit provision. Performance-related remuneration consists of participation in the annual bonus plan and the award of shares under the PSP. The performance-related elements of remuneration are intended to provide a significant proportion of executive directors' potential total remuneration.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Base salary			
<p>To provide a competitive, fixed cash component that reflects the scope of individual responsibilities and recognises sustained individual performance in the role.</p>	<p>Remunerate fairly for individual performance, having regard to the importance of motivation.</p> <p>Base salaries are typically reviewed annually, taking into account remuneration levels in the Group as a whole, individual and business performance and objective research into comparable companies.</p>	<p>While there is no maximum salary, if the Committee is satisfied with the individual's performance increases will normally broadly follow those awarded for the rest of the organisation, in percentage of salary terms.</p> <p>Increases above the level awarded for the rest of the organisation may be awarded in appropriate circumstances which may include, but are not limited to:</p> <ul style="list-style-type: none"> • Changes in the scope or responsibilities of a director's role • Development or performance in role • A change in the size and/or complexity of the business; and • Change in market practice or a director's salary substantially falling behind a market competitive rate 	<p>None.</p>

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Benefits			
To provide market levels of benefits on a cost-effective basis.	<p>Private health cover for the executive and their family, life insurance cover of up to seven times salary and company car or cash alternative.</p> <p>Other benefits may be offered from time to time taking into account individual circumstances.</p>	<p>Private health care benefits are provided through third party providers and therefore the cost to the company and the value to the director may vary from year-to-year</p> <p>Whilst no absolute maximum level of benefits has been set, it is intended the maximum value of benefits offered will remain broadly in line with market practice.</p>	None.
Retirement benefits			
To provide competitive post-retirement benefits (or an appropriate cash allowance).	<p>1/37.5 of basic annual salary for each year of eligible service.</p> <p>A cash alternative is offered in lieu of pension accrual, equating to the approximate cost to the Company of defined benefit provision, normally reviewed every five years.</p> <p>For new external appointments a cash allowance or company pension contribution may be awarded.</p>	<p>Maximum pension 2/3 of salary at retirement or the value of the annual cash alternative calculated by the Company's actuary.</p> <p>The maximum pension contribution (or cash allowance) for new external appointments will be up to 25% of salary.</p>	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Annual bonus			
<p>To incentivise executives to achieve specific, predetermined goals that drive delivery of the Company's operational objectives.</p> <p>To reward individual performance.</p> <p>To encourage retention and alignment with shareholders' interests through a three-year deferral of a proportion of bonus, awarded in shares.</p>	<p>Each executive director's annual bonus is based on a challenging mix of performance measures.</p> <p>25% of amounts awarded in excess of £50,000 are deferred under the DSBP, to be satisfied in shares, for three years. Higher levels of deferment may be required by the Committee or, with the approval of the Committee, may be elected for by the director. The Committee retains discretion to pay the whole of the bonus in cash in circumstances where the amount to be deferred would, in the opinion of the Committee, be so small as to make operation of the DSBP unduly administratively burdensome.</p> <p>Awards under the DSBP can take the form of a nil-cost option with a ten-year life, a conditional award of shares or an award of forfeitable shares.</p> <p>Awards may include the right to receive a benefit of a value determined by reference to dividends that would have been paid on shares in respect of dividend record dates between grant and, except as described in the 'legacy arrangements' section of this policy, vesting. The benefit may assume the reinvestment of dividends and may be delivered in shares or in cash.</p> <p>The annual bonus is non-pensionable. 'Malus' and 'clawback' apply to the annual bonus as described in the notes to this table.</p>	<p>Maximum annual bonus potential is 200% of salary.</p> <p>For target performance a bonus of 100% of salary will be awarded, with additional amounts being awarded for exceptional performance.</p> <p>If a bonus is awarded the minimum that could be paid is 8.25% of salary.</p> <p>For performance below threshold, no bonus is payable.</p>	<p>The performance targets are set by the Committee at the start of the year with input, as appropriate, from the Chairman and Chief Executive.</p> <p>Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance.</p> <p>The bonus is calculated as follows:</p> <ul style="list-style-type: none"> performance against a range of measures, with at least 50% relating to financial metrics and any balance reflecting risk-related measures; and each element is then subject to a scale factor that can reduce or increase the bonus (subject to the overall cap of 200% of salary) according to performance against personal and strategic objectives.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Performance Share Plan ('PSP')			
<p>To incentivise executives to achieve enhanced returns for shareholders.</p> <p>To encourage long-term retention of key executives.</p> <p>To align the interests of executives and shareholders.</p>	<p>An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period.</p> <p>The performance conditions used are reviewed on an annual basis to ensure they remain appropriate.</p> <p>Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares.</p> <p>Awards may include the right to receive a benefit of a value determined by reference to dividends that would have been paid on vested shares in respect of dividend record dates between grant and vesting. The benefit may assume the reinvestment of dividends and may be delivered in shares or in cash.</p> <p>For any externally appointed executive director, awards under the PSP will be subject to an additional holding period of two years following the date of vesting before they are released to the participant.</p> <p>The Committee may at its discretion structure awards as "Qualifying PSP Awards" comprising both an HMRC tax qualifying option and a standard PSP award, with the extent to which the standard PSP award may be exercised being scaled back to take account of any gain made on exercise of the tax-qualifying option.</p> <p>'Malus' and 'clawback' apply to the PSP as described in the notes to this table.</p>	<p>Maximum award is 200% of salary in any year. Where a 'Qualifying PSP Award' is granted, the shares subject to the HMRC tax qualifying option part of the award are not taken into account for the purposes of this limit, reflecting the 'scale back' referred to in the 'Operation' column.</p> <p>In determining the number of shares subject to an award, the market value of a share shall, unless the Committee determines otherwise, be assumed to be the average share price for the five days following the announcement of the Company's results for the previous financial year.</p>	<p>Granted subject to challenging performance measures that reflect the Company's strategic priorities. Performance conditions may include financial measures (eg adjusted EPS and / or relative TSR), and / or risk based measures and / or strategic measures. Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.</p> <p>25% of the awards will vest for threshold performance, with full vesting taking place for equalling or exceeding the maximum performance target.</p>

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Sharesave Plan			
To provide all employees with the opportunity to become shareholders on similar terms.	<p>Periodic invitations are made to participate in the Company's Sharesave Plan.</p> <p>A savings contract over three or five years with the funds used on maturity either to purchase shares by exercising options or returned to the participant.</p> <p>The option is granted at a discount to the share price at the time of grant of up to 20%.</p> <p>The Plan provides tax benefits in the UK subject to satisfying certain HMRC requirements and is operated on an 'all employee' basis.</p>	HMRC monthly savings limits apply.	None.

Malus and clawback

The cash element of the annual bonus, DSBP awards and PSP awards are subject to 'malus and clawback' provisions as follows.

For up to three years following the payment of the cash element of any bonus, the Committee may clawback up to the net amount of any cash bonus if a higher bonus payment than would otherwise have been the case is paid as a result of a material misstatement of the results for the bonus year or any error or inaccurate or misleading information or assumptions relating to the bonus year or if the participant is dismissed for misconduct.

DSBP and PSP awards may be reduced or cancelled before vesting or clawed back for up to two years after vesting if the Committee determines that a larger award than would otherwise have been the case is granted or vests as a result of a material misstatement of results or any error or inaccurate or misleading information or assumptions or, in the case of post vesting clawback, if the participant is dismissed for misconduct.

Shareholding guidelines

All executive directors are encouraged to hold a number of shares in the Company with a market value of 200% of their salary. The guideline must be met within a reasonable timeframe (typically expected to be within seven years of appointment) and executive directors are required to retain 50% of the shares acquired on the vesting of PSP or DSBP awards (after sales to cover tax) until the guideline is met. The number, net of income tax and national insurance, of vested but unexercised shares granted under the DSBP and PSP count towards the aggregate shares held by each director for these purposes.

For these purposes, the salary is the salary applying at 31 December each year and the value of shares is: (1) for shares acquired before 1 January 2017, PGC's average share price over the preceding three years; and (2) for shares acquired on or after 1 January 2017, the market value of a share at the date of acquisition (or, in the case of a vested but unexercised PSP or DSBP award, the value at the date of vesting).

Operation of share plans

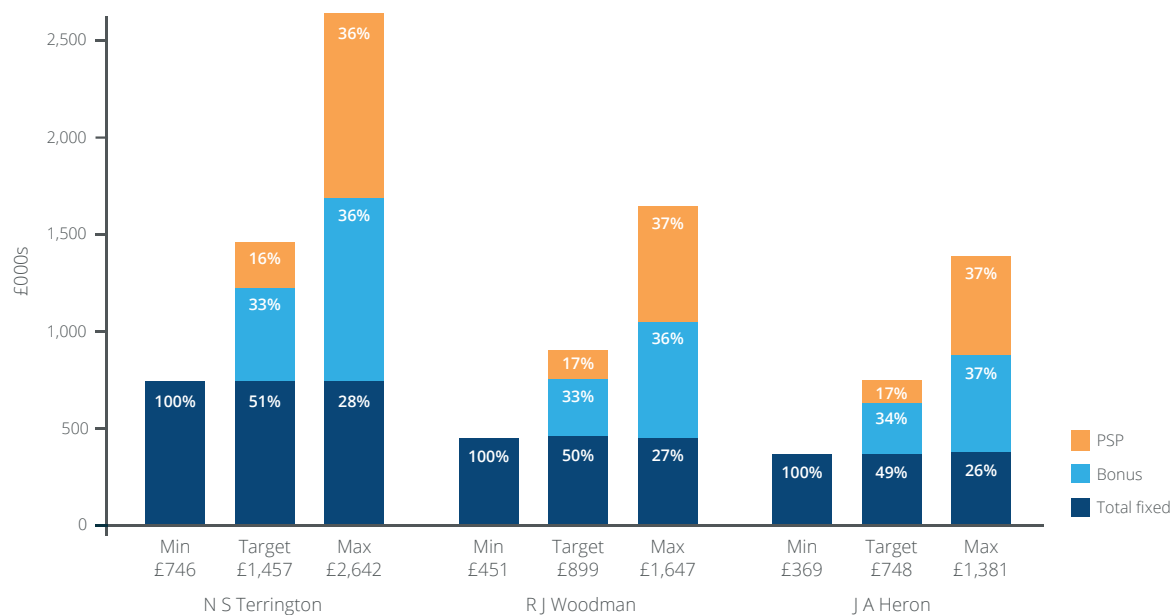
Awards under the Company's share plans (and any applicable performance conditions) may be adjusted in the event of any variation of the Company's share capital, demerger or special dividend.

Awards under the Company's share plans may vest early in the event of demerger, special dividend or other event which the Committee considers would affect the Company's share price, or in the event of a change of control. The extent to which PSP awards will vest will be determined taking into account the extent to which performance conditions have been satisfied (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed.

Awards may be settled in cash in appropriate circumstances as provided for in the rules of the plans.

Illustrations of the application of the remuneration policy

The chart below illustrates the remuneration opportunity provided to each executive director at different levels of performance for the coming year:



In developing the above scenarios the following assumptions have been used:

Total fixed pay is based on the latest salary, benefits and pension allowances (including both the accrual under the defined benefit scheme and the cash supplement), with the amounts being calculated on a basis consistent with those shown in the single total figure of remuneration table for the year ended 30 September 2016.

	Salary	Benefits	Pension	Total fixed
	£000	£000	£000	£000
N S Terrington	474	14	258	746
R J Woodman	299	12	147	458
J A Heron	253	12	140	405

Minimum is based on the directors receiving only their total fixed pay.

Target is based on what each director would receive if performance was in line with targets. Annual bonuses pay out at 50% of the maximum for on-target performance and PSP awards vest at 25% of the maximum.

Maximum is based on 100% of the annual bonus and 100% vesting of the PSP awards.

As Sharesave awards are provided on an all employee basis they have not been included in the above analysis.

Elements of the remuneration policy for the Chairman and non-executive directors

The Chairman receives a salary, a company car or cash alternative and is eligible for private health cover for himself and his family in the same way as the executive directors. Non-executive directors are remunerated solely by fees. Neither the Chairman nor the non-executive directors are eligible to participate in any of the Company's incentive or pension schemes and they are not entitled to receive compensation for early termination of their terms of engagement.

Benefits may also be provided to non-executive directors related to the performance of their duties (eg travel and hospitality).

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Salary and fees			
To ensure that the Group can attract and retain the appropriate number and mix of non-executive directors with the correct experience to provide balance, oversight and challenge.	<p>Non-executive director fees are reviewed on a periodic basis and are subject to the Articles of Association. The Chairman's fee is set by the Committee, whilst the non-executive directors' fees are determined by the Board.</p> <p>The Board will exercise judgement in determining the extent to which non-executive directors' fees are altered in line with market practice, given the requirement to procure and retain the appropriate skills and given the expected time commitments.</p> <p>Non executive directors are paid an annual base fee with additional fees for the roles of Senior Independent Director and / or chairman of a board committee.</p>	<p>Increases above those awarded for the rest of the organisation may be made to reflect the periodic nature of any review.</p> <p>Changes in the scope or responsibilities of a director's role, or the time commitment required, may require an adjustment to the level of their fee.</p> <p>The Articles of Association of the Company contain a maximum level of fees that can be paid annually to non-executive directors (currently £400,000). This is reviewed by the Board from time to time.</p>	None.

Choice of performance measures and approach to target setting

Annual bonus

The choice of the performance measures applicable to the annual bonus scheme reflects the Committee's belief that incentives should be appropriately challenging and tied to the achievement of both forward and backward-looking financial objectives, risk metrics and specific individual objectives linked to the Company's strategy.

The Committee reviews the measures each year and varies them as appropriate to reflect the priorities for the business in the year ahead. A sliding scale of targets is set for each measure to encourage continuous improvement and challenge the delivery of above-target performance.

PSP

The PSP is subject to performance measures that reflect the Group's strategic priorities. For the year ending 30 September 2017, awards will be subject to a combination of relative TSR and EPS growth and risk measures. EPS is considered appropriate as the activities of the Group in developing its new lending and other income streams should result in improvements to profitability and including a profit measure such as EPS will be reflective of long term performance. Risk represents a key area of focus for the Group in managing its long term stability and well-being. Both of these internal measures provide a balance to relative TSR, which considers shareholder value creation and is a measure of market expectations of future performance.

The use of relative TSR, EPS growth and risk for the PSP provides a combined focus on the Group's financial performance and shareholder value creation. Targets for EPS are set by reference to internal budgeting plans and external market expectations. Risk performance will be assessed across a range of quantitative and qualitative measures which are business critical. TSR targets are set on a standard practice, median to upper quartile ranking range.

Changes to performance conditions

If an event occurs which results in the annual bonus or PSP performance conditions and / or targets being deemed no longer appropriate (ie a material acquisition or divestment) then the Committee will have the ability to adjust the measures and / or targets and alter weightings so that the conditions achieve their original purpose.

Recruitment and conditions of service

Policy on recruitment and promotion

Salaries for newly recruited directors will be set to reflect their skills and experience, the Company's intended pay positioning and the market rate for the role. If it is considered appropriate to appoint a new director on a below market salary (for example, to allow the director to gain experience in the role) the individual's salary may be increased to a market level by way of a series of above inflation increases over such period as the Committee determines, subject to their performance and development in the role.

A new appointment would be offered benefits comparable to existing directors, as well as other reasonable expenses such as legal, tax equalisation and relocation costs (if necessary on a net of tax basis).

The prevailing maximum bonus opportunity for existing directors will not be exceeded for any newly recruited director and would be pro-rated to reflect the proportion of the year worked. It may be necessary to set different performance measures and targets initially and / or to vary the proportion of the annual bonus that will be deferred and the deferral period, dependent on the timing of the appointment and the nature of the role taken up. Guaranteed bonuses will not be offered.

Long term incentive awards will be granted in line with the policy outlined for existing directors (although, the Committee may vary or disapply any holding period that would otherwise apply to the new executive director's first PSP award), with the same maximum opportunity for any newly recruited director. Awards may be granted shortly after an appointment (subject to the Company not being in a prohibited period).

The maximum level of variable remuneration that may be awarded (excluding buyout awards as referred to below) is 400% of salary.

The Committee may make payments or grant awards to a newly recruited executive to buy out entitlements (for example, bonus and share awards) which will lapse on the executive's departure from a previous position. In doing so, the Committee will take into account relevant factors, including performance conditions attached to the lapsing arrangements and the time over which they would have vested. The Committee will generally seek to structure such awards or payments on a like for like basis to the lapsing arrangement.

In the event that an existing employee is promoted to the Board, any contractual commitments made to the employee prior to such promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled.

Notice periods and terms of engagement

The Chairman and executive directors hold one year rolling contracts in line with current market practice and the Committee reviews the terms of these contracts regularly. The dates of the service contracts for the Chairman and executive directors are set out in section B5.2.4.

All new executive directors will have service contracts that are terminable by the Company on a maximum of twelve months' notice.

Non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company upon three months' notice. The terms of engagement for the current non-executive directors are set out section B5.2.4.

Policy on termination payments

The Company has discretion to make a payment in lieu of notice in respect of all or part of the notice period. Any such payment would consist of salary, benefits and pension for the relevant part of the notice period. Specific change of control provisions or entitlements to enhanced redundancy payments are excluded.

Any statutory entitlements or sums to settle or compromise claims in connection with the termination would be paid as necessary. In appropriate circumstances, outplacement services, legal fees and relocation expenses may be provided at normal market rates for directors, along with payments in respect of accrued holiday.

The payment of annual bonuses will be at the discretion of the Committee on an individual basis and the decision as to whether or not to award an annual bonus in full or in part will be dependent on a number of factors, including the circumstances of the individual's departure. For example, in certain good leaver situations (injury or disability, redundancy, employment transferred outside the Group, or any other reason the Committee decides) a bonus may be payable at the Committee's discretion, based on an assessment of performance. Any annual bonus award amounts paid will be pro-rated for time in service during the annual bonus period and will, subject to performance, be paid at the usual time (although the Committee retains discretion to pay the annual bonus award earlier in appropriate circumstances). Any bonus earned for the year of departure and, if relevant, for the prior year may be paid wholly in cash at the discretion of the Committee.

The treatment of share based incentive awards will be determined by the Committee based on the relevant rules of the plan concerned.

The default treatment for outstanding unvested PSP awards will be that they lapse on cessation of employment. In good leaver circumstances (as described above), unvested awards will continue until the normal vesting date and vest subject to the satisfaction of the performance conditions, unless the Committee decides it shall vest on the date of cessation subject to the satisfaction of the performance conditions (as assessed by the Committee). In either case, the extent of vesting will be reduced to reflect the proportion of the vesting period that has elapsed at the date of cessation, unless the Committee determines otherwise. If an award is granted to an externally appointed executive director and he ceases employment in any applicable holding period, the award will ordinarily continue and be released (to the extent it had vested) at the end of the holding period (unless he leaves due to summary dismissal, in which case it will lapse), although the Committee retains discretion to release the award at the date of cessation.

For awards granted under the DSBP, good leaver status would result in awards vesting on the date of cessation unless the Committee determines they should continue to the normal vesting date.

The leaver provisions for any 'buyout' award granted in connection with the recruitment of a director would be determined at the time of grant.

On determination of a good leaver status or as the result of a death, awards under all plans may be exercised within twelve months of the date of vesting.

Consideration of employment conditions elsewhere in the Group

There is no employee representative on the Committee. However, employees have the opportunity to make comments on any aspect of the Company's activities through employee forums and surveys and the views of employees are taken into account by Human Resources. One of the duties of the People Director is to brief the Board on employee views and, as a regular invitee to Committee meetings, this ensures that decisions are made with appropriate insight to employees' views.

Directors and senior management participate in the annual bonus scheme, which is designed to incentivise executives to achieve specific, predetermined goals, reward individual performance and encourage retention through deferral of a proportion of the bonus. All employees whose performance has been exceptional are eligible for a discretionary bonus.

Directors and senior employees are eligible to participate in the PSP. The plan is in place to encourage the long-term retention of key executives who are considered to have the potential to influence shareholder value creation and awards are not offered to employees generally.

Employees below director and head of function level are eligible to participate in the Group's profit related pay scheme, which pays out a flat sum to all eligible staff based on a percentage of the Group's profits.

The Group's pension arrangements provide for a pension of 1/37.5 of basic annual salary (to a maximum of 2/3 for every year of eligible service) for directors and certain senior executives, whereas the accrual rate for other employees who are members of the Paragon Pension Plan is 1/60. The Plan was closed to new entrants in 2002 and participation in a stakeholder defined contribution scheme was offered to new employees from that date.

In determining pay levels for the employees as a whole, the Group annually considers externally provided benchmark levels for comparable jobs as well as individual development and performance. The general level of increase resulting from this review informs the Committee's deliberations on appropriate pay levels for the executive directors, together with external data specific to their roles which is used to ensure that the levels of remuneration are appropriate.

Consideration of shareholders' views

The Committee considers shareholder feedback received in relation to the AGM each year at a meeting shortly following the AGM. This feedback, plus any additional feedback received during any meetings from time to time, is then considered as part of the Company's annual review of remuneration policy.

In addition, the Chairman of the Committee and the Chairman of the Company regularly engage directly with major shareholders and their representative bodies and report their views back to the Committee, who take them into account when formulating any material changes to the remuneration policy.

Details of votes cast for and against the resolution to approve last year's remuneration report and the resolution to approve the Directors' Remuneration Policy at the 2014 AGM along with any matters relating to remuneration discussed with shareholders during the year are set out in the Annual Report on Remuneration.

Legacy arrangements

The Committee retains discretion to make any remuneration payment or payment for loss of office outside the policy in this report where the terms of the payment were agreed before the policy came into effect, provided in the case of any payment whose terms were agreed after the previous Directors' Remuneration Policy was approved at the Company's 2014 AGM and before the policy in this report became effective, the remuneration payment or payment for loss of office was permitted under that former policy. For these purposes, 'payment' includes the satisfaction of awards of variable remuneration and, in relation to an award over shares, the terms of the payment are agreed at the time the award is granted.

In accordance with the rules of the DSBP, participants are entitled to dividend equivalents determined by reference to dividends that would have been paid on shares in respect of dividend record dates between grant and the date on which the shares subject to the DSBP award are acquired. Dividend equivalents may be awarded on this basis in respect of the deferred share element of bonuses earned for the financial years ended 30 September 2013, 30 September 2014 and 30 September 2015. In accordance with the policy table, the deferred share element of bonuses earned for the financial year ended 30 September 2016 and future years will only attract dividend equivalents by reference to dividends that would have been paid on shares in respect of dividend record dates between grant and vesting.

B5.4 Approval of Directors' Remuneration Report

The information provided in this part of the Directors' Remuneration Report is not subject to audit.

This Directors' Remuneration Report, section B5 of the Annual Report and Accounts, including the Statement by the Chairman of the Committee, the Annual Report on Remuneration and the Policy Report, has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended and has been approved by the Board of Directors.

Signed on behalf of the Board of Directors

Alan K Fletcher

Chairman of the Remuneration Committee

23 November 2016

B6 RISK MANAGEMENT

B6.1 Statement by the Chairman of the Risk and Compliance Committee



Dear Shareholder

I am pleased to present the Risk and Compliance Committee's report as to how we have discharged our responsibilities in the last year.

The Risk and Compliance Committee is the senior risk committee within the Group. It operates under an authority delegated by the Board and assists the Board in fulfilling its responsibilities for risk management across the Group.

As a Committee, our primary responsibility is to maintain oversight of the effectiveness of the Group's risk management framework and of the Group's systems and controls for compliance with its statutory and regulatory obligations. This includes satisfying ourselves that the Group's risk culture and risk appetite are adequately embedded within the organisation.

In line with my comments at the end of the previous financial year, the Committee has continued to monitor the development of the Group's risk management framework, including the expansion of its independent Risk and Compliance function. It is pleasing to report that the Group has made effective progress in this area, consistent with its continuing aim of operating as a prudent, risk focussed, specialist lender.

The Committee has again sought to ensure that its agenda is dynamic, balancing standing items of risk management with reviews of new risks that have emerged during the year. Core components of each meeting have included:

- Considering and challenging executive management's rating of the various risk categories to which the Group is exposed
- Reviewing the principal risks facing the Group now and in the reasonably foreseeable future
- Considering the potential impact of key regulatory developments; and
- Considering whether the scope and the capabilities of the risk management framework remain adequate given the growing breadth, scale and future plans of the business

Specific areas of focus during the year have included reviews of the implications of changes to the fiscal and regulatory regime for buy-to-let lending, cyber security and incident response planning, the potential impacts on the Group of the decision to leave the European Union and progress with the integration of the acquired Paragon Bank Asset Finance business. In addition, during the year the Committee:

- Reviewed the Group's ICAAP report prior to submission to the Prudential Regulation Authority
- Received a presentation on the ILAA report for the Group's banking subsidiary, Paragon Bank PLC

- Monitored progress in relation to the Group's applications for consumer credit, regulated mortgage lending and consumer buy-to-let regulatory permissions
- Reviewed the annual Money Laundering Reporting Officer's report in relation to the adequacy of the Group's financial crime prevention arrangements
- Regularly reviewed progress against the Group's Compliance Monitoring Plan
- Considered the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

During the coming year, the Committee's priorities will include:

- Undertaking a full review of the Group's risk appetite prior to referral for approval to the Board
- Reviewing the Group's stress testing exercises and their results
- Undertaking a number of detailed reviews in relation to specific risk categories and business areas, including conduct risk, capital and liquidity risk, outsourced supplier arrangements and asset finance lending
- Monitoring progress with regard to the Group's strategic decision to seek regulatory approval to implement an Internal Ratings Based approach for credit risk
- Monitoring the Group's adherence to the FCA / PRA requirements in relation to the Senior Managers and Certification Regime

In summary, whilst the activities of the Committee have continued to evolve during the year, I am pleased to confirm that it has met its key objectives and carried out its role effectively. This was confirmed by an independent review of the Board and its subsidiary Board Committees conducted in July 2016. Looking ahead, it is clear that the economic, political and regulatory environment within which the Group operates will continue to be challenging, but the Committee is confident that the Group has the necessary skills and experience to maintain its position as a prudent, risk focussed, specialist lender.

Fiona J Clutterbuck

Chairman of the Risk and Compliance Committee

23 November 2016

B6.2 Risk Governance

The Risk and Compliance Committee comprises the independent non-executive directors and the Chairman of the Company. Its terms of reference include all matters indicated by the Code.

The Committee's responsibilities include reviewing:

- The effectiveness of the Group's risk management framework and the extent to which risks inherent in the Group's business activities are controlled within the risk appetite established by the Board
- The effectiveness of the Group's systems and controls for compliance with statutory and regulatory obligations, as well as its obligations under significant contracts
- The oversight of the timely completion of any remedial actions found to be necessary
- The appropriateness of the Group's risk culture, to ensure it supports the Group's stated risk appetite
- The effectiveness of the Group in addressing issues requiring remedial attention to ensure actions are completed in a timely manner and minimise the potential for risk appetite thresholds to be exceeded

The Risk and Compliance Committee provides oversight and challenge to the Group's enterprise-wide risk management arrangements. The Risk and Compliance Committee is supported by an executive level Operational Risk and Compliance Committee, Credit Committee and Asset and Liability Committee.

The Committee meets at least four times a year and normally invites the executive directors, Group Chief Risk Officer, Chief Operating Officer and Director of Internal Audit to attend its meetings. However, it reserves the right to request any of these individuals to withdraw or to request the attendance of any other Group employee. The Committee meets with the Group Chief Risk Officer at least once a year, without the presence of executive management, to discuss his remit and any issues arising from it.

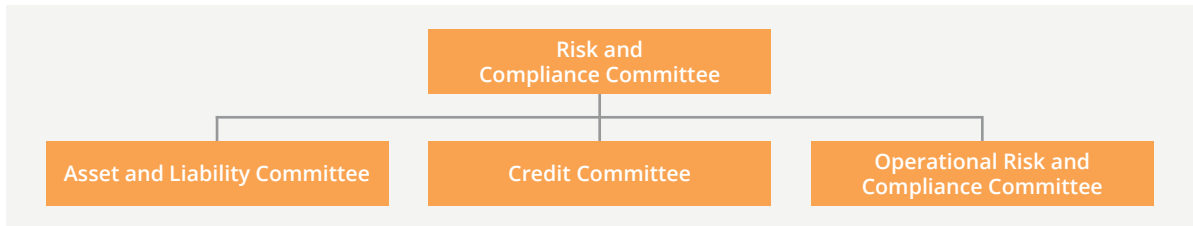
The Committee also has the opportunity to meet with the Director of Internal Audit and / or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Agenda items for regular meetings of the Committee include:

- Reviewing the Group's register of principal risks
- Receiving and considering reports relating to the Group's consolidated risk profile, its performance against risk appetite and the progress of any resulting management actions and key risks
- Reviewing any proposed material changes to the Group's risk appetite prior to approval by the Board
- Reviewing the Group's Compliance Monitoring Plan and the proposed management actions to address any adverse reports
- Receiving reports relating to key regulatory developments affecting the Group
- Reviewing the Group's conduct strategy and receiving reports from management on conduct risk
- Receiving reports from the Group's Money Laundering Reporting Officer on compliance with Anti Money Laundering requirements

- Reviewing material operational risk events to assess the effectiveness of the Group risk and control assessment framework
- Reviewing the timeliness, effectiveness and progress of any executive management actions required to remediate issues identified
- Reviewing the Group's capital adequacy assessments and stress testing analysis
- Considering the minutes of its executive sub-committees

The structure of the executive committees reporting to the Committee and their reporting lines is illustrated below:



Each of the executive committees operates within terms of reference formally approved by the Risk and Compliance Committee. The primary functions of each of these committees is described below.

Asset and Liability Committee ('ALCO')

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

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

Credit Committee

The Credit Committee comprises senior managers from the Risk, Finance and Collections functions and is chaired by the Group Finance Director.

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

Operational Risk and Compliance Committee ('ORCC')

The Operational Risk and Compliance Committee comprises heads of relevant functions and is chaired by the Group Chief Risk Officer.

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

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

The Committee also considers business risks and their potential to impact the delivery of the Group's objectives.

B6.3 Risk Management Culture

The Board is committed to maintaining an effective risk management framework that is consistent and commensurate with the nature, complexity and risk profile of the business and is responsive to both internal and external events. The Group is an inherently risk-averse organisation which is expressed through the culture promoted by the Board and senior management. This has resulted in historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers. The Group aims to help its customers by offering financial options which meet individual needs and achieve fair customer outcomes in a well-controlled environment.

The following risk principles are designed to support and protect the Group's strategic goals:

- Risk management is used to protect the Group's customers, shareholders, creditors and its reputation
- The fair treatment of customers and the delivery of fair outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach
- The Group encourages a risk culture that has robust risk management at the heart of all decision-making within an open and transparent environment
- The Group only carries out business where the potential risk to itself and its customers has been considered together with the potential reward and where the residual risk exposure is within its defined risk appetite
- The Group utilises appropriate risk management processes to ensure that risks are identified, assessed, prioritised and managed in a consistent way
- Appropriate, timely and accurate risk management information is maintained and developed to support business decisions and to ensure the Group operates within its agreed risk appetite
- An independent Risk and Compliance function provides an effective second line oversight capability together with a source of specialist support and advice for business areas in relation to the management of risk.

B6.4 Risk Management Framework

Introduction

The Group's risk management framework is designed to enable management to identify and focus attention on the risks most significant to its objectives and to provide an early warning of events that put those objectives at risk. The framework includes:

- The Board Risk and Compliance Committee and its sub-committees as described in B6.2
- Dedicated teams within the Risk and Compliance function covering particular risk areas, described below
- A suite of risk policies, which include policies addressing:
 - Conduct risk
 - Complaint handling
 - Forbearance
 - Vulnerable customers
 - Operational risk
 - Credit risk
 - Financial crime
- A Compliance Handbook to advise business areas on regulatory matters supported by an active programme of Compliance 'surgeries'
- Risk Champions appointed within all business areas to support the embedding of an effective risk culture across the Group
- A well-established and experienced Internal Audit function, supported by ongoing co-source arrangements with external providers when specific specialist skills are required

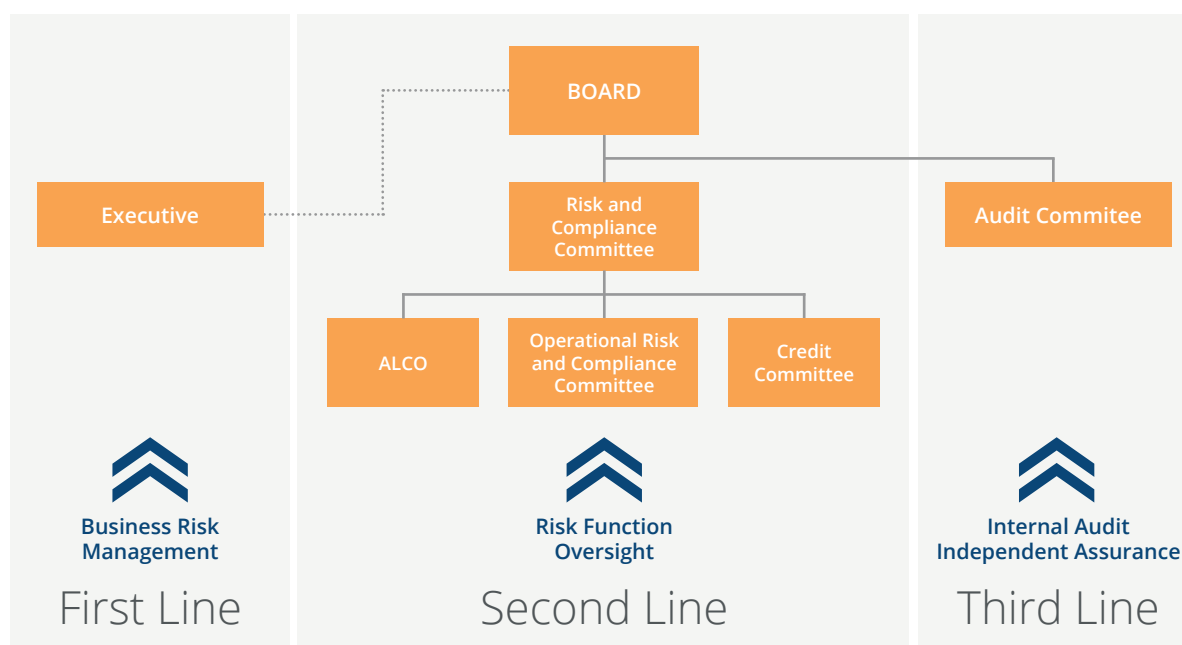
Three lines of defence model

The committee structures outlined above form the cornerstone for the governance of risk in a management framework organised within a **Three Lines of Defence** model as follows:

- The **first line of defence**, comprising executive directors, managers and employees, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The **second line of defence** is provided by the Risk and Compliance function together with oversight provided by the Risk and Compliance Committee and supporting sub-committees
- The **third line of defence** is provided by the Internal Audit function and the Audit Committee which are responsible for reviewing the effectiveness of the first and second lines of defence

In addition, there are further external levels of control that complement the three internal layers, provided by the external audit process and the monitoring activities of regulatory bodies.

The way in which this three lines of defence model aligns with the wider governance framework is illustrated below:



The risk management framework is intended to provide a structured and disciplined approach to the management of risk within an agreed appetite. The key objectives of the risk management framework are to:

- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction of the frequency and severity of risk events
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and to support the regulatory requirements associated with the ICAAP
- Provide senior management and relevant committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information included within these reports
- Promote an appropriate risk culture across the Group
- Support the achievement of the Group's strategic objectives

The Group publishes further information on its risk management system and risk profile in its Pillar III report, which can be found on the investor relations section of the Group's website at www.paragon-group.co.uk.

Risk management function

Integral to the Group's risk management framework are the following dedicated second line functions which report to the Group Chief Risk Officer:

- Credit Risk
- Compliance and Conduct Risk
- Operational Risk
- Property Risk
- Financial Crime Risk

The key responsibilities of the Group Chief Risk Officer are to:

- Develop and maintain the risk management framework covering all areas of the Group
- Develop and maintain Group risk policies within that framework, ensuring these are consistent with the Board's risk appetite
- Ensure that risks generated by the business are measured, monitored, controlled and reported on a timely basis
- Ensure compliance with all new and existing regulatory requirements
- Maintain open and constructive engagement with the regulatory authorities

The Group Chief Risk Officer is also responsible for the effective day-to-day running of the Risk and Compliance function and its relationship with the Board, its committees and senior management as well as for championing the Group's risk culture, providing support and advice to employees in the discharge of their risk responsibilities.

Within the overall Group framework, Paragon Bank maintains an appropriately independent risk management function under a Bank Chief Risk Officer. To ensure consistency of approach across the Group, the Bank Chief Risk Officer maintains an indirect reporting line to the Group Chief Risk Officer.

Risk categorisation

The maintenance of a standard, common risk language across the Group is a key enabler for risk identification and effective risk management. It provides a consistent basis for risk assessment and the development of policy, risk appetite and appropriate risk management structures. It also facilitates risk aggregation, risk reporting and segregation of accountabilities. Accordingly, the following common risk categorisations are used:

- Business Risk
- Credit Risk
- Conduct Risk
- Operational Risk
- Liquidity and Capital Risk
- Market Risk
- Pension Obligation Risk

The principal risks identified under each of these headings are discussed in detail overleaf.

B6.5 Principal Risks and Uncertainties

The Group 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 Group's strategic objectives, how the Group 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 Group's gross risk position as presented to, and discussed by the Risk and Compliance Committee as part of their ongoing monitoring of the Group's risk profile.

This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Group but rather those which the Group 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 Group employs a risk management framework, described in section B6.4. 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, Market Risk, and Pension Obligation Risk.

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




Business Risk

Economic risk

Description	Mitigation	
<p>The Group could be materially affected by a severe downturn in the UK economy given its income is wholly derived from activities within the UK. Adverse economic conditions could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.</p>	<p>The Group operates as a specialist lender in chosen markets where its employees have significant levels of expertise.</p> <p>Robust underwriting and monitoring processes are employed which reflect prudent credit policies designed to be maintained through economic cycles.</p> <p>To support the validation of asset values for its core buy-to-let lending products, the Group maintains an in-house team of Chartered Surveyors with considerable experience and understanding of the sector.</p> <p>The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic advisors. This ensures it is able to consider various economic scenarios within its formal business planning cycle.</p> <p>In addition, the Group maintains a robust stress testing framework to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities.</p>	
<p>Change</p>	<p>Whilst UK economic performance has remained generally stable in the last financial year, the outlook has become considerably more uncertain given various recent global and domestic developments. These include the referendum decision to leave the European Union. Given this heightened level of economic and political uncertainty, the overall risk assessment is considered to have increased.</p>	


Business Risk

Concentration risk

Description	Mitigation	
<p>The Group is heavily reliant on lending to customers investing in the UK private rented sector.</p> <p>It is therefore exposed to any systemic deterioration in performance of the sector, which will be influenced by underlying factors such as house prices, supply of rental property, and demographic changes.</p> <p>The buy-to-let sector has been subject to a high level of fiscal and regulatory intervention in recent years, including changes affecting the tax position of landlords and the regulation of underwriting requirements. Where such changes make buy-to-let less attractive to potential customers or affect the viability of existing customers' businesses, the Group is exposed to adverse consequences.</p>	<p>The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market.</p> <p>This includes a long history of performance data through the economic cycle together with regular independently conducted research commissioned over a period of more than ten years. It seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector both directly and through membership of the CML, IMLA and the National Landlords Association.</p> <p>Given its deep specialist knowledge of the sector and its historically prudent approach to underwriting, the Group is very well placed to cope with recent and emerging regulations relating to buy-to-let, and to continue to provide appropriate products to customers in the new environment.</p> <p>The Group also continues to exploit prudent opportunities to diversify the range of its activities and income streams. This is illustrated by the development of its Idem Capital debt acquisition business and the organic development and acquisitions within Paragon Bank.</p>	
<p>Change</p>	<p>Whilst the Group has continued to diversify its areas of operation in the last financial year, it continues to have significant exposure to buy-to-let lending. Changes to the UK taxation regime for private landlords and greater regulatory intervention in the sector could reduce demand and availability of buy-to-let lending products.</p>	

Business Risk

Transition risk

Description	Mitigation	
<p>The Group has acquired two asset finance businesses, PBAF and Premier, in the year, extending its operations to a new sector.</p> <p>In addition, the Group remains alert to potential opportunities to complement organic growth through further good quality acquisitions.</p> <p>Any failure to integrate acquired businesses safely and effectively could impact adversely on the Group's financial performance and its reputation</p>	<p>The Group's core strategy is only to consider acquisitions in areas that it understands and which are complementary to its existing business activities.</p> <p>Extensive pre acquisition due diligence is always undertaken with support from respected, high quality advisors.</p> <p>Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board.</p> <p>Where necessary, enhancements have been made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider Group.</p> <p>Similarly, where necessary experienced additional resource has been recruited to ensure that operational and risk management capabilities are suitably robust.</p>	
<p>Change</p>	<p>The increase in the Group's acquisition activity in the last year has inevitably led to a potential for greater risk in this area and this risk has been added in the year.</p>	

Credit Risk

Customer risk	
Description	Mitigation
<p>As a lender, a failure to target and underwrite lending effectively could expose the Group to the risk of unexpected material losses in the event of customers being unable to repay their debts.</p> <p>Recoverable amounts on loans may also be affected by adverse movements in security values such as house prices.</p>	<p>The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Credit policies incorporate limits for concentration risk arising from factors such as large exposures to particular counterparties, geographical areas or types of lending. Exceptions to these policies require approval by the Group's Credit Risk function, operating under a mandate from the Credit Committee.</p> <p>The Credit Risk function provides regular reports to the Credit Committee and Risk and Compliance Committee on the performance of each of the Group's lending portfolios.</p> <p>Originated loan assets are subject to individual underwriting approval with robust control and support provided by well-established decision tools, while purchased assets are subject to extensive pre-contract due diligence and rigorous ongoing analysis and monitoring.</p> <p>The majority of the Group's loans by value are secured against residential property in England and Wales at conservative loan-to-value levels.</p> <p>Rigorous and timely collections and arrears management processes are also in place. These processes benefit from specialist staff, especially for buy-to-let mortgages, where the Group's receiver of rent experience and use of in-house property specialists enhance recoveries.</p> <p>As indicated previously, the Group maintains a robust stress testing framework to assess its expected performance under a range of operating conditions, including falls in asset values and increases in interest rates. This framework provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities.</p>
<p>Change</p> <p>The Group's impairment rate has remained very low, reflecting the maintenance of robust, proven credit disciplines, generally favourable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration following the referendum decision to leave the European Union is being monitored closely across all Group portfolios. Currently no deterioration has been seen in actual performance, nor underlying customer profile.</p> <p>The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are described in note 7 to the accounts.</p>	

Credit Risk


Counterparty risk

Description	Mitigation	
<p>The Group is exposed to the failure of counterparties with which it places deposits.</p> <p>In addition, it is exposed to the risk of loss in the event of the failure of a counterparty with which it has negotiated hedging agreements to mitigate interest rate and foreign exchange risk.</p>	<p>The Group has a strictly controlled number of approved treasury counterparties. In order to be approved, counterparties must meet specific credit rating criteria. Exposure to these counterparties is monitored daily by senior management within the Group's Treasury function with all trading performed within approved limits.</p> <p>The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO.</p> <p>Treasury counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, they must comply with criteria set out in the financing arrangements, which are monitored externally.</p> <p>Where a counterparty to the Group's cross currency basis swaps, which form its principal derivative exposures, fails to meet the required credit criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit.</p> <p>Interest rate and foreign exchange derivatives are held solely for hedging purposes.</p>	
<p>Change</p>	<p>The credit quality of the treasury counterparties, with whom the Group transacts has been maintained, taking into account collateral arrangements.</p>	

Conduct Risk


Customer fair outcomes

Description	Mitigation
<p>The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to deliver fair outcomes for customers.</p>	<p>The Group has policies and oversight procedures addressing the fair treatment of customers across all its portfolios. These include:</p> <ul style="list-style-type: none"> • Conduct risk • Complaint handling • Responsible lending • Forbearance; and • Vulnerable customer treatment <p>Within its Consumer Lending area, a dedicated Quality and Control team monitors the activities of customer facing employees to validate the delivery of fair treatment for customers. This area also has a dedicated Customer Support team that manages any customers deemed to be vulnerable until such time as a suitable, sustainable exit strategy has been agreed. Controls in place include:</p> <ul style="list-style-type: none"> • All inbound and outbound calls are recorded with a sample of calls and correspondence reviewed each month • Forbearance agreements are reviewed in order to ensure these are not extended to the detriment of the customer's circumstances • Embedded system controls restrict which areas of the business can action the accounts of customers identified as vulnerable • The volume of customers disclosing sensitive information and the nature of their vulnerability is closely monitored via management information • Accounts are monitored where customers have been requested to provide evidence to support their health issues to ensure such requests are appropriate • Customers in financial difficulty are actively encouraged to obtain appropriate free independent advice from reputable, approved organisations such as 'StepChange Debt Charity' and 'Payplan' <p>All employees are required to undertake conduct risk related training with those in consumer facing roles also receiving monthly focused training which is subject to performance testing.</p> <p>The Group maintains a centralised complaint handling function for consumer loans to ensure complaints are dealt with in a consistent and efficient manner.</p> <p>The ORCC has a remit which extends to overseeing the fair treatment of customers. The Committee receives reports each month from selected business areas relating to customer treatment and complaint handling.</p>

	<p>The Group's Compliance function has a formal monitoring plan which is heavily focused on conduct risk and the fair treatment of customers, particularly those in financial difficulty. The plan is reviewed by the Risk and Compliance Committee. Management actions to address any adverse reports are overseen at both the ORCC and the Risk and Compliance Committee.</p> <p>During the last year, various Group subsidiaries have made a number of successful applications for regulatory permissions in relation to Consumer and Mortgage lending. These applications have included reviews of key customer-related policies and procedures. Alongside the business-wide training noted above, this has served to enhance business areas' focus on customer outcomes. This has also been supported by strengthened second line review and reporting during the period.</p>	
Change	<p>The increasingly regulated nature of the Group's operations and the continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure.</p>	


Operational Risk

People risk

Description	Mitigation
<p>The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels. Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives.</p> <p>This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be hard to replicate in the short term.</p>	<p>The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies. These include:</p> <ul style="list-style-type: none"> • Undertaking formal succession planning reviews covering all key roles • Monitoring external remuneration and reward structures to ensure it remains competitive and is able to recruit and retain key personnel • Offering a range of employee benefits in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related performance scheme for most employees • Having an effective performance appraisal system to identify and provide appropriate training and development opportunities for employees; and • Providing regular internal training for all employees and financial support to employees undertaking relevant external professional qualifications <p>The Group has been accredited under the 'Investors in People' scheme since 1997 and achieved Champion status in May 2014. This is awarded to a very small proportion of accredited organisations who are seen as pioneers in people management practices and role models in strategic leadership.</p>
<p>Change</p>	<p>During the last year, a generally improving employment market and buoyant demand for skilled financial services employees has undoubtedly resulted in increasing competition to recruit and retain employees. However, the Group remains confident in its ability to manage this risk successfully as evidenced by the results of an employee survey during the year which indicated an 86% engagement level. This level is above the average for the financial services sector.</p> <p>The development of formal succession planning for senior roles has also helped to mitigate the Group's key person exposure in respect of certain executive personnel.</p> <div style="text-align: center;">  </div>

Operational Risk

Systems risk

Description	Mitigation
<p>The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs and fail to offer adequate protection against the threat of cyber-crime.</p> <p>Failure in these systems, either in terms of capacity or security, could result in detriment to customers, regulatory censure and reputational damage, all of which could materially impact income and profitability.</p> <p>This also includes the risk that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.</p>	<p>During the course of the year, the Group has strengthened its capabilities in relation to its information technology infrastructure management, including the appointment of an experienced external IT Director.</p> <p>The Group has a formally agreed IT Strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. These include the provision of management information to enable business heads to exercise effective control of key operational risks. The Group also employs a robust vendor management process to select and monitor third party IT suppliers.</p> <p>The Group maintains an ongoing programme of investment in IT infrastructure and systems. This includes investment in security solutions to counteract cyber security threats. There is also continued focus on the information security management system to ensure that controls, testing and user awareness is maintained and improved. The Group is currently certified to ISO 27001 (Information Security Management). As part of this, a significant investment was made to enhance the Group's controls regarding data loss during the last year.</p> <p>Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.</p> <p>In order to ensure it can deal effectively with unexpected operational disruptions, the Group has a well-established Business Continuity plan which is updated and tested regularly. The Group is currently certified to ISO 22301 (Business Continuity).</p> <p>The Group has added resource in the Risk and Internal Audit areas to ensure its second and third line review processes have the capability to properly address these issues.</p> <p>Before the Group outsources any key activities to a third party, it undertakes robust due diligence on them and ongoing performance and customer outcome monitoring thereafter. The Group only outsources activities under formal contractual arrangements which clearly set out the rights and obligations of both parties.</p>
<p>Change</p>	<p>Whilst the Group continues to maintain a robust and secure IT infrastructure that supports its operational needs, the level and sophistication of cyber-crime continues to increase, heightening the risk of an impact on its business model and strategic objectives.</p>
	

Operational Risk

Regulatory risk	
Description	Mitigation
<p>The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations.</p> <p>The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains much of its funding, have been subject to increasing legislative and regulatory intervention over recent years.</p> <p>Many of the Group's own business activities are now also subject to direct and increasing levels of regulation. This is increasingly significant given the greater levels of business being undertaken through Paragon Bank.</p>	<p>The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert third party advice is also sought where necessary.</p> <p>Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the Risk and Compliance Committee.</p> <p>The Compliance function has developed a formal monitoring plan which is reviewed by the ORCC and the Risk and Compliance Committee to ensure that regulatory requirements have been satisfactorily embedded.</p> <p>Similarly, the Group's Financial Crime function provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements.</p> <p>All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained.</p> <p>During the last year a number of group companies submitted successful applications for permissions under the FCA's Consumer Credit and Mortgage regimes.</p>
Change	<p>The increasingly regulated nature of the Group's operations heightens the potential risk of financial losses or censure as a result of a failure to comply with current regulations or to respond effectively to new and emerging regulations.</p>



Liquidity and Capital Risk

Funding risk


Description	Mitigation
<p>The Group is exposed to the risk that increases in the cost or reductions in the availability of funding could adversely impact its business model and strategic objectives. The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory changes, this might result in the scaling back or cessation of some business lines.</p> <p>Paragon Bank relies on retail deposits and therefore changes in market liquidity could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity. In addition, there is a risk that the Group could face sudden, unexpected and large cash outflows from customer withdrawals.</p>	<p>Comprehensive treasury policies are in place for both the Group and the Bank to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due.</p> <p>The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements.</p> <p>The Board, through the delegated authority provided to the ALCO, sets strict limits as to the level, composition and maturity of liquidity arrangements.</p> <p>Compliance with the approved limits is monitored daily. Detailed management information is reported monthly to ALCO in order to ensure that the Group can maintain adequate liquidity even under stressed conditions.</p> <p>The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs.</p> <p>The Group uses securitisation to mitigate its exposure to liquidity risk on its borrowings, ensuring, as far as possible, that the maturities of assets and liabilities are matched.</p> <p>The Company has a BBB- investment grade credit rating from Fitch to support maintenance of its access to funding markets.</p> <p>Paragon Bank is authorised to accept deposits. As such it 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.</p>
<p>Change</p>	<p>Whilst wholesale funding markets have tightened somewhat during the financial year, the Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. It is also well placed to access further funding if required.</p>
	

Liquidity and Capital Risk


Capital risk		
Description	Mitigation	
<p>The major part of the Group's lending portfolio is secured on residential property. Proposals made by the BCBS regarding potential changes from 2021 to the minimum capital requirements for lending secured on such assets could have a material impact on the Group.</p> <p>If the BCBS proposals are implemented as currently outlined, the Group would be particularly affected by changes to risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by property, such as buy-to-let lending. In anticipation of these potential developments, the Group is already actively engaged in progressing mitigating actions.</p>	<p>In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group has taken a strategic decision to seek the necessary regulatory approval to implement an IRB approach for credit risk.</p> <p>In support of this, the Group has recently appointed an experienced Director of IRB to lead this initiative and plans are now progressing to map out the approval and implementation route.</p> <p>The programme of work will cover all relevant areas including data integrity, the development of compliant models, training and development, governance and use tests. It is anticipated that work already completed in relation to IFRS 9 changes will allow for accelerated development of initial IRB models.</p>	
Change	<p>The Group's exposure to this risk has remained broadly consistent during the financial year with feedback on the BCBS proposals not expected until 2017.</p> <p>Further information on the Group's management of capital risk is given in note 6 to the accounts.</p>	

Market Risk

Interest rate risk

Description	Mitigation	
<p>The Group is exposed to the risk that changes in interest rates may adversely affect its net income and profitability. In particular, the Group's profitability is determined by the difference between the interest rates at which it lends and those at which it borrows. Changes in market interest rates could therefore materially impact the Group's profits as a result of significant mismatches between its assets and liabilities.</p>	<p>Comprehensive treasury policies are in place to ensure that the risk posed by changes and mismatches in interest rates is effectively managed.</p> <p>The Group manages this risk outside the Bank by maintaining floating rate liabilities and matching these with floating rate assets, by hedging fixed rate assets and liabilities using interest rate swap or cap agreements and by maintaining a proportion of fixed rate liabilities.</p> <p>The Group has a dedicated Treasury function which is responsible for the day-to-day management and control of its exposure to interest rate risk.</p> <p>ALCO monitors the interest rate risk exposure on the Group's loan assets and asset backed loan notes on a monthly basis. This ensures compliance with the requirements of the trustees in respect of the Group's securitisations and the terms of other borrowings, as well as adherence to internal policies.</p> <p>Paragon Bank has its own Treasury Policy and ALCO which focuses on the risks within the Bank, including the retail deposit position. Notwithstanding this, the Group ALCO maintains oversight of market risk across the whole Group.</p> <p>Paragon Bank's retail deposits either bear variable interest rates or are fixed rate liabilities which are hedged in accordance with the Group's interest risk management strategy.</p> <p>The Group has no direct exposure to market interest rate risk.</p>	
<p>Change</p>	<p>The Group's interest risk exposure profile, relative to its balance sheet and its approach to managing the risks inherent in it have remained broadly similar through the period and therefore associated risk levels remain generally stable compared to previous periods.</p> <p>Further information regarding the Group's management of interest rate risk is given in note 7 to the accounts.</p>	

Pension Obligation Risk

Pension obligation risk		
Description	Mitigation	
<p>The Group operates both a defined benefit and defined contribution pension scheme in the UK. There is a risk that the Group's pension liabilities may be adversely affected by a range of factors including bond yields, inflation rates, interest rates, changes to pension regulations and demographic factors.</p>	<p>The defined benefit scheme was closed to new members with effect from February 2002. Since that time, new employees have been invited to join the Group's defined contribution pension scheme which carries no investment or mortality risk for the Group.</p> <p>The defined benefit scheme is formally valued independently by the Plan actuary every three years, most recently as at 31 March 2013. At that time the deficit, agreed by the Trustee was £15.0 million and a recovery plan was agreed between the Trustee and the Group, whereby the Group undertook to fund the deficit to meet the statutory funding objective by 31 August 2019.</p> <p>A new valuation process, as at 31 March 2016 has commenced, but has not yet been completed. The valuation of the deficit on an IAS 19 accounting basis by the Group's actuarial advisers at that date showed a deficit of £24.0 million.</p> <p>Once the valuation has been completed discussions will take place between the Trustee and the Group to agree a new deficit reduction plan.</p>	
<p>Change</p>	<p>During the last year, changes in bond yields, equity prices, interest rates, mortality assumptions and inflation rates have all impacted on the Group's exposure in relation to its pension obligations.</p>	

B7 DIRECTORS' REPORT

The directors of The Paragon Group of Companies PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('Schedule 7'), which also includes additional disclosures made in accordance with the Listing Rules of the UK Listing Authority.

Directors and their interests

The directors of the Company during the year were:

R G Dench
N S Terrington
R J Woodman
J A Heron
A K Fletcher*
P J N Hartill*
F J Clutterbuck*
H R Tudor*

* Non-executive directors.

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in section B5. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2016.

Mr H R Tudor additionally has an interest in £750,000 of the Company's 6.00% sterling denominated notes due 2020.

Other than as stated above, the directors had no interests in securities issued by the Company. The directors have no interests in the shares or debentures of the Company's subsidiary companies.

The appointment and replacement of the Company's directors is governed by its Articles of Association, the Code, the Companies Act 2006 and related legislation, and the individual service contracts and terms of appointment of the directors. The powers of the directors, and their service contracts and terms of appointment, are described in the Corporate Governance section, Section B3.1. The Articles of Association may only be amended by the Company's shareholders in general meeting.

Under Article 161 of the Company's Articles of Association, the Company has qualifying third party indemnity provisions for the benefit of its directors 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 Code recommends that all directors should be subject to reappointment annually and therefore all of the directors, Mr R G Dench, Mr N S Terrington, Mr R J Woodman, Mr J A Heron, Mr A K Fletcher, Mr P J N Hartill, Ms F J Clutterbuck and Mr H R Tudor, have agreed to voluntarily retire from the Board at the end of the forthcoming Annual General Meeting, and, being eligible, offer themselves for re-election.

None of the directors has a service contract with the Company requiring more than 12 months' notice of termination to be given.

A director has had a statutory duty to avoid a situation in which he or she has, or can have, an interest that conflicts or possibly may conflict with the interests of the Company. A director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles of Association by the other directors. The Articles of Association include the relevant authorisation for directors to approve such conflicts.

None of the directors had, either during or at the end of the year, any material interest in any contract of significance with the Company or its subsidiaries.

Capital structure

Details of the issued share capital of the Company, together with details of movements in its issued share capital in the year, are given in note 43 to the accounts. The Company has one class of ordinary shares which carries no right to fixed income. Each ordinary share carries the right to one vote at general meetings of the Company. The rights and obligations attaching to ordinary shares are set out in the Articles of Association of the Company.

There are no specific restrictions on the size of a member's holding or on the transfer of shares. Both of these matters are governed by the general provisions of the Company's Articles of Association and prevailing legislation. The Articles of Association may be amended by special resolution of the shareholders. The directors are not aware of any agreements between holders of the Company's shares in respect of voting rights or which might result in restrictions on the transfer of securities.

Details of employee share schemes are set out in note 20 to the accounts. Votes attaching to shares held by the Group's employee benefit trust are not exercised at general meetings of the Company.

The Company presently has the authority to issue ordinary shares up to a value of £29.6 million and to make market purchases of up to 29,600,000 £1 ordinary shares, granted at the Annual General Meeting on 11 February 2016. These authorities expire at the conclusion of the forthcoming Annual General Meeting on 9 February 2017 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

At 30 September 2007 the Company had, as part of a £40.0 million repurchase programme, repurchased 6,689,000 10p ordinary shares having an aggregate nominal value of £668,900. The reasons for the repurchase programme were set out in an announcement made by the Company through RNS on 25 May 2005. On 29 January 2008 these shares were consolidated into 668,900 £1 ordinary shares.

On 25 November 2014 the Group announced a share buy-back programme of up to £50.0 million, which was extended to £100.0 million on 24 November 2015. During the year 16,663,408 £1 ordinary shares (2015: 11,732,500) having an aggregate nominal value of £16,663,408 (2015: £11,732,500), were purchased under this programme. The reasons for this purchase were set out in section A3.3 of the Annual Report for the year ended 30 September 2015. Total consideration paid in the year was £51.0 million, including costs (2015: £49.7 million).

All of the shares acquired under these programmes were held as treasury shares.

On 18 August 2016, 13,716,094 of the treasury shares acquired under these programmes were cancelled. These shares had a nominal value of £13,716,094 and represented 4.87% of the issued share capital excluding treasury shares at that time.

The number of treasury shares held at 30 September 2016 was 15,348,714 (2015: 12,401,400), representing 5.47% of the issued share capital excluding treasury shares (2015: 4.18%). The maximum holding of treasury shares during the year was 27,716,094 (2015: 12,401,400) representing 9.83% of the issued share capital excluding treasury shares at that time (2015: 4.18%).

On 23 November 2016 the Company announced that the buy-back programme would be extended by a further amount of up to £50.0 million. The reasons for this extension are set out in section A3.3 of this Annual Report.

Dividends

The directors recommend a final dividend of 9.2p per share (2015: 7.4p per share) which, taken with the interim dividend of 4.3p per share (2015: 3.6p per share) paid on 22 July 2016, would give a total dividend for the year of 13.5p per share (2015: 11.0p per share).

Major shareholdings

Notifications of the following major voting interests, comprising over 3%, in the Company's ordinary share capital, notifiable in accordance with Chapter 5 of the FCA's Disclosure and Transparency Rules or section 793 of the Companies Act 2006, had been received by the Company as at 30 September 2016 and at 31 October 2016, being a date not more than one month before the date of the notice convening the forthcoming Annual General Meeting.

	31 October 2016		30 September 2016	
	Ordinary Shares	% Held	Ordinary Shares	% Held
BlackRock, Inc	23,513,790	8.38%	23,513,790	8.38%
Standard Life Investments	19,768,588	7.05%	19,768,588	7.05%
Royal London Asset Management	18,263,836	6.51%	18,263,836	6.51%
Prudential plc group of companies	18,012,554	6.42%	18,012,554	6.42%
Norges Bank	8,596,684	3.07%	8,596,684	3.07%

Significant agreements

The Company is not party to any significant agreements that would take effect, alter or terminate following a change of control of the company.

The Company does not have any agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover of the Company, except that provisions of the Company's share based remuneration arrangements may cause awards granted to employees under such plans to vest in such circumstances.

Political expenditure

Company law requires the disclosure of political donations and political expenditure by any Group company. During the year ended 30 September 2016 no such payments were made (2015: £nil).

Auditors

The directors have taken all reasonable steps to make themselves and the Company's auditors, 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 auditors are unaware.

The directors, having considered the requirements for rotation of auditors, the length of service of KPMG LLP and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the reappointment of KPMG LLP, who have expressed their willingness to continue in office, as the auditors of the Company is to be proposed at the forthcoming Annual General Meeting. The evaluation process is described more fully in the Audit Committee section B4.

Annual General Meeting

The Annual General Meeting of the Company will take place on 9 February 2017 in London. A notice convening the Annual General Meeting is being circulated to shareholders with this Annual Report and Accounts.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than the fact that the trustees of its employee share ownership trusts (note 52) have waived their right to receive dividends on any shares held from time to time. As these shares are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

Information presented in other sections

Certain information required to be included in a directors' report by Schedule 7 can be found in 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 Group is included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 7 to the accounts
- Information concerning directors' contractual arrangements and entitlements under share based remuneration arrangements is given in section B5, the Directors' Remuneration Report
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in section A5.1 – 'Employees'
- Disclosures concerning greenhouse gas emissions are given in Section A5.2 – 'Environmental policy'

Rule DTR 7.2.1 of the Disclosure and Transparency Rules requires the Group's disclosures on Corporate Governance to be included in the Directors' Report. This information is presented in sections B3, B4, B5 and B6 and the information in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

Rule DTR 4.1.5 of the Disclosure and Transparency Rules requires that the annual report of a listed company contains a management report containing certain prescribed information. This Directors' Report, including the other sections of the Annual Report incorporated by reference, comprises a management report for the Group for the year ended 30 September 2016, for the purposes of the Disclosure and Transparency Rules.

Section B7 of this Annual Report, together with the other sections of the Annual Report incorporated by reference, comprise a directors' report for the Company which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

Pandora Sharp

Company Secretary

23 November 2016

B8 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. The directors are required to prepare accounts for the Group in accordance with International Financial Reporting Standards ('IFRS') and have also elected to prepare company financial statements in accordance with IFRS. In respect of the financial statements for the year ended 30 September 2016, company law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 2006 and Article 4 of the IAS Regulation.

International Accounting Standard 1 – 'Presentation of Financial Statements' requires that financial statements present fairly for each financial year the Company'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. Directors are also required to:

- Properly select and apply accounting policies
- Make an assessment of the Group's and the Company's ability to continue as a going concern
- 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

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 Group and Company and the Group's profit or loss for the year.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, 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, directors' report, directors' remuneration report and corporate governance statement which comply with the applicable requirements of the Companies Act 2006.

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

The directors confirm that, to the best of their knowledge:

- The financial statements, prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and of the Group taken as a whole
- The Directors' Report, including those other sections of the Annual Report incorporated by reference, comprises a management report for the purposes of the Disclosure and Transparency Rules, which includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- The Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy

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

PANDORA SHARP

Company Secretary

23 November 2016

C. INDEPENDENT AUDITOR'S REPORT

Report by the independent auditor of the Company, KPMG LLP on the financial statements

C1 INDEPENDENT AUDITOR'S REPORT

To the members of The Paragon Group of Companies PLC only

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of The Paragon Group Companies PLC for the year ended 30 September 2016 set out in section D. In our opinion:

- The financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 30 September 2016 and of the Group's profit for the year then ended
- The group 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)
- The parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows:

Revenue recognition for loans and advances £377.8 million

Refer to section B4 (Audit Committee Report), note 3 (accounting policy) and notes 5 and 13 (critical accounting estimates and financial disclosures)

The risk

The recognition of revenue (interest receivable) on loans and advances to customers under the effective interest rate ("EIR") method requires the Directors to apply judgement, with the most critical being the estimation of a loan's expected behavioural life for originated assets and estimated remaining collections ("ERCs") for acquired loan portfolios. The duration and profile of the collections are used in models to determine the rate at which to recognise interest and fee income, incentives and origination costs expected for each particular asset type. The level of judgement required is illustrated by the sensitivity to changes in expected lives assumptions.

The Group's calculations are performed in Excel based models outside the core systems. Given the nature and complexity of the models there is an increased risk of error or opportunity for fraud.

Originated assets

The Group has segmented its portfolio of originated loans and advances in two ways - firstly by asset type and secondly by vintage. Separate behavioural lives are estimated for each segment. There is a risk that the choice of segmentation is inappropriate resulting in the estimation of an incorrect behavioural life.

The expected life assumptions utilise repayment profiles which represent how customers are expected to repay. As the forecast profiles extend significantly into the future this creates a high level of estimation uncertainty and subjects the judgement to future market changes. The Group makes its expected life assumptions based on its forecasting process which incorporates both historical experience and judgmental overlays made by management. However, both of these have limitations. The impact of recent developments in regulation and tax on buy-to-let products has increased the level of judgement required in the forecasting of behaviour for these products which represent 90% of the Group portfolio. The Group also has less historical experience for its newer lending due to the relatively unseasoned nature of these portfolios.

Purchased loan portfolios

For the Group's purchased debt portfolios the risk is that estimated future cash collections are not reflected by actual cash receipts. Given the nature of the company's debt portfolios, estimation of future cash collections requires significant judgement to make assumptions about the value, probability and timing of expected future cash flows for each type of asset class within a portfolio. Due to the level of subjectivity inherent in the assumptions used in the cash flow forecast, this is a key judgment area for our audit.

Our response - Our procedures included:

- Testing application controls, with the involvement of specialists, over the completeness and accuracy of data extraction into the models
- Agreeing to the Group reporting systems a sample of data inputs used to segment and estimate redemption profiles and calculate interest income
- Inspecting product literature to ensure that interest rate features, fees and costs were appropriately incorporated into the Group's models as required by the relevant accounting standards
- Performing sensitivity analysis to identify the most critical assumptions
- Challenging the appropriateness of key assumptions used in the models, including the expected lives and future cash flows, by comparing these to the Group's historical trends and actual portfolio behaviour, future outlook and our own expectations for comparable lending products
- For purchased debt portfolios, critically assessing the cash flow forecast with reference to our understanding of the Group and the current and past performance of the Group's portfolios, including recent cash collections; and
- Considering the adequacy of the Group's disclosures about the changes in estimate that occurred in the year and the sensitivity to changes in the key assumptions against the relevant requirements of accounting standards

Interest payable on asset backed loan notes £103.4 million

Refer to section B4 (Audit Committee Report), note 3 (accounting policy) and notes 5 and 14 (critical accounting estimates and financial disclosures)

The risk

The recognition of interest payable on asset backed loan note liabilities under the effective interest rate ("EIR") method requires the Directors to apply significant judgement in forecasting future cash flows, the most significant being the expected date of redemption. Due to the significant carrying value of the loan notes, small changes in the expected redemption date or in the methodology used to recognise interest payable would have a significant effect on the Group's interest payable and the carrying amount of the liability.

Our response - Our procedures included:

- Inspection of the contractual terms of the loan notes to assess the completeness and accuracy of input data
- Assessing the methodology used to recognise interest over the expected life of the loan notes against our interpretation of the requirements of the relevant accounting standards. This included the consideration of alternative modelling by us, to assess whether the carrying value of the loan notes is appropriate
- Performing sensitivity analysis to assess the significance of assumptions
- Assessing the expected date of redemption by comparing it with historical experience of similar arrangements, the Group's three year plans and anticipated movements in market conditions which may affect the availability and attractiveness of alternative sources of funding; and
- Considering the adequacy of the Group's disclosures about the changes in estimate that occurred in the year and the sensitivity to changes in the key assumptions against the relevant requirements of accounting standards

Impairment of loans and receivables £112.6 million

Refer to section B4 (Audit Committee Report), note 3 (accounting policy) and notes 5 and 36 (critical accounting estimates and financial disclosures)

The risk

The overall impairment provision recognised against loans and receivables does not appropriately provide for losses incurred at the reporting date.

The impairment provision relating to the Group's loan portfolios requires the Directors to make significant judgements and assumptions over the recoverability of loans and receivables. Changes to these assumptions may significantly impact the required level of impairment provision. For impairment purposes, the Group segments its portfolios along product lines to reflect the risk characteristics of each product type including buy-to-let mortgages, secured lending, car finance and finance leases. Impairment provisions are assessed on an individual and collective basis and we consider the key assumptions and risks for each in turn.

The Group's calculations are performed in Excel based models outside the core systems. Given the nature and complexity of the models there is an increased risk of error or opportunity for fraud.

Individual impairment

A critical assumption is the appropriate identification of the impairment trigger. The individual provision model uses arrears as the primary impairment trigger as well as whether the property is in receivership for buy-to-let property. There is a risk that other impairment triggers are not identified on a timely basis. The other key assumptions used in the calculation of the individual provision include the quantum and timing of future cash flows on impaired loans. In the estimation of future cash flows, the Group considers past payment behaviour, the expected collections approach, including net rental income from the receiver of rent arrangement through its subsidiary Redbrick, and the likely collateral valuation.

Collective impairment

For the purposes of the collective provision assessment, the Group calculates an emergence provision based on the previous loss experience for loans that have become individually impaired overlaid with management judgement. There is a risk that the overall provision is not reflective of the incurred losses at the end of the period due to the period of time assumed that it takes for incurred losses to emerge, changes in customer credit quality or other market factors which are not sufficiently incorporated into the model such as the tax position of borrowers, changes in rental income on buy-to-let properties, and house prices.

Our response - Our procedures included:

- Testing the key controls over the acceptance, monitoring and reporting of credit risk
- Testing application controls, with the involvement of specialists, over the completeness and accuracy of data extraction into the models
- Validating the accuracy of the collective and individual impairment models by re-performing the calculations
- Assessing the methodologies used against our interpretation of the requirements of the relevant accounting standards and our wider industry experience. This included the consideration of alternative statistically based provisioning methodologies, to assess whether the current modelled provision is sufficient
- Challenging the appropriateness of the Group's key assumptions, including collateral valuations and forecast cash flows under a receivership of rent arrangement. This is performed by reference to the Group's own historical experience, available benchmark data for similar asset classes at peer group organisations and a forward looking assessment of economic conditions
- Considering alternative impairment triggers and assessing whether these were sufficiently captured by the Group's models
- Performing sensitivity analysis over management's assumptions to identify those critical to the provision calculations; and
- Considering the adequacy of the Group's disclosures in relation to impairment including about the degree of sensitivity to key assumptions against the relevant requirements of accounting standards

Retirement benefit obligation valuation £58.4 million

Refer to section B4 (Audit Committee Report), note 3 (accounting policy) and notes 5 and 56 (critical accounting estimates and financial disclosures)

The risk

Small changes in the assumptions and estimates used to value the Group's pension obligation (before deducting scheme assets) would have a significant effect on the Group's net pension deficit. The level of judgement required in this estimation is highlighted by the level of sensitivity to changes in assumptions as shown by the increase in the deficit during the year.

Our response - Our procedures included:

- Challenging the key assumptions applied, being the discount rate, inflation rate and mortality/life expectancy, with the support of our own actuarial specialists
- Comparison of these key assumptions against externally derived data
- Considering the adequacy of the Group's disclosures in respect of the sensitivity of the deficit to these assumptions

Recoverability of goodwill £98.4 million

Refer to section B4 (Audit Committee Report), note 3 (accounting policy) and notes 5 and 29 (critical accounting estimates and financial disclosures)

The risk

During the year the Group has made two acquisitions, Paragon Bank Asset Finance and Premier Asset Finance, upon which significant goodwill balances were recognised in the consolidated statement of financial position. The estimated recoverable amount calculated under a value in use approach is subjective due to the inherent uncertainty involved in forecasting and discounting future cash flows.

The Paragon Bank Asset Finance CGU represents the most significant singular element of the goodwill balance. This business has undergone a period of transition under the Group's new ownership. In calculating the recoverable amount, the directors made assumptions over certain key inputs including profitability growth, the discount rate and the long-term growth rate. There is a risk of recoverability of the associated goodwill due to changes in market factors since the acquisition and the risk of the CGU not achieving a successful transition.

Our response - Our procedures included:

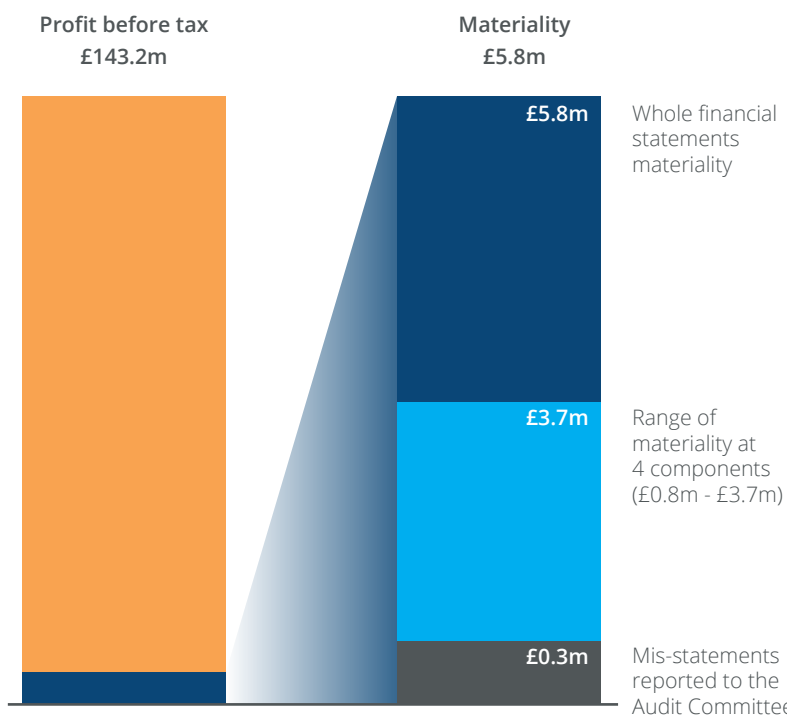
- Assessing whether the CGUs have been appropriately identified in relation to the requirements of the accounting standards, with consideration of how directors monitor and manage the business
- Comparing the Group's assumptions to externally derived data as well as our own assessments in relation to key inputs such as projected economic growth and discount rates, as well as performing break-even analysis on the assumptions
- Challenging forecast cash flows and growth rates in the context of the historical experience of the CGU and management's plans for the business; and
- Assessing whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill

3. Our application of materiality and an overview of the scope of our audit

The materiality for the group financial statements as a whole was set at £5.8 million, determined with reference to a benchmark of group profit before tax of £143.2 million, of which it represents 4.1%.

We report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.3 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's five components, we subjected four to audits for group reporting purposes. The component for which we performed the review was not individually significant but was included in the scope of our group reporting work in order to provide further coverage over the Group's results.



The Group audit team approved the component materialities which ranged from £0.8m to £3.7m having regard to the mix of size and risk profile of the Group across the components. The work on one of the five components, the Paragon Bank Asset Finance ("PBAF") sub-group, was performed by component auditors and the rest by the Group team.

The Group audit team instructed the component auditor as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team met with the component management team and component auditor as a part of the audit planning process. Throughout the audit, meetings were held to ensure regular engagement. At these meetings, the findings reported to the Group audit team were discussed in more detail. The Group auditor also reviewed and challenged the component auditor's work in significant risk areas. Any further work required by the Group team was then performed by the component auditor.

The audit was performed using the materiality levels set out above, 99% of total Group revenue, Group loss before taxation, and total Group assets were covered by audits for Group reporting purposes with the remainder covered by reviews.

4. Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- The part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- The information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- The directors' viability statement in section A4, concerning the principal risks, their management, and, based on that, the directors' assessment and expectations of the Group's continuing in operation over the 3 years to 30 September 2019; or
- The disclosures in note 3(c) of the financial statements concerning the use of the going concern basis of accounting

6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- We have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- The Audit Committee report Section B4 does not appropriately address matters communicated by us to the audit committee

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

Under the Listing Rules we are required to review:

- The directors' statements, set out in section A3, in relation to going concern and longer-term viability; and
- The part of the Corporate Governance Statement in section B3 relating to the company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement in section B8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Andrew Walker (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH

23 November 2016

D. THE ACCOUNTS

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

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D1.1 Consolidated Income Statement

For the year ended 30 September 2016

	Note	2016	2016	2015	2015
		£m	£m	£m	£m
Interest receivable	13		411.4		341.0
Interest payable and similar charges	14		(188.2)		(143.6)
Net interest income			223.2		197.4
Other leasing income	15	13.0		-	
Related costs	15	(10.0)		-	
Net leasing income		3.0		-	
Other income	16	17.8		14.1	
Other operating income			20.8		14.1
Total operating income			244.0		211.5
Operating expenses	17		(92.5)		(71.2)
Provisions for losses	22		(7.7)		(5.6)
Operating profit before fair value items			143.8		134.7
Fair value net (losses)	23		(0.6)		(0.5)
Operating profit being profit on ordinary activities before taxation			143.2		134.2
Tax charge on profit on ordinary activities	24		(27.2)		(27.1)
Profit on ordinary activities after taxation for the financial year			116.0		107.1

	Note	2016	2015
Earnings per share			
- basic	26	40.5p	35.5p
- diluted	26	39.7p	34.8p

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

D1.2 Consolidated Statement of Comprehensive Income

For the year ended 30 September 2016

	Note	2016		2015	
		£m	£m	£m	£m
Profit for the year			116.0		107.1
Other comprehensive income					
<i>Items that will not be reclassified subsequently to profit or loss</i>					
Actuarial (loss) on pension scheme	56	(37.2)		(4.3)	
Tax thereon	27	6.8		0.9	
			(30.4)		(3.4)
<i>Items that may be reclassified subsequently to profit or loss</i>					
Cash flow hedge gains / (losses) taken to equity	48	5.0		(3.1)	
Tax thereon	27	(1.0)		0.6	
			4.0		(2.5)
Other comprehensive income for the year net of tax			(26.4)		(5.9)
Total comprehensive income for the year			89.6		101.2

D1.3 Consolidated Balance Sheet

30 September 2016

	Note	2016 £m	2015 £m	2014 £m
Assets employed				
Non-current assets				
Intangible assets	28	105.4	7.7	7.9
Property, plant and equipment	30	39.2	22.1	22.9
Financial assets	32	12,116.4	10,745.8	9,969.6
		12,261.0	10,775.6	10,000.4
Current assets				
Other receivables	40	12.7	6.2	6.5
Short term investments	41	7.1	41.1	39.4
Cash and cash equivalents	42	1,237.6	1,056.0	848.8
		1,257.4	1,103.3	894.7
Total assets		13,518.4	11,878.9	10,895.1
Financed by				
Equity shareholders' funds				
Called-up share capital	43	295.9	309.3	307.3
Reserves	44	736.1	760.2	688.0
Share capital and reserves		1,032.0	1,069.5	995.3
Own shares	52	(62.5)	(100.0)	(48.2)
Total equity		969.5	969.5	947.1
Current liabilities				
Financial liabilities	53	1,128.3	339.6	54.4
Current tax liabilities	58	16.7	12.5	11.9
Other liabilities	59	56.3	43.0	40.1
		1,201.3	395.1	106.4
Non-current liabilities				
Financial liabilities	53	11,264.8	10,481.4	9,814.0
Retirement benefit obligations	56	58.4	21.5	17.3
Deferred tax	57	2.0	11.3	10.1
Other liabilities	59	22.4	0.1	0.2
		11,347.6	10,514.3	9,841.6
Total liabilities		12,548.9	10,909.4	9,948.0
		13,518.4	11,878.9	10,895.1

Approved by the Board of Directors on 23 November 2016.

Signed of behalf of the Board of Directors

N S Terrington

Chief Executive

R J Woodman

Group Finance Director

D1.4 Company Balance Sheet

30 September 2016

	Note	2016 £m	2015 £m	2014 £m
Assets employed				
Non-current assets				
Property, plant and equipment	30	18.9	19.3	19.6
Investment in subsidiary undertakings	31	984.8	1,018.3	928.0
		1,003.7	1,037.6	947.6
Current assets				
Other receivables	40	84.6	141.3	103.9
Cash and cash equivalents	42	361.3	196.8	166.5
		445.9	338.1	270.4
Total assets		1,449.6	1,375.7	1,218.0
Financed by				
Equity shareholders' funds				
Called-up share capital	43	295.9	309.3	307.3
Reserves	44	470.1	497.5	456.4
Share capital and reserves		766.0	806.8	763.7
Own shares	52	(46.2)	(89.2)	(39.5)
Total equity		719.8	717.6	724.2
Current liabilities				
Financial liabilities	53	110.0	-	-
Current tax liabilities	58	0.4	2.6	2.3
Other liabilities	59	173.2	248.7	196.5
		283.6	251.3	198.8
Non-current liabilities				
Financial liabilities	53	444.3	404.9	293.2
Deferred tax	57	1.9	1.9	1.8
		446.2	406.8	295.0
Total liabilities		729.8	658.1	493.8
		1,449.6	1,375.7	1,218.0

Approved by the Board of Directors on 23 November 2016.
Signed of behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Group Finance Director

D1.5 Consolidated Cash Flow Statement

For the year ended 30 September 2016

	<i>Note</i>	2016	2015
		£m	£m
Net cash generated / (utilised) by operating activities	61	865.2	(25.9)
Net cash (utilised) by investing activities	62	(278.6)	(3.6)
Net cash (utilised) / generated by financing activities	63	(405.5)	237.1
Net increase in cash and cash equivalents		181.1	207.6
Opening cash and cash equivalents		1,055.3	847.7
Closing cash and cash equivalents		1,236.4	1,055.3
Represented by balances within:			
Cash and cash equivalents		1,237.6	1,056.0
Financial liabilities		(1.2)	(0.7)
		1,236.4	1,055.3

D1.6 Company Cash Flow Statement

For the year ended 30 September 2016

	Note	2016 £m	2015 £m
Net cash generated by operating activities	61	67.6	100.5
Net cash generated / (utilised) by investing activities	62	32.5	(105.2)
Net cash generated by financing activities	63	64.4	35.0
Net increase in cash and cash equivalents		164.5	30.3
Opening cash and cash equivalents		196.8	166.5
Closing cash and cash equivalents		361.3	196.8
Represented by balances within:			
Cash and cash equivalents		361.3	196.8
Financial liabilities		-	-
		361.3	196.8

D1.7 Consolidated Statement of Movements in Equity

For the year ended 30 September 2016

	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Cash flow hedging reserve £m	Profit and loss account £m	Own shares £m	Total equity £m
Transactions arising from								
Profit for the year	-	-	-	-	-	116.0	-	116.0
Other comprehensive income	-	-	-	-	4.0	(30.4)	-	(26.4)
Total comprehensive income	-	-	-	-	4.0	85.6	-	89.6
Transactions with owners								
Dividends paid (note 50)	-	-	-	-	-	(33.9)	-	(33.9)
Shares cancelled	(13.7)	-	13.7	-	-	(94.0)	94.0	-
Own shares purchased	-	-	-	-	-	-	(59.9)	(59.9)
Shares issued to ESOP	0.3	-	-	-	-	-	(0.3)	-
Exercise of share awards	-	-	-	-	-	(3.7)	3.7	-
Charge for share based remuneration (note 18)	-	-	-	-	-	4.4	-	4.4
Tax on share based remuneration (note 27)	-	-	-	-	-	(0.2)	-	(0.2)
Net movement in equity in the year	(13.4)	-	13.7	-	4.0	(41.8)	37.5	-
Opening equity	309.3	64.6	-	(70.2)	(1.9)	767.7	(100.0)	969.5
Closing Equity	295.9	64.6	13.7	(70.2)	2.1	725.9	(62.5)	969.5

D1.7 Consolidated Statement of Movements in Equity

For the year ended 30 September 2015

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	107.1	-	107.1
Other comprehensive income	-	-	-	-	(2.5)	(3.4)	-	(5.9)
Total comprehensive income	-	-	-	-	(2.5)	103.7	-	101.2
Transactions with owners								
Dividends paid (note 50)	-	-	-	-	-	(29.1)	-	(29.1)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(56.9)	(56.9)
Shares issued to ESOP	1.0	-	-	-	-	-	(1.0)	-
Exercise of share awards	1.0	0.5	-	-	-	(6.1)	6.1	1.5
Charge for share based remuneration (note 18)	-	-	-	-	-	4.5	-	4.5
Tax on share based remuneration (note 27)	-	-	-	-	-	1.2	-	1.2
Net movement in equity in the year	2.0	0.5	-	-	(2.5)	74.2	(51.8)	22.4
Opening equity	307.3	64.1	-	(70.2)	0.6	693.5	(48.2)	947.1
Closing Equity	309.3	64.6	-	(70.2)	(1.9)	767.7	(100.0)	969.5

D1.8 Company Statement of Movements in Equity

Year ended 30 September 2016

	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Profit and loss account £m	Own shares £m	Total equity £m
Transactions arising from							
Profit for the year	-	-	-	-	82.4	-	82.4
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	82.4	-	82.4
Transactions with owners							
Dividends paid (note 50)	-	-	-	-	(33.9)	-	(33.9)
Shares cancelled	(13.7)	-	13.7	-	(94.0)	94.0	-
Own shares purchased	-	-	-	-	-	(51.0)	(51.0)
Shares issued to ESOP	0.3	-	-	-	-	-	0.3
Exercise of share awards	-	-	-	-	-	-	-
Charge for share based remuneration (note 18)	-	-	-	-	4.4	-	4.4
Net movement in equity in the year	(13.4)	-	13.7	-	(41.1)	43.0	2.2
Opening equity	309.3	64.6	-	(23.7)	456.6	(89.2)	717.6
Closing Equity	295.9	64.6	13.7	(23.7)	415.5	(46.2)	719.8

D1.8 Company Statement of Movements in Equity

Year ended 30 September 2015

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	65.2	-	65.2
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	65.2	-	65.2
Transactions with owners							
Dividends paid (note 50)	-	-	-	-	(29.1)	-	(29.1)
Shares cancelled	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	(49.7)	(49.7)
Shares issued to ESOP	1.0	-	-	-	-	-	1.0
Exercise of share awards	1.0	0.5	-	-	-	-	1.5
Charge for share based remuneration (note 18)	-	-	-	-	4.5	-	4.5
Net movement in equity in the year	2.0	0.5	-	-	40.6	(49.7)	(6.6)
Opening equity	307.3	64.1	-	(23.7)	416.0	(39.5)	724.2
Closing Equity	309.3	64.6	-	(23.7)	456.6	(89.2)	717.6

D2 NOTES TO THE ACCOUNTS

For the year ended 30 September 2016

1. General Information

The Paragon Group of Companies PLC is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 2336032. The address of the registered office is 51 Homer Road, Solihull, West Midlands B91 3QJ. The nature of the Group's operations and its principal activities are set out in the Strategic Report in section A2.

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

2. Adoption of New and Revised Reporting Standards

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

(a) Standards not yet adopted

At the date of authorisation of these financial statements the following International Financial Reporting Standards and Interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

- IFRS 9 – 'Financial Instruments'
- IFRS 15 – 'Revenue from Contracts with Customers'
- IFRS 16 – 'Leases'
- IAS 7 – 'Disclosure initiative amendments'

IFRS 9

IFRS 9 largely replaces the requirements of the existing financial instruments standard, IAS 39: 'Financial Instruments: Recognition and Measurement'. It addresses the areas of recognition, bases of valuation, income recognition methods, impairment and hedging for financial instruments and will become the standard governing the accounting for Group's Loans to Customers, Borrowings and Derivative Financial Assets and Liabilities. Only the rules relating to the Group's portfolio hedging arrangements will remain subject to IAS 39, though the International Accounting Standards Board ('IASB') are also working on this area.

This standard will come into force with effect from the Group's financial statements for the year ending 30 September 2019, if it is endorsed by the European Union. The EU has indicated that endorsement may be expected in the final quarter of 2016.

Following the publication of the final version of the Standard by the IASB in July 2014, during the year ended 30 September 2015 the Group began to assess its potential impact. The Group's preliminary conclusions are that the effect of the replacement of IAS 39 with IFRS 9 in most areas of accounting will not be significant, as many of the current rules are repeated in broadly similar form in the new standard. In particular the amortised cost basis of valuation and the related EIR method of income recognition remain largely unchanged, and the revisions to hedging are likely to produce a broadly similar result to the present methodology.

The area where the new standard is likely to have the most significant impact on the Group is in accounting for impaired loans. In general terms IFRS 9 will require earlier recognition of losses than IAS 39 does, including some element of loss provision from day one of a loan. It will also require that firms take account of a wider set of indicators to establish when an impairment provision is required.

During the year the Group has continued its project to ensure it is able to comply with the new requirements. The project includes finance, analysis and credit risk personnel, is sponsored by the Group Finance Director and reports regularly to the Audit Committee.

Project workflows have included analysis of historic internal and external credit performance metrics, prototype model design and consideration of how external economic factors should affect IFRS 9 impairments. External consultants and the Group's auditors have been engaged with as appropriate, with initial work focussing on the Group's most significant asset classes.

Work will continue on this project through the year ending 30 September 2017 and a further report on progress will be given in that year's Annual Report and Accounts.

IFRS 15

IFRS 15 will replace the standards currently governing the recognition of that part of the Group's income which does not derive directly from financial assets. If endorsed by the EU, it will come in to force with effect from the Group's financial statements for the year ending 30 September 2019, but is not expected to have a material impact on its results or financial position.

IFRS 16

IFRS 16 will replace the standards currently governing the accounting for operating and finance leases. If endorsed by the EU, it will come in to force with effect from the Group's financial statements for the year ending 30 September 2020, but as the changes from the existing standard, IAS 17, affect principally accounting by lessees the introduction of the new standard is not expected to have a material impact on its results or financial position.

IAS 7

The Disclosure Initiative amendments to IAS 7 – 'Statement of Cash Flows', which will come into force with effect from the Group's financial year ending 30 September 2018 if endorsed by the EU, will require entities to present a note to the accounts describing movements in liabilities arising from financing cash flows. The Group already presents such a note on a voluntary basis (note 64), therefore the introduction of the standard will have minimal impact.

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

3. Accounting Policies

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. In the financial years reported upon this means that the financial statements accord also with International Financial Reporting Standards as approved by the International Accounting Standards Board.

The particular policies applied 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 consolidated financial statements deal with the accounts of the Company and its subsidiaries made up to 30 September 2016. Subsidiaries comprise all those entities over which the Group has control. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

In accordance with IFRS 10 – ‘Consolidated Financial Statements’ companies owned by charitable trusts into which loans originated by group companies were sold as part of its warehouse and securitisation funding arrangements, where the Group enjoys the benefits of ownership, are treated as subsidiaries.

Similarly, trusts set up to hold shares in conjunction with the Group’s employee share ownership arrangements are also treated as subsidiaries.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

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.

In order to assess the appropriateness of the going concern basis the directors considered the Group’s financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them.

After performing this assessment, the directors concluded that it was appropriate for them to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

Negative goodwill is written off as it arises.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – ‘Business Combinations’ to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – ‘Business Combinations’. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(f) Leases

Leases are accounted for as operating or finance leases in accordance with IAS 17 – ‘Leases’. A finance lease is deemed to be one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Rental income and costs under operating leases are credited or charged to the profit and loss account on a straight line basis over the period of the leases.

(g) Property, plant and equipment

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

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. This depreciation is deducted in arriving at net lease income and is shown in note 15.

The assets’ residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Freehold premises	2% per annum
Short leasehold premises	over the term of the lease
Computer hardware	25% per annum
Furniture, fixtures and office equipment	15% per annum
Company motor vehicles	25% per annum

(h) Investments in subsidiaries

The Company's investments in subsidiary undertakings are valued at cost less provision for impairment.

(i) Loans to customers

Loans to customers are considered to be 'loans and receivables' as defined by IAS 39 – 'Financial Instruments: Recognition and Measurement'. They 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 procurement 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 for balances which are considered to be impaired.

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.

(j) 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 accounted for on the actuarial basis.

(k) Impairment of loans and receivables

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date in accordance with IAS 39. Where loans exhibit objective evidence of impairment (a 'loss event') the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security (net of sales costs) discounted at the original EIR.

Within its buy-to-let portfolio the Group 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. Properties in receivership are either returned to their landlord owners or sold.

Loss events reflect both loans that display delinquency in contractual payments of principal or interest or, for buy-to-let loans in receivership but up to date at the balance sheet date, properties where the receiver adopts a sale strategy, where a shortfall may or may not arise.

In addition to loans where loss events are evident, loans are also assessed collectively, grouped by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date. Collective impairment provisions are calculated for each key portfolio based on recent historical performance, with adjustments for expected changes in losses based on management's judgement.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments. An impairment charge is only recognised in the income statement if the total receipts from an acquired portfolio are below the original purchase price. Changes to expected cash flows from acquired portfolios are reflected by discounting the future expected cash flows by the original effective interest rate, with any change from the prevailing carrying value being recognised in the income statement.

For financial accounting purposes provisions for impairments of loans to customers when first recognised in the income statement are held in an allowance account. These balances are released to offset against the gross value of the loan when it is written off to profit and loss on the administration system. After this point a salvage balance may be held in respect of any further recoveries expected on the loan.

(l) Investments 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.

(m) Amounts owed by or to group companies

In the accounts of the Company 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 ‘Loans and Receivables’ or ‘Other financial liabilities’, respectively.

(n) Short term investments

Short term investments are held as part of the liquidity requirement of Paragon Bank PLC. As such they are designated as ‘Available for Sale’, as defined by IAS 39 - ‘Financial Instruments: Recognition and Measurement’ and are consequently measured at their fair value which corresponds to their market value at the balance sheet date.

(o) 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.

(p) Own shares

Shares in The Paragon Group of Companies PLC held in treasury or by the trustees of the Group’s employee share ownership plans are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

(q) Taxation

The charge for taxation represents the expected UK corporation tax and other income taxes arising from the Group’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 Group 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.

(r) 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.

(s) 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.

(t) Derivative financial instruments

Derivative instruments utilised by the Group comprise currency swap, interest rate swap and interest rate option agreements. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Group in line with the Group's risk management policies.

The Group does not enter into speculative derivative contracts.

All derivatives 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.

(u) Hedging

For all hedges, the Group documents, at inception, the relationship between the hedging instruments and the hedged items, as well as its risk management strategy and objectives for undertaking the transaction. The Group 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 highly probable.

(v) 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.

(w) Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the income statement. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(x) Revenue

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

(y) Fee and commission income

Other income includes:

- Administration fees charged to borrowers, 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, which are taken to profit at the point at which the Group becomes unconditionally entitled to the income
- Maintenance income charged as part of the Group's contract hire arrangements which is recognised as the services are provided. Costs of these services are deducted in other income; and
- Broker fees receivable on the arrangement of loans funded by third parties, which are taken to profit at the point of completion of the related loan

(z) Share based payments

In accordance with IFRS 2 – ‘Share based Payments’, the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group’s various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

(aa) 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 Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders’ funds.

(bb) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – ‘The Effects of Changes in Foreign Exchange Rates’. The functional currency of the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(cc) Segmental reporting

The accounting policies of the operating segments are the same as those described above for the Group as a whole. Costs attributed to each segment represent the direct costs incurred by the segment operations and an allocation of the costs of areas of the business which serve all segments. Such allocations are weighted by the value of loan assets in each segment, adjusted for the relative effort involved in the administration of each asset class.

4. Fair Values of Financial Assets and Financial Liabilities

IFRS 7 – ‘Financial Instruments: Disclosures’ requires that where assets are measured at fair value these measurements should be classified using a fair value hierarchy reflecting the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from 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 Group had no financial assets or liabilities in the year ended 30 September 2016 or the year ended 30 September 2015 valued using level 3 measurements.

The Group 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 is set out below.

a) Assets and liabilities carried at fair value

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group 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 benchmark interest rates for the currencies in which the instruments are denominated, sterling, euros and dollars. The cross currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. 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 39.

Short term investments

The short term investments described in note 41 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

b) Assets and liabilities carried at amortised cost

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, 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. This also applies to the parent company's loans to its subsidiaries.

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 and an adjustment is required. As these valuation exercises are not wholly market based they are considered to be level 2 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group'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 redemption rates. Given the mixture of observable and non-observable inputs, these are considered to be level 2 measurements.

Loan assets

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group'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 2 measurements.

The fair values for financial assets and liabilities held at amortised cost, other than those where carrying values are so low that any difference would be immaterial, determined in accordance with the methodologies set out above is summarised below.

	2016 Carrying amount £m	2016 Fair value £m	2015 Carrying amount £m	2015 Fair value £m
The Group				
Financial assets				
Loans and receivables				
Loans to customers	10,737.5	10,754.4	10,062.4	10,063.6
Cash	1,237.6	1,237.6	1,056.0	1,056.0
	11,975.1	11,992.0	11,118.4	11,119.6
Financial liabilities				
Other liabilities				
Asset backed loan notes	8,374.1	8,374.1	8,274.6	8,274.6
Corporate and retail bonds	554.3	573.3	404.9	411.2
Retail deposits	1,873.9	1,887.2	708.7	707.5
Bank loans	1,573.0	1,573.0	1,425.4	1,425.4
	12,375.3	12,407.6	10,813.6	10,818.7
The Company				
Financial assets				
Loans and receivables				
Loans to group companies	465.4	465.4	671.8	671.8
Cash	361.3	361.3	196.8	196.8
	826.7	826.7	868.6	868.6
Financial liabilities				
Other liabilities				
Corporate and retail bonds	554.3	573.3	404.9	411.2
	554.3	573.3	404.9	411.2

5. 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. The key 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 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 conditions.

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.

To illustrate this the impairment provisions were recalculated by changing one factor in the calculation and keeping all others at their current levels. This exercise indicated that:

- Adopting a sale strategy for 5% of currently let buy-to-let properties with a receiver of rent in place would increase impairment provisions by £2.6m
- 5% of receiver of rent properties currently vacant or for sale becoming fully performing would reduce impairment provisions by £0.4m
- A 10% reduction in house prices would increase impairment provisions across the first mortgage assets by £3.0m, while a 10% increase would reduce impairment provisions by £2.5m
- A reduction in cash flows from receiver of rent properties of 10% would increase impairment provision by £0.2m

It should be noted that all of these changes would, in reality be interrelated so examining them singly may not give reliable guidance to future behaviour.

(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 loan and hence the cash flows relating thereto. For purchased accounts this will involve estimating the likely future 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 those predicted, which in turn would depend directly or indirectly on customer behaviour.

To illustrate this the impairment provisions were recalculated by changing one factor in the calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction (or increase) of the assumed average lives of loans secured on residential property by three months would reduce (or increase) balance sheet assets by £1.6m
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £14.5m
- An increase of one year in the estimated lives of FRN borrowings would increase balance sheet liabilities by £1.0m

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

(c) Impairment of goodwill

The carrying value of the goodwill recognised on the Group's acquisition of PBAF and Premier is verified by use of an impairment test based on the projected cash flows for the cash generating unit, based on management forecasts and other assumptions described in note 29, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the cash generating unit is able to achieve in practice. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 29.

(d) Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions relating to inflation, long-term return on investments and mortality. These are listed in note 56. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

Information on the sensitivity of the valuation to the various assumptions is given in note 56.

6. Capital Management

The Group's objectives in managing capital are:

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

The Group sets the amount of capital in proportion to risk, availability and cost. The Group 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 Group 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.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

(a) Dividend policy

The Group's dividend policy, announced in 2012 has been to target a dividend cover ratio of between 3.0 and 3.5 times by the end of this financial year. The dividend cover ratio had reached 3.2 times in respect of the year ended 30 September 2015 and the target of 3.0 times was achieved in respect of the financial year ended 30 September 2016. The Group has stated its intention to operate a progressive dividend policy, maintaining the three times cover ratio going forward. The Group considers that it has sufficient cash resources available to pay dividends at this level, and that the parent company has abundant distributable reserves for this purpose.

The most common measure of dividend cover used by financial analysts is based on earnings and dividend per share. The Group has confirmed that its dividend cover target will be based on this calculation. The expected level of dividend cover on this basis in respect of the year, subject to the approval of the final dividend at the Annual General Meeting, is shown below.

	<i>Note</i>	2016	2015
Earnings per share (p)	26	40.5	35.5
Proposed dividend per share in respect of the year (p)	50	13.5	11.0
Dividend cover (times)		3.0	3.2

(b) Return on tangible equity

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

The Group's consolidated RoTE for the year ended 30 September 2016 is derived as follows:

	Note	2016 £m	2015 £m
Profit for the year		116.0	107.1
Amortisation of intangible assets	17	1.6	1.4
Adjusted profit		117.6	108.5
Divided by			
Opening equity		969.5	947.1
Opening intangible assets	28	(7.7)	(7.9)
Opening tangible equity		961.8	939.2
Closing equity		969.5	969.5
Closing intangible assets	28	(105.4)	(7.7)
Closing tangible equity		864.1	961.8
Average tangible equity		913.0	950.5
Return on Tangible Equity		12.9%	11.4%

This table is not subject to audit

(c) Gearing

The Board of Directors regularly review the proportion of working capital represented by debt and equity. Net debt is calculated as total debt, other than securitised and warehouse debt, valued at principal value, less free cash up to a maximum of the total debt. Adjusted equity comprises all components of equity (share capital, share premium, capital redemption reserve, retained earnings, and revaluation surplus) other than amounts recognised in equity relating to cash flow hedges.

The debt and equity amounts at 30 September 2016 and at 30 September 2015 were as follows:

	<i>Note</i>	2016	2015
		£m	£m
Debt			
Corporate bond	55	260.0	110.0
Retail bonds	55	297.5	297.5
Bank overdraft	53	1.2	0.7
Less: Applicable free cash	42	(366.5)	(199.9)
Net debt		192.2	208.3
Equity			
Total equity		969.5	969.5
Less: cash flow hedging reserve	48	(2.1)	1.9
Adjusted equity		967.4	971.4
Total working capital		1,159.6	1,179.7
Debt		16.6%	17.7%
Equity		83.4%	82.3%
Total working capital		100.0%	100.0%

The movements in the proportion of working capital represented by debt and equity during the year ended 30 September 2016 resulted primarily from the operation of the policy described above.

(d) Regulatory capital

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

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

At 30 September 2016 the Group's regulatory capital of £1,005.6m (2015: £976.3m) was comfortably in excess of that required by the regulator.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2016 is set out below.

	Note	2016 £m	2015 £m
Total equity		969.5	969.5
Deductions			
Proposed final dividend	50	(25.5)	(21.8)
Intangible assets	28	(105.4)	(7.7)
Deferred tax adjustment	*	-	(0.3)
Common Equity Tier 1 ('CET1') capital		838.6	939.7
Other tier 1 capital		-	-
Total Tier 1 capital		838.6	939.7
Corporate bond	55	260.0	110.0
Less: amortisation adjustment	†	(97.8)	(75.8)
		162.2	34.2
Collectively assessed credit impairment allowances		4.8	2.4
Total Tier 2 capital		167.0	36.6
Total regulatory capital		1,005.6	976.3

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

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. As the Group's £110.0m Corporate Bond matures in 2017, this adjustment is required in respect of this instrument. No such adjustment is required in respect of the Corporate Bond issued in the year, which matures in 2026.

The total exposure amount 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.

	2016	2015
	£m	£m
Credit risk		
Balance sheet assets	4,728.4	4,426.8
Off balance sheet	51.5	88.7
Total credit risk	4,779.9	4,515.5
Operational risk	445.7	363.6
Market risk	-	-
Other	61.9	50.2
Total exposure amount	5,287.5	4,929.3
Solvency ratios	%	%
CET1	15.9	19.1
Total regulatory capital	19.0	19.8

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.

The table below shows the calculation of the leverage ratio, based on the consolidated balance sheet assets adjusted as shown. The PRA has set a minimum leverage ratio of 3.0% for UK firms.

	Note	2016	2015
		£m	£m
Total balance sheet assets		13,518.4	11,878.9
Less: Derivative assets	39	(1,366.4)	(660.1)
On-balance sheet items		12,152.0	11,218.8
Less: Intangible assets	28	(105.4)	(7.7)
Total on balance sheet exposures		12,046.6	11,211.1
Derivative assets	39	1,366.4	660.1
Potential future exposure on derivatives		68.6	69.1
Total derivative exposures		1,435.0	729.2
Post offer pipeline at gross notional amount		273.8	482.3
Adjustment to convert to credit equivalent amounts		(136.9)	(241.1)
Off balance sheet items		136.9	241.2
Tier 1 capital		838.6	939.7
Total leverage exposure		13,618.5	12,181.5
Basel III leverage ratio		6.2%	7.7%

This table is not subject to audit

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

7. Financial Risk Management

The principal financial risks arising from the Group's normal business activities are credit risk, liquidity risk, interest rate risk and currency risk. The Board of Directors has a Risk and Compliance Committee, established in 2014, consisting of the Chairman and the non-executive directors which is responsible for risk management. The Credit Committee and the ALCO are executive sub-committees of the Risk and Compliance Committee which review and agree policies for managing each of these risks, which are summarised below. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees. The financial risk management policies have remained unchanged throughout the year and since the year end. The position disclosed below is materially similar to that existing throughout the year. Paragon Bank has its own risk management structure, which also covers the asset finance operations, which is overseen by the Group committees.

Use of derivative financial instruments

The Group uses derivative financial instruments for risk management purposes. Such instruments are contracts with counterparties and are used only to reduce or eliminate the exposure of the Group to movements in market interest or exchange rates.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken, and hence all of the Group's derivative financial instruments are for commercial hedging purposes only. These are used to protect the Group from exposures principally arising from fixed rate lending or borrowing and borrowings denominated in foreign currencies. Hedge accounting is applied where appropriate, though it should be noted that some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, while 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 Group has designated a number of derivatives as fair value hedges for accounting purposes. In particular this treatment is used for:

- (a) hedging the interest rate risk of groups of fixed rate prepayable loan assets with interest rate derivatives on a portfolio basis; and
- (b) hedging the interest rate risk of groups of fixed rate retail deposits with interest rate derivatives on a portfolio basis.

In both cases the Group believes this solution is the most appropriate as it is consistent with the economic hedging approach taken by the Group to these assets and liabilities.

The Group has also designated cash flow hedging relationships, principally arising from currency borrowings, where a specified foreign exchange basis swap, set up as part of the terms of the borrowing is used.

The Company has no derivative assets or liabilities.

Credit risk

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

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

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

The assets of the Group and the Company which are subject to credit risk are set out below:

	Note	The Group		The Company	
		2016 £m	2015 £m	2016 £m	2015 £m
Loans to customers	35	10,737.5	10,062.4	-	-
Investments in structured entities	38	-	18.1	-	-
Derivative financial assets	39	1,366.4	660.1	-	-
Amounts owed by Group companies	40	-	-	84.5	141.2
Accrued interest income	40	0.3	0.4	0.1	0.1
CSA assets	40	3.7	0.9	-	-
Trade debtors	40	2.4	-	-	-
Short term investments	41	7.1	41.1	-	-
Cash	42	1,237.6	1,056.0	361.3	196.8
Maximum exposure to credit risk		13,355.0	11,839.0	445.9	338.1

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

Loans to customers and other investments in loan assets

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

The Group's loan assets at 30 September 2016 are analysed as follows:

	2016	2016	2015	2015
	£m	%	£m	%
Buy-to-let mortgages	9,621.2	89.6%	9,363.2	93.0%
Owner occupied mortgages	19.4	0.2%	47.6	0.5%
Total first residential mortgages	9,640.6	89.8%	9,410.8	93.5%
Secured loans	526.8	4.9%	387.1	3.9%
Loans secured on residential property	10,167.4	94.7%	9,797.9	97.4%
Development finance	9.1	0.1%	-	-
Commercial mortgages	2.9	-	-	-
Loans secured on property	10,179.4	94.8%	9,797.9	97.4%
Car loans	95.3	0.9%	43.4	0.4%
Retail finance loans	0.2	-	0.2	-
Other consumer loans	194.9	1.8%	220.9	2.2%
Asset finance loans	250.4	2.3%	-	-
Factoring and discounting balances	16.9	0.2%	-	-
Other loans	0.4	-	-	-
Total loans to customers	10,737.5	100.0%	10,062.4	100.0%

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

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

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

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.

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

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on property by value at 30 September 2016 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2016	2016	2015	2015
	First mortgages	Secured loans	First mortgages	Secured loans
	%	%	%	%
Loan to value ratio				
Less than 70%	60.7	50.9	51.9	33.7
70% to 80%	23.4	17.8	27.6	16.3
80% to 90%	11.3	13.0	12.8	16.7
90% to 100%	2.2	8.9	4.9	13.5
Over 100%	2.4	9.4	2.8	19.8
	100.0	100.0	100.0	100.0
Average loan to value ratio	67.1	72.7	69.5	80.9
Buy-to-let	67.2		69.7	
Owner-occupied	27.5		28.8	

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 5.3% in the year ended 30 September 2016 (2015: 3.8%).

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 2016 and 30 September 2015, compared to the industry averages at those dates published by the CML and the FLA, was:

	2016	2015
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.11	0.19
Buy-to-let accounts excluding receiver of rent cases	0.02	0.04
Owner-occupied accounts	3.23	3.55
CML data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.55	0.66
Buy-to-let accounts excluding receiver of rent cases	0.50	0.60
Owner-occupied accounts	1.11	1.27
All mortgages	1.01	1.17
Secured loans		
Accounts more than two months in arrears	17.15	19.56
FLA data for point of sale hire purchase	12.50	15.40
Car loans		
Accounts more than two months in arrears	0.30	0.67
FLA data for point of sale hire purchase	1.50	1.20
Asset finance loans		
Accounts more than two months in arrears	0.82	-
FLA data for business lease / hire purchase loans	0.70	0.80
Other loans		
Accounts more than two months in arrears	96.35	94.66

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2016 has been published by the FLA or CML, the comparative industry figures above have been amended.

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

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

The improvement in the arrears position for car loans shown above is due to the recommencement of lending in this market, through Paragon Bank, with the new performing cases reducing the overall average.

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

The payment status of the carrying balances of the Group's live loan assets, before provision for impairment, at 30 September 2016 and at 30 September 2015 split between those accounts considered as performing and those included in the population for impairment testing, is shown below. Balances for immaterial asset classes are not shown. Asset finance loans below includes other related loan balances. Fully provided non-live accounts are excluded from the tables below.

Days past due is not a relevant measure for the development finance or invoice discounting businesses, due to their particular contractual arrangements.

First mortgages

	2016	2015
	£m	£m
Not past due	9,528.1	9,274.0
Arrears less than 3 months	82.1	100.8
Performing accounts	9,610.2	9,374.8
Arrears 3 to 6 months	2.4	4.6
Arrears 6 to 12 months	2.8	4.1
Arrears over 12 months	11.0	15.8
Possessions and similar cases	31.1	28.8
Impairment population	47.3	53.3
Total gross balances	9,657.5	9,428.1
Impairment provision on live cases	(16.4)	(15.3)
Timing adjustments	(0.5)	(2.0)
Carrying balance	9,640.6	9,410.8

Consumer and asset finance

	Secured loans	Car loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2016				
Not past due	415.0	92.7	251.6	759.3
Arrears less than 2 months	33.3	3.0	1.5	37.8
Performing accounts	448.3	95.7	253.1	797.1
Arrears 2 to 6 months	20.3	0.2	1.0	21.5
Arrears 6 to 9 months	8.3	-	0.3	8.6
Arrears 9 to 12 months	7.4	-	-	7.4
Arrears over 12 months	51.0	0.2	0.4	51.6
Specifically impaired asset finance cases	-	-	3.3	3.3
Impairment population	87.0	0.4	5.0	92.4
Total gross balances	535.3	96.1	258.1	889.5
Impairment provision on live cases	(3.4)	(0.6)	(0.5)	(4.5)
Timing adjustments	(5.1)	(0.2)	(3.9)	(9.2)
Carrying balance	526.8	95.3	253.7	875.8

	Secured loans	Car loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2015				
Not past due	265.2	43.3	-	308.5
Arrears less than 2 months	25.7	0.2	-	25.9
Performing accounts	290.9	43.5	-	334.4
Arrears 2 to 6 months	20.2	-	-	20.2
Arrears 6 to 9 months	8.9	-	-	8.9
Arrears 9 to 12 months	7.4	-	-	7.4
Arrears over 12 months	63.5	0.4	-	63.9
Specifically impaired asset finance cases	-	-	-	-
Impairment population	100.0	0.4	-	100.4
Total gross balances	390.9	43.9	-	434.8
Impairment provision on live cases	(5.4)	(0.5)	-	(5.9)
Timing adjustments	1.6	-	-	1.6
Carrying balance	387.1	43.4	-	430.5

Other loans

	2016	2015
	£m	£m
Not past due	4.1	6.7
Arrears less than 1 months	0.3	0.5
Performing accounts	4.4	7.2
Arrears 1 to 3 months	0.4	0.5
Arrears 3 to 6 months	0.7	0.9
Arrears 6 to 12 months	2.3	2.7
Arrears over 12 months	203.5	226.5
Impairment population	206.9	230.6
Total gross balances	211.3	237.8
Impairment provision	(16.4)	(16.9)
Timing adjustments	-	-
Carrying balance	194.9	220.9

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

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

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.

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

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

	2016 Carrying value £m	2016 84 month ERC £m	2016 120 month ERC £m	2015 Carrying value £m	2015 84 month ERC £m	2015 120 month ERC £m
Loans to customers						
Idem Capital	283.3	398.4	454.3	432.9	555.1	647.3
Paragon Bank	250.6	252.9	286.4	-	-	-
Loans to customers	533.9	651.3	740.7	432.9	555.1	647.3
Investments in structured entities	-	-	-	18.1	25.7	30.4
	533.9	651.3	740.7	451.0	580.8	677.7

Amounts shown as loans to customers above include loans disclosed as first mortgages and other loans (note 32).

Derivative financial assets

In order to control credit risk relating to counterparties to the Group's derivative financial instruments and cash deposits, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Such counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally. Where a derivative counterparty fails to meet the required criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit. The amounts of these cash collateral deposits, which do not form part of the Group's cash position, are given in note 35.

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

	2016 £m	2015 £m
Carrying value of derivative financial assets		
Counterparties rated		
AA-	218.7	91.9
A+	58.1	6.2
A	969.2	515.1
BBB+	120.4	46.9
Gross exposure	1,366.4	660.1
Collateral amounts posted	(1,184.2)	(753.5)
Net exposure	182.2	(93.4)

Trade debtors

The Group's trade debtors balance represents principally amounts outstanding on unpaid operating lease obligations in the asset finance business, where similar customer acceptance criteria as are used for finance lease cases apply.

Short term investments

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

Cash and cash equivalents

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

Liquidity risk

Liquidity risk is the risk that the Group might be unable to satisfy any payment which is required to be made out of cash available to it at the time. The Group manages the liquidity requirements of its lending operations in two ways.

- Within the Paragon Mortgages and Idem Capital divisions, securitisation is used to mitigate its exposure to liquidity risk on its borrowings, ensuring, as far as possible, that the maturities of assets and liabilities are matched
- Within Paragon Bank, which is funded by the acceptance of retail deposits, liquidity is subject to regulation by the PRA. This regulation 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 Group's originated loan assets, outside Paragon Bank, are principally financed by asset backed loan notes ('Notes') issued through the securitisation process. In a securitisation an SPV company within the Group will issue Notes secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 55 and the assets backing the Notes are shown in notes 33 and 34.

In each case the Group provides funding to the SPV at inception, subordinated to the Notes, which means that the primary credit risk on the pool assets is retained within the Group. The Group receives the residual income generated by the assets. These factors mean that the risks and rewards of ownership of the assets remain with the Group, and hence the loans remain on the Group's balance sheet.

Cash received from time to time in each SPV is held until the next interest payment date when, following payment of principal, interest and the associated costs of the SPV, the remaining balances become available to the Group. Cash balances are also held within each SPV to provide credit enhancement for the particular securitisation, allowing interest and principal payments to be made even if some of the loans default. In order to provide further credit enhancement in certain of the SPVs, specific economic trigger events exist which cause additional cash to be retained in the SPV rather than being transferred to the Group. While the Group can, if it chooses, contribute additional cash to cover these requirements, it is under no obligation to do so. No such events occurred in the year ended 30 September 2016 or the year ended 30 September 2015. Whether any such events in any of the Group's other SPVs arise in the future will depend on the performance of the general economy and its impact on mortgage and loan arrears in each SPV. However if all of the remaining trigger events occurred, a total of £92.5m of additional cash would be retained in the SPV companies (2015: £90.8m). The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 42 as 'securitisation cash'.

Newly originated mortgage loans are initially funded by a revolving loan facility or 'warehouse' from the point of their origination until their inclusion in a securitisation transaction. A warehouse company functions in a similar way to an SPV, except that funds are drawn down as advances are made, repaid when loans are securitised or refinanced by an internal asset sale and may subsequently be redrawn.

On 29 February 2008 the warehouse facility provided to Paragon Second Funding Limited ceased to be available for new drawings and new mortgage lending ceased, although the secured assets held within it at that time continued to be funded. Repayment of the principal on this warehouse facility is not required unless amounts are realised from the underlying secured assets. The final repayment date of the facility is later than the final due date of the secured assets it funds.

Mortgage loans advanced since the recommencement of lending in 2010 have been funded through one of four warehouse facilities, which are detailed in note 55. Each warehouse facility is agreed with an individual bank and is available for drawing and redrawing for a set commitment period, although each has the option to be renewed before the period ends. After the end of the commitment period the funding will remain in place for a further period until the underlying assets can be sold or refinanced. Repayment of the principal amount of the facilities is not required unless amounts are realised from the secured assets either through repayment, securitisation or asset sales, even after the end of the period. There is no further recourse to other assets of the Group in respect of either interest or principal on the borrowings. The warehouse facilities due for expiry in the period were all renewed on the same or improved terms.

As with the SPVs, the Group provides subordinated funding to the warehouse companies and restricted cash balances are held within them. Contributions to the subordinated funding are made each time a drawing on the facility concerned is made. These amounts provide credit enhancement to the warehouse and cover certain fees. This funding is repaid when assets are securitised or refinanced by an internal asset sale. The amount of subordinated funding outstanding in the three active warehouse companies at 30 September 2016 was £118.8m (2015: £54.9m).

Further details of the warehouse facilities are given in note 55 and details of the loan assets within the warehouses are given in note 33.

The securitisation process and the terms of the warehouse facilities effectively limit liquidity risk from the funding of the Group's loan assets. The remaining liquidity risk relates to ensuring that sufficient funding is available to fund the Group's participation in the SPVs, provide capital support for new loans and working capital for the Group. This responsibility rests with ALCO which makes recommendations for the Group's liquidity policy for Board approval and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

The final repayment date for all of the securitisation borrowings and the old warehouse borrowing is more than five years from the balance sheet date, the earliest falling due in 2033 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2016 under the SPV and warehouse arrangements, allowing for the effect of the cross currency basis swaps, described under currency risk below, which are net settled with the loan payments, was £8,596.3m (2015: £9,052.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date would be £13,295.5m (2015: £15,157.8m). As the principal will, as discussed above, reduce as customers repay or redeem their accounts, the cash flow will in practice be far less than this amount.

In February 2013, the Company initiated a Euro Medium Term Note issuance programme, with a maximum issuance of £1,000.0m. The Company had the ability to issue further notes under the programme within twelve months of its inauguration and it was subsequently renewed for a further twelve months in January 2016 and may be further renewed. Since that time the Company has issued three fixed rate bonds for a total of £297.5m, with interest rates ranging from 6.000% to 6.125% and maturities ranging from December 2021 to August 2023, the most recent issue of £112.5m being made in August 2015.

The Group's investments in purchased loan portfolios and structured entities are funded from its free cash balances and securitisation borrowings and these investments carry no obligation to make further payments. They therefore pose no liquidity risk to the Group.

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the Group's, and the Company's, non-securitisation borrowings and retail deposits, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Contingent liabilities	Retail deposits	Corporate bonds	Retail bonds	Total
	£m	£m	£m	£m	£m
a) The Group					
30 September 2016					
Payable in less than one year	1.9	1,036.8	125.0	18.0	1,181.7
Payable in one to two years	2.5	596.0	10.9	18.0	627.4
Payable in two to five years	6.6	312.9	32.6	111.3	463.4
Payable in over five years	5.0	-	204.4	261.6	471.0
	16.0	1,945.7	372.9	408.9	2,743.8
30 September 2015					
Payable in less than one year	-	341.3	4.1	18.0	363.4
Payable in one to two years	-	187.8	114.1	18.0	319.9
Payable in two to five years	-	206.3	-	54.0	260.3
Payable in over five years	-	-	-	336.9	336.9
	-	735.4	118.2	426.9	1,280.5

	Corporate bonds £m	Retail bonds £m	Total £m
b) The Company			
30 September 2016			
Payable in less than one year	125.0	18.0	143.0
Payable in one to two years	10.9	18.0	28.9
Payable in two to five years	32.6	111.3	143.9
Payable in over five years	204.4	261.6	466.0
	372.9	408.9	781.8
30 September 2015			
Payable in less than one year	4.1	18.0	22.1
Payable in one to two years	114.1	18.0	132.1
Payable in two to five years	-	54.0	54.0
Payable in over five years	-	336.9	336.9
	118.2	426.9	545.1

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 59 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2016 disclosed in note 59.

In order to reduce the liquidity risk inherent in the retail deposit balances shown above, which are held by Paragon Bank PLC, its regulator, the PRA requires that it, like other regulated banks, maintains a buffer in the form of liquid assets to ensure it has sufficient available funds at all times to protect against unforeseen circumstances. The Bank's ongoing participation in the Bank of England Funding for Lending Scheme ('FLS') is a significant contributor to its liquidity position, reducing its requirement to hold sovereign bonds.

The amount of this buffer is calculated using Individual Liquidity Guidance ('ILG') set by the PRA based on the ILAAP submitted by Paragon Bank. The ILAAP determines the liquid resources that must be maintained in the Bank based upon stress tests linked to its key liquidity risks and for other purposes specified by the regulator. At 30 September 2016 the liquidity buffer of High Quality Liquid Assets ('HQLA') comprised the following assets, all held within Paragon Bank.

	Note	2016 £m	2015 £m
Short term investments	41	7.1	41.1
Balances with central banks	42	315.0	286.0
Total HQLA		322.1	327.1

The above analysis does not include off balance sheet funding of £108.8m (2015: £nil) in respect of primary liquidity representing short dated UK Treasury bills held as a result of drawings under the FLS.

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:

	2016	2015
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	0.4	-
Payable in one to two years	0.4	0.1
Payable in two to five years	0.9	0.3
Payable in over five years	0.5	0.4
	2.2	0.8
On derivative assets		
Payable in less than one year	(8.0)	(5.2)
Payable in one to two years	(4.1)	(1.0)
Payable in two to five years	(2.3)	0.1
Payable in over five years	(0.5)	(0.4)
	(14.9)	(6.5)
	(12.7)	(5.7)

Interest rate risk

The Group is exposed to interest rate risk, the risk that margins will be adversely affected by movements in market interest rates, through its lending, deposit taking and borrowing activities. As certain of the Group's financial assets and liabilities bear interest at rates which float with market rates and others are fixed, either for a term or for their whole lives, a movement in market rates can change the net interest margin on the Group's activities unless the exposure is managed.

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

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

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

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

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

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

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

The return to the Group from its investments in structured entities is primarily attributable to the cash generation of the underlying portfolio. There is no direct exposure to market interest rate risk.

The Group's working capital borrowings comprise corporate bonds and retail bonds issued under a Euro Medium Term Note Programme. All bonds issued to date have fixed interest rates and therefore are not exposed to fluctuations in interest rates, although the retail bond programme includes the facility to issue floating rate instruments in the future.

The Group has entered into various interest rate basis swap arrangements to alter the effective basis of interest payments on certain borrowings to match the underlying assets, though due to their nature and low notional value, they do not have a significant impact on the Group's results.

To assess the Group's exposure to interest rate movements, the notional impact of a 1% change in UK interest rates on the equity of the Group at 30 September 2016, and the notional annualised impact of such a change on the operating profit of the Group, based on the year-end balance sheet have been calculated.

On this basis, a 1% increase in UK interest rates would reduce the Group's equity at 30 September 2016 by £3.1m (2015: £3.1m) and increase profit before tax by £1.9m (2015: increase by £9.4m).

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 Group's business and results.

Although certain of the Group's borrowings have interest rates dependent on US Dollar and Euro LIBOR rates, the effect of the cross currency basis swaps is such that the Group's results have no material exposure to movements in these rates. The effects of independent 1% increases in US or Euro interest rates would be to increase the Group's equity by £1.2m (2015: £1.1m) and £2.3m (2015: £1.9m) respectively.

All the borrowings of the Company have fixed interest rates. Assets and liabilities with other group companies bear interest at floating rates based on LIBOR which reset within three months of the balance sheet date; all other balances are non-interest bearing.

Currency risk

All of the Group's significant assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in US dollars and euros, which are described in note 55. Although IAS 39 requires that they be accounted for as currency liabilities and valued at their spot rates, a condition of the issue of these notes was that interest rate and currency swaps ('cross-currency basis swaps') were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing. Where the asset finance contracts to purchase assets in currency these liabilities are hedged by the purchase of appropriate currency balances. As a result the Group has no material exposure to foreign currency risk, and no sensitivity analysis is presented for currency risk.

The equivalent sterling principal amounts of notes in issue under the arrangements described above, and their carrying values at 30 September 2016 and 30 September 2015 are:

	2016 Equivalent sterling principal £m	2016 Carrying value £m	2015 Equivalent sterling principal £m	2015 Carrying value £m
US dollar notes	1,829.5	2,667.6	2,048.3	2,555.1
Euro notes	2,004.1	2,532.5	2,011.3	2,171.4
	3,833.6	5,200.1	4,059.6	4,726.5

None of the assets or liabilities of the Company are denominated in foreign currencies.

8. Acquisitions

The Group acquired two businesses in the year ended 30 September 2016. PBAF was acquired on 3 November 2015 and Premier was acquired on 30 September 2016. The disclosures required by IFRS 3 – 'Business Combinations' in respect of these acquisitions are given in notes 9 and 10.

Amounts shown in other notes in respect of these acquisitions are analysed as shown below.

	Note	PBAF Note 9 £m	Premier Note 10 £m	Total £m
Goodwill arising on acquisition	28	79.1	17.7	96.8
Intangible assets acquired	28	1.0	0.1	1.1
Property, plant and machinery acquired	30	12.4	-	12.4
Loans to customers acquired	35	221.7	-	221.7
Deferred tax balances at acquisition	57	3.5	-	3.5
Cash flows on acquisition	62	305.3	4.8	310.1
Acquisition related costs		2.8	0.3	3.1

Had both acquisitions taken place on 1 October 2015, the consolidated revenue of the Group for the year ended 30 September 2016 would have been £448.8m and its consolidated profit before tax for the period would have been £145.2m.

9. Acquisition of Paragon Bank Asset Finance

On 3 November 2015 the Group acquired the entire share capital of Paragon Bank Asset Finance Limited (formerly Five Arrows Leasing Group Limited) from Rothschild & Co. PBAF is the parent company of a group of companies ('PBAF Group') providing a range of asset finance products to UK SMEs, including equipment, vehicle and construction equipment finance and is also a provider of lease servicing. The acquisition allows the Group to diversify its range of both products and the markets it serves within the financial services sector.

The Group acquired 100% of the voting equity interests in PBAF and the consideration was satisfied entirely in cash. Cash transferred on completion was £308.2m, £117.0m in respect of equity and £191.2m to settle existing debt owed by PBAF Group to the vendor. There are no contingent consideration arrangements. Transaction costs of £1.7m have been included in operating expenses for the year ended 30 September 2016.

The principal operating companies of the PBAF Group are listed below.

Company	Principal activity
Paragon Bank Asset Finance Limited <i>(Five Arrows Leasing Group Limited at acquisition)</i>	Holding company and portfolio administration
Dash Commercial Finance Limited	Asset finance
Paragon Bank Business Finance PLC <i>(Five Arrows Business Finance PLC at acquisition)</i>	Asset finance
Paragon Bank Technology Finance Limited <i>(Five Arrows Media Finance Limited at acquisition)</i>	Asset finance
Specialist Fleet Services Limited	Asset finance and contract hire

The contribution of PBAF Group to consolidated revenue for the year ended 30 September 2016 was £40.2m and its contribution to consolidated profit before tax for the period is set out below.

	£m	£m
Contribution to consolidated profit excluding costs of acquisition		9.4
Transaction costs	(1.7)	
Other acquisition related expenses	(1.1)	
		(2.8)
Contribution to consolidated profit after costs of acquisition		6.6

The amounts recognised in the consolidated accounts on acquisition in respect of the identifiable assets acquired and liabilities assumed are set out below. The amounts presented are considered to be materially consistent with the existing accounting policies of the Group.

	<i>Note</i>	£m	£m
Non-current assets			
Operating lease assets		10.6	
Other property, plant and equipment		1.8	
Property, plant and equipment		12.4	
Intangible assets	<i>a</i>	1.0	
Loans to customers	<i>b</i>	221.7	
Deferred tax		3.5	
			238.6
Current assets			
Other receivables		5.2	
Cash	<i>c</i>	3.4	
			8.6
Total assets			247.2
Current liabilities			
Financial liabilities - bank overdraft	<i>c</i>	0.5	
Current tax liabilities		0.2	
Other liabilities		14.3	
			15.0
Non-current liabilities			
Contingent liability		3.1	
			3.1
Total liabilities			18.1
Total net identifiable assets			229.1
Goodwill	<i>d</i>		79.1
Consideration	<i>c</i>		308.2

a) **Intangible assets**

Identifiable intangible assets acquired represent broker networks and trading arrangements. They will be amortised over a ten year period.

b) Loans to customers

The financial assets acquired at 3 November 2015 comprised:

	Fair value	Gross Contractual Value	Contractual flows not to be collected
	£m	£m	£m
Asset finance leases	203.6	207.7	2.2
Commercial mortgages	3.6	4.2	0.5
Factoring and discounting	14.1	14.1	-
Other loans	0.4	0.4	-
Loans to customers	221.7	226.4	2.7

c) Cash flows on acquisition

Net cashflows on acquisition were:

	Total
	£m
Payment for shares	117.0
Settlement of existing vendor balances	191.2
Consideration paid on completion	308.2
Cash	(3.4)
Bank overdraft	0.5
Net cash outflow (note 8)	305.3

The fair value and the gross contractual value of the cash balances acquired was equal to their book value, there are no contractual flows which are expected not to be collectable.

d) Goodwill

The goodwill of £79.4m arising from the acquisition consists of the values of the business relationships, market positions and knowledge base inherent in the business which do not qualify for recognition as intangible assets. These will be utilised in the future development of the acquired business and in expanding the Group's asset finance activities. None of the goodwill is expected to be deductible for tax purposes.

The Group's review of the goodwill arising in the transaction for the purposes of IAS 36 – 'Impairment of Assets' is described in note 29.

10. Acquisition of Premier Asset Finance

On 30 September 2016 the Group acquired the entire share capital of Premier Asset Finance Limited ('Premier'). Premier is an asset finance broker dealing with specialist sectors of the SME market. The acquisition allows the Group to increase the reach of its asset finance operations.

The Group acquired 100% of the voting equity interests in Premier and the consideration will be satisfied entirely in cash. Cash transferred on completion was £7.0m, with a further payment to be made, following the agreement of completion accounts, estimated at £1.9m.

Further contingent consideration is payable in cash, up to a maximum of £12.0m based on the future performance of the acquired business. £10.6m has been provided in the accounts in respect of this contingent consideration, based on the net present value of the maximum amount. This is considered to be the fair value of the consideration at the transaction date, based on initial forecasts for the business. Transaction costs of £0.3m have been included in operating expenses for the year ended 30 September 2016.

As the acquisition occurred on 30 September 2016 the contribution of Premier to consolidated revenue for the year ended 30 September 2016 was £nil and its contribution to consolidated profit before tax for the period comprised only the transaction costs set out above.

The amounts recognised in the consolidated accounts on acquisition in respect of the identifiable assets acquired and liabilities assumed are set out below. The amounts presented are considered to be materially consistent with the existing accounting policies of the Group. Due to the proximity of the acquisition date to the year end, the Group has yet to finalise its exercise to determine these balances and therefore the amounts presented in this note should be considered as provisional. Final amounts will be presented with the Group's annual results for the year ending 30 September 2017.

	<i>Note</i>	£m	£m
Non-current assets			
Property, plant and equipment		-	
Intangible assets	<i>a</i>	0.1	
			0.1
Current assets			
Other receivables		0.2	
Cash	<i>b</i>	2.2	
			2.4
Total assets			2.5
Current liabilities			
Corporation tax payable		(0.2)	
Other liabilities		(0.5)	
			(0.7)
Total liabilities			(0.7)
Total net identifiable assets			1.8
Goodwill	<i>c</i>		17.7
Consideration	<i>d</i>		19.5

a) Intangible assets

Identifiable intangible assets acquired represent broker networks and trading arrangements. They will be amortised over a ten year period.

b) Cash flows on acquisition

Net cashflows on acquisition were:

	Total £m
Consideration paid on completion	7.0
Cash	(2.2)
Net cash outflow (note 8)	4.8

The fair value and the gross contractual value of the cash balances acquired was equal to their book value, there are no contractual flows which are expected not to be collectable.

c) Goodwill

The goodwill of £17.7m arising from the acquisition consists of the values of the business relationships, market positions and knowledge base inherent in the business which do not qualify for recognition as intangible assets. These will be utilised in the future development of the acquired business and in expanding the Group's asset finance activities. None of the goodwill is expected to be deductible for tax purposes.

The Group's review of the goodwill arising in the transaction for the purposes of IAS 36 – 'Impairment of Assets' is described in note 29.

d) Consideration

The total consideration accounted for on acquisition was:

	Total £m
Consideration paid on completion (note (c))	7.0
Accrual for payment due on agreement of completion accounts	1.9
Contingent consideration	10.6
Total consideration	19.5

11. Segmental Information

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the entities within the Group generating its assets. The segments used are described below:

- Paragon Mortgages includes revenue, in the form of interest and ancillary income, from the Group's first mortgage operations, other than the buy-to-let lending of Paragon Bank, and from other assets remaining in legacy portfolios
- Idem Capital includes revenue generated from assets purchased by the Group's debt investment business, Idem Capital Holdings Limited, other than those financed by Paragon Bank and from third party loan administration activity
- Paragon Bank includes revenue, in the form of interest and ancillary income, generated from the Group's regulated banking business, Paragon Bank PLC and its subsidiary companies including PBAF Group

Each of these businesses invests in consumer finance assets or SME finance, and an analysis of the Group's financial assets by type and segment is shown in note 32.

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared costs, and the financing costs of the Group's working capital invested, are allocated based on the segment's use of those resources.

No profit has been recognised in the segmental disclosures below in respect of transfers of loan assets between segments.

The costs arising from the PBAF and Premier acquisitions in the period of £3.1m are included in the Paragon Bank segmental profit and loss account for the year.

All of the Group's operations are conducted in the UK, all revenues arise from external customers and there are no inter-segment revenues. No customer contributes more than 10% of the revenue of the Group.

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below.

Year ended 30 September 2016

	Paragon Mortgages	Idem Capital	Paragon Bank	Total
	£m	£m	£m	£m
Interest receivable	264.2	76.4	70.8	411.4
Interest payable	(144.5)	(11.9)	(31.8)	(188.2)
Net interest income	119.7	64.5	39.0	223.2
Other operating income	8.1	4.0	8.7	20.8
Total operating income	127.8	68.5	47.7	244.0
Operating expenses	(31.8)	(23.1)	(37.6)	(92.5)
Provisions for (losses)	(6.1)	-	(1.6)	(7.7)
	89.9	45.4	8.5	143.8
Fair value net (losses)	(0.4)	-	(0.2)	(0.6)
Operating profit / (loss)	89.5	45.4	8.3	143.2
Tax charge				(27.2)
Profit after tax				116.0

Year ended 30 September 2015

	Paragon Mortgages	Idem Capital	Paragon Bank	Total
	£m	£m	£m	£m
Interest receivable	263.2	71.6	6.2	341.0
Interest payable	(128.1)	(9.9)	(5.6)	(143.6)
Net interest income	135.1	61.7	0.6	197.4
Other operating income	8.5	5.3	0.3	14.1
Total operating income	143.6	67.0	0.9	211.5
Operating expenses	(44.0)	(17.7)	(9.5)	(71.2)
Provisions for (losses)	(5.6)	-	-	(5.6)
	94.0	49.3	(8.6)	134.7
Fair value net (losses)	(0.4)	-	(0.1)	(0.5)
Operating profit / (loss)	93.6	49.3	(8.7)	134.2
Tax charge				(27.1)
Profit after tax				107.1

The assets and liabilities attributable to each of the segments at 30 September 2016, 30 September 2015 and 30 September 2014 were:

	Paragon Mortgages	Idem Capital	Paragon Bank	Total
	£m	£m	£m	£m
30 September 2016				
Segment assets	11,044.9	314.2	2,159.3	13,518.4
Segment liabilities	(10,560.9)	(71.6)	(1,916.4)	(12,548.9)
	484.0	242.6	242.9	969.5
30 September 2015				
Segment assets	10,622.9	481.2	774.8	11,878.9
Segment liabilities	(9,927.7)	(276.5)	(705.2)	(10,909.4)
	695.2	204.7	69.6	969.5
30 September 2014				
Segment assets	10,343.3	445.8	106.0	10,895.1
Segment liabilities	(9,658.8)	(226.6)	(62.6)	(9,948.0)
	684.5	219.2	43.4	947.1

All of the assets shown above were located in the UK.

The total additions to non-current assets, excluding financial instruments, attributable to each segment during the years ended 30 September 2016 and 30 September 2015 were:

	2016	2015
	£m	£m
Paragon Mortgages	1.3	1.3
Idem Capital	0.9	0.5
Paragon Bank	119.7	0.1
	121.9	1.9

Being:

	<i>Note</i>	2016	2015
		£m	£m
Intangible Assets	28	99.3	1.2
Property, plant and equipment	30	22.6	0.7
		121.9	1.9

12. Revenue

	<i>Note</i>	2016	2015
		£m	£m
Interest receivable	13	411.4	341.0
Operating lease income	15	13.0	-
Other income	16	17.8	14.1
Total revenue		442.2	355.1

Arising from:

Paragon Mortgages	272.3	271.7
Idem Capital	80.4	76.9
Paragon Bank	89.5	6.5
Total revenue	442.2	355.1

13. Interest Receivable

	2016	2015
	£m	£m
<i>Interest receivable in respect of</i>		
First mortgages	277.1	245.2
Secured consumer loans	63.9	50.4
Other consumer loans	36.6	35.9
Development finance	0.2	-
Finance leases	22.6	0.9
Interest on loans to customers	400.4	332.4
Other interest receivable	5.6	5.4
Factoring income	3.0	-
Income from structured entities	2.4	3.2
Total interest on financial assets	411.4	341.0

Interest on loans to customers includes £4.1m (2015: £5.5m) charged on accounts where an impairment provision has been made.

14. Interest Payable and Similar Charges

	<i>Note</i>	2016	2015
		£m	£m
On retail deposits		29.5	5.5
On asset backed loan notes		103.4	94.7
On corporate bonds		4.8	4.1
On retail bonds		18.5	12.3
On bank loans and overdrafts		29.7	25.1
Total interest on financial liabilities		185.9	141.7
On pension scheme deficit	56	0.8	0.7
Other finance costs		1.5	1.2
		188.2	143.6

15. Net Operating Lease Income

	2016	2015
	£m	£m
Income		
Operating lease rentals	7.9	-
Maintenance income	5.1	-
Total operating lease income	13.0	-
Costs		
Depreciation of lease assets	(3.0)	-
Maintenance salaries	(2.0)	-
Other maintenance costs	(5.0)	-
Total operating lease costs	(10.0)	-
Net operating lease income	3.0	-

16. Other Income

	2016	2015
	£m	£m
Loan account fee income	7.7	6.7
Insurance income	1.2	1.2
Third party servicing	7.4	4.9
Other income	1.5	1.3
	17.8	14.1

17. Operating Expenses

	<i>Note</i>	2016	2015
		£m	£m
Employment costs	18	58.1	46.9
Auditor remuneration	21	1.2	1.1
Amortisation of intangible assets	28	1.6	1.4
Depreciation on operating assets	30	1.9	1.5
Operating lease rentals payable	65	2.6	2.2
Other administrative costs		27.1	18.1
		92.5	71.2

18. Employees

The average number of persons (including directors) employed by the Group during the year was 1,249 (2015: 1,020). The number of employees at the end of the year was 1,299 (2015: 1,040).

Costs incurred during the year in respect of these employees were:

	2016	2016	2015	2015
	£m	£m	£m	£m
Share based remuneration	4.4		4.5	
Other wages and salaries	47.8		35.9	
Total wages and salaries		52.2		40.4
National Insurance on share based remuneration	(0.1)		1.1	
Other social security costs	4.5		3.1	
Total social security costs		4.4		4.2
Defined benefit pension cost	1.7		1.7	
Other pension costs	1.8		0.6	
Total pension costs		3.5		2.3
Total employment costs		60.1		46.9

Of which

Included in operating expenses (note 17)	58.1	46.9
Included in maintenance costs (note 15)	2.0	-
	60.1	46.9

Details of the pension schemes operated by the Group are given in note 56.

The Company has no employees. Details of the directors' remuneration are given in note 19.

19. Key Management Remuneration

The remuneration of the directors, who are the key management personnel of the Group and the Company, is set out below in aggregate in accordance with IAS 24 – ‘Related Party Transactions’. Further information about the remuneration of individual directors is provided in the Report of the Board to the Shareholders on Directors’ Remuneration in section B5.2.2.

	2016	2016	2015	2015
	£m	£m	£m	£m
Salaries and fees	1.6		1.5	
Cash amount of bonus	1.1		1.4	
Social security costs	0.5		0.6	
Short-term employee benefits		3.2		3.5
Post-employment benefits		0.4		0.4
IFRS 2 cost in respect of directors	1.9		1.8	
National Insurance thereon	0.2		0.7	
Share based payment		2.1		2.5
		5.7		6.4

Post-employment benefits shown above are shown as ‘Pension allowance’ in section B5.2.2. Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

Social security costs paid in respect of directors are required to be included in this note by IAS 24, but do not fall within the scope of the disclosures in the Directors’ Remuneration Report.

20. Share Based Remuneration

During the year the Group had various share based payment arrangements with employees. They are accounted for by the Group and the Company as shown below.

The effect of the share based payment arrangements on the Group’s profit is shown in note 18.

Further details of share based payment arrangements are given in the Report of the Board to the Shareholders on Directors’ Remuneration in section B5.2.2.

(a) Share option schemes

The Group operates an All Employee Share Option ('Sharesave') scheme. Grants under this scheme vest, in the normal course, after the completion of the appropriate service period and subject to a savings requirement.

A reconciliation of movements in the number and weighted average exercise price of options over £1 ordinary shares during the year ended 30 September 2016 and the year ended 30 September 2015 is shown below.

	2016 Number	2016 Weighted average exercise price p	2015 Number	2015 Weighted average exercise price p
Options outstanding				
At 1 October 2015	2,343,499	305.19	2,282,662	230.33
Granted in the year	2,339,040	249.44	1,375,691	345.68
Exercised or surrendered in the year	(55,827)	105.51	(991,033)	137.09
Lapsed during the year	(1,390,586)	334.95	(323,821)	351.06
At 30 September 2016	3,236,126	255.27	2,343,499	305.19
Options exercisable	-	-	48,972	100.32

The weighted average remaining contractual life of options outstanding at 30 September 2016 was 30.8 months (2015: 30.8 months). The weighted average market price at exercise for share options exercised in the year was 334.01p (2015: 423.34p).

Options are outstanding under the Sharesave schemes to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number 2016	Number 2015
20/07/2010	01/09/2015 to 01/03/2016	100.32p	-	48,972
20/12/2011	01/02/2017 to 01/08/2017	142.56p	138,747	138,747
23/12/2013	01/02/2017 to 01/08/2017	276.32p	494,575	568,489
23/12/2013	01/02/2019 to 01/08/2019	276.32p	161,309	219,929
11/06/2015	01/08/2018 to 01/02/2019	345.68p	153,079	1,152,591
11/06/2015	01/08/2020 to 01/02/2021	345.68p	13,881	214,771
20/06/2016	01/08/2019 to 01/02/2020	249.44p	1,798,313	-
20/06/2016	01/08/2021 to 01/02/2022	249.44p	476,222	-
			3,236,126	2,343,499

A number of the above options were granted to former employees whose rights terminate at the later of twelve months following redundancy or forty-two months after the issue of the options.

The fair value of options granted is determined using a binomial model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2016 and the year ended 30 September 2015 are shown below.

Grant date	20/06/16	20/06/16	11/06/15	11/06/15
Number of awards granted	1,855,602	483,438	1,160,920	214,771
Market price at date of grant	297.10p	297.10p	439.00p	439.00p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	0.50	0.52	1.12	1.10

Inputs to valuation model

Expected volatility	26.62%	29.47%	31.99%	31.99%
Expected life at grant date (years)	3.46	5.45	3.43	5.44
Risk-free interest rate	0.84%	0.98%	1.25%	1.25%
Expected dividend yield	3.94%	3.94%	2.19%	2.19%
Expected annual departures	5.00%	5.00%	5.00%	5.00%

The expected volatility of the share price used in determining the fair value for the 2015 schemes is based on the annualised standard deviation of daily changes in price over the six years preceding the grant date. The three year 2016 scheme uses share price data for the preceding three years from grant date, and the five year 2016 scheme uses the preceding five years.

(b) Paragon Performance Share Plan

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and will vest on the third anniversary of their granting, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

Awards are exercisable from the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied to the day before the tenth anniversary of the grant date. Clawback provisions apply to awards granted under the PSP as detailed in the remuneration policy.

The conditional entitlements outstanding under this scheme at 30 September 2016 and 30 September 2015 were:

Grant date	Period exercisable	Number	
		2016	2015
09/01/2007	09/01/2010 to 08/01/2017 †	569	2,709
28/03/2007	28/03/2010 to 27/03/2017 †	-	3,164
14/06/2007	14/06/2010 to 13/06/2017 †	743	4,410
26/09/2007	26/09/2010 to 25/09/2017 †	-	7,896
26/11/2007	26/11/2010 to 25/11/2017 †	3,287	17,312
18/03/2008	18/03/2011 to 17/03/2018 †	-	88,261
21/05/2009	21/05/2012 to 20/05/2019 †	400,714	400,714
04/01/2010	04/01/2013 to 03/01/2020 †	79,334	84,817
17/12/2010	17/12/2013 to 16/12/2020 †	292,338	298,793
21/12/2011	21/12/2014 to 20/12/2021 †	624,259	678,260
28/02/2013	28/02/2016 to 27/02/2023 ‡	757,817	1,307,804
10/12/2013	10/12/2016 to 09/12/2023 ‡	1,211,741	1,212,546
18/12/2014	18/12/2017 to 17/12/2024 ‡	1,029,729	1,030,435
22/12/2015	22/12/2018 to 21/12/2025 §	1,434,027	-
		5,834,558	5,137,121

† These awards, which were conditional on the achievement of performance based criteria, have now vested.

‡ 50% of these awards are subject to a TSR test and 50% are subject to an EPS test. The TSR test compares the rank of the Company's TSR against a comparator group of companies comprising the constituents of the FTSE-250. 25% of the TSR tested awards vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance. The EPS test provides that 25% of EPS tested awards will vest where EPS growth is equal to the increase in the retail price index plus 3%, increasing on a straight line basis to full vesting for EPS growth equal to the increase in the retail price index plus 7% or more. In each case the testing period is the three financial years commencing with the year of grant.

§ 50% of these awards are subject to a TSR test and 50% are subject to an EPS test as described above, except that full vesting of the EPS tested awards takes place where EPS growth is equal to the increase in the retail price index plus 13% or more.

The number of share options outstanding and the exercise price under each of the arrangements shown above which were outstanding at the time of the share consolidation on 29 January 2008 and the rights issue on 21 February 2008 were adjusted in accordance with the respective scheme rules.

The fair value of awards granted under the Performance Share Plan is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2016 and the year ended 30 September 2015 are shown below:

Grant date	22/12/15	18/12/14
Number of awards granted	1,487,166	1,038,634
Market price at date of grant	362.70p	409.60p
Fair value per share at date of grant	204.46p	317.76p

Inputs to valuation model

Expected volatility	24.99%	26.62%
Risk-free interest rate	1.21%	1.18%
Expected dividend yield	3.03%	2.20%

For all of the above grants the contractual life and expected life at grant date is three years and no departures are expected.

For awards granted before 18 July 2008 the expected volatility of the share price used in determining the fair value was based on the annualised standard deviation of daily changes in price over the previous year from the grant date. The expected volatility for awards granted between this date and 30 September 2008 is calculated using the same method but using daily changes in price over the six years preceding the grant date. The expected volatility for awards granted after this date is calculated using the same method but using daily changes in price over the three years preceding the grant date.

c) Deferred Bonus awards

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2016 and 30 September 2015 were:

Grant date	Period exercisable	Number	Number
		2016	2015
23/11/2012	01/10/2015 to 22/11/2016	-	259,537
10/12/2013	10/12/2016 to 09/12/2023	174,519	174,519
18/12/2014	18/12/2017 to 17/12/2024	113,202	113,202
22/12/2015	22/12/2018 to 21/12/2025	134,524	-
		422,245	547,258

The Deferred Bonus shares awarded before 2013 can be exercised from the third anniversary of the start of the financial year in which the award was made until the day before the fourth anniversary of the award date. The Deferred Bonus shares awarded during 2013 and thereafter can be exercised from the third anniversary of the award date until the day before the tenth anniversary of the date of grant.

The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2016 and the year ended 30 September 2015 are shown below.

Grant date	22/12/15	18/12/14
Number of awards granted	134,524	113,202
Market price at date of grant	362.7p	409.6p
Fair value per share at date of grant	362.7p	409.6p

Inputs to valuation model

Risk-free interest rate	1.21%	1.18%
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(d) Matching Share Plan

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and will vest on the third anniversary of their granting to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

The conditional entitlements outstanding under this scheme at 30 September 2016 and at 30 September 2015 were:

Grant date	Period exercisable	Number	Number
		2016	2015
09/01/2007	09/01/2010 to 09/01/2017	-	3,723
02/01/2008	02/01/2011 to 02/01/2018	9,969	22,329
		9,969	26,052

The numbers of share options outstanding and the exercise prices under each of the arrangements shown above which was outstanding at the time of the share consolidation on 29 January 2008 and the rights issue on 21 February 2008 were adjusted in accordance with the respective scheme rules.

The fair value of awards granted under the Matching Share Plan is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. No awards were made in the year ended 30 September 2016 or the year ended 30 September 2015.

21. Auditor Remuneration

The analysis of fees payable to the Company's auditors (KPMG LLP in 2016 and Deloitte LLP in 2015) and their associates, excluding irrecoverable VAT, required by the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 is set out below. This analysis includes amounts charged to the profit and loss account or included within the issue costs of debt and equity in respect of fees paid to the Group auditors and their associates. For each firm the fees shown are those arising in their period of office.

	KPMG		Deloitte		Deloitte	
	2016	2016	2016	2016	2015	2015
	£000	£000	£000	£000	£000	£000
Audit fee of the company		119				127
Other services						
Audit of subsidiary undertakings pursuant to legislation		633		(4)		436
Total audit fees		752		(4)		563
Audit related assurance services						
Interim review		57		-		45
Tax compliance services	-		-		125	
Tax advisory services	-		29		79	
		-		29		204
Other assurance services						
Securitisation reporting		-		82		188
Corporate finance services		-		8		26
Other services		103		42		68
Total fees		912		157		1,094
Irrecoverable VAT		182		32		219
Total cost to the Group		1,094		189		1,313
Fees Paid to Deloitte LLP				189		1,313
Fees Paid to KPMG LLP				1,094		-
				1,283		1,313
Of which:						
Charged to profit and loss account (note 17)				1,184		1,056
Included in issue costs of debt				99		257
Total cost to the Group				1,283		1,313

In addition to the amounts above, Deloitte received fees of £7,000 in 2015, excluding VAT, in respect of the audit of the Group pension scheme.

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.

22. Provisions For Losses

	2016	2015
	£m	£m
Impairment of financial assets (note 36)		
First mortgage loans	4.8	3.6
Other secured loans	0.4	0.3
Finance lease receivables	0.6	(0.4)
Other loans	1.9	2.1
	7.7	5.6

23. Fair Value Net (Losses)

	2016	2015
	£m	£m
Net (loss) on derivatives designated as fair value hedges	(7.2)	(3.8)
Fair value adjustments from hedge accounting	6.5	4.0
Ineffectiveness of fair value hedges	(0.7)	0.2
Ineffectiveness of cash flow hedges	-	(1.0)
Net gains on other derivatives	0.1	0.3
	(0.6)	(0.5)

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 Group.

24. Tax Charge on Profit on Ordinary Activities

a) Analysis of charge in the year

	2016	2015
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	28.2	25.4
Adjustment in respect of prior periods	(0.6)	(0.1)
Total current tax	27.6	25.3
Deferred tax	(0.4)	1.8
Tax charge on profit on ordinary activities	27.2	27.1

(b) Deferred tax charge for the year

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

	2016	2015
	£m	£m
Accelerated tax depreciation	(0.3)	0.1
Retirement benefit obligations	0.1	-
Impairment and other provisions	0.6	0.8
Utilisation of tax (losses)	0.1	-
Other timing differences	(0.1)	0.6
Deferred tax charge for the year	0.4	1.5
Prior period adjustment	(0.1)	0.3
Change in tax rate	(0.7)	-
Deferred tax (credit) / charge (note 57)	(0.4)	1.8

During the year ended 30 September 2013 the UK Government enacted provisions reducing the rate of corporation tax from 21.0% to 20.0% from 1 April 2015.

During the year ended 30 September 2015 the Government announced provisions further reducing the rate of corporation tax to 19.0% with effect from 1 April 2017 and to 18.0% from 1 April 2020 which were substantially enacted during the year. The tax rate applying from 1 April 2020 was further reduced to 17.0% during the year.

Therefore the standard rate of corporation tax applicable to the Group for the year ended 30 September 2016 was 20.0%, the rate in the year ended 30 September 2017 is expected to be 19.5%, the rate in the years ending 30 September 2018 and 30 September 2019 are expected to be 19.0%, the rate in the year ending 30 September 2020 is expected to be 18.0% and the rate in subsequent years is expected to be 17.0%. The expected impact on deferred tax balances of the changes to 19.0% and 17.0% was accounted for in the year ended 30 September 2016.

(c) Factors affecting tax charge for the year

The Group operates wholly in the UK and all but a nominal amount of the Group's incomes arise in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the appropriate comparator to the effective tax rate. The UK Corporation tax rate applicable to the Group for the year was 20.0% (2015: 20.5%).

	2016	2015
	£m	£m
Profit on ordinary activities before taxation	143.2	134.2
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	28.6	27.5
Effects of:		
Permanent differences		
- Disallowable acquisition costs	0.3	-
- Income from structured entities	(0.8)	(1.0)
- Recurring disallowable expenditure and similar items	0.2	0.3
Mismatch in timing differences	0.3	0.1
Change in rate of taxation on deferred tax assets and liabilities	(0.7)	-
Prior year charge / (credit)	(0.7)	0.2
Tax charge for the year	27.2	27.1

The income from the Group's investment in structured entities is recognised in the income statement net of taxes incurred by the structured entities and consequently appears as a reconciling item in the tax charge.

The timing difference mismatch arises from the fact that tax relief for share based payments is given on a different basis to that on which the accounting charge for the provision of these awards is recognised under IFRS 2.

The expected changes to UK corporation tax rates in future periods mentioned above have reduced the rates at which temporary differences are expected to reverse, resulting in a tax credit.

(d) Factors affecting future tax charges

As practically all of the Group's profit is subject to UK corporation tax the effective tax rate is expected to fall in line with the reductions in the standard rate described above.

The banking surcharge was introduced with effect from 1 January 2016. This subjects any profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional 8% of tax to the extent they exceed £25.0m.

The purchase of PBAF has introduced a leasing business into the Group. Whilst such businesses do not, in general, have significant permanent differences, the taxable profits in a given accounting period are usually significantly different from the accounting profits due to temporary differences. Consequently, the acquisition will have no material impact on the effective tax rate, but may have on the Group's tax payments.

As a wholly UK based business the Group does not expect to be significantly impacted by the OECD project on Base Erosion and Profit Shifting ('BEPS').

25. Profit Attributable to Members of The Paragon Group of Companies PLC

The Company's profit after tax for the financial year amounted to £82.4m (2015: £65.2m). A separate income statement has not been prepared for the Company under the provisions of Section 408 of the Companies Act 2006.

The Company has no other items of comprehensive income for the years ended 30 September 2016 or 30 September 2015.

26. Earnings Per Share

Earnings per ordinary share is calculated as follows:

	2016	2015
Profit for the year (£m)	116.0	107.1
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	286.5	301.9
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	5.5	5.9
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	292.0	307.8

Earnings per ordinary share

- basic	40.5p	35.5p
- diluted	39.7p	34.8p

27. Tax Credited / (Charged) to Equity

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
On actuarial (loss) on pension scheme (note 56)	6.8	0.9	-	-
On gains / (losses) on cash flow hedges (note 48)	(1.0)	0.6	-	-
Total tax on items recognised in comprehensive income	5.8	1.5	-	-
On share based payment (note 49)	(0.2)	1.2	-	-
Total tax credited to equity	5.6	2.7	-	-
Of which				
Current tax	0.2	2.1	-	-
Deferred tax (note 57)	5.4	0.6	-	-
	5.6	2.7	-	-

28. Intangible Assets

	Goodwill (note 29)	Computer software	Other intangible assets	Total
	£m	£m	£m	£m
Cost				
At 1 October 2014	7.6	4.4	8.1	20.1
Acquisitions	-	-	-	-
Additions	-	1.2	-	1.2
Disposals	-	-	-	-
At 30 September 2015	7.6	5.6	8.1	21.3
Acquisitions	96.8	-	1.1	97.9
Additions	-	1.4	-	1.4
Disposals	-	-	-	-
At 30 September 2016	104.4	7.0	9.2	120.6
Accumulated amortisation and impairment				
At 1 October 2014	6.0	3.1	3.1	12.2
Amortisation charge for the year	-	0.9	0.5	1.4
On disposals	-	-	-	-
At 30 September 2015	6.0	4.0	3.6	13.6
Amortisation charge for the year	-	0.9	0.7	1.6
On disposals	-	-	-	-
At 30 September 2016	6.0	4.9	4.3	15.2
Net book value				
At 30 September 2016	98.4	2.1	4.9	105.4
At 30 September 2015	1.6	1.6	4.5	7.7
At 30 September 2014	1.6	1.3	5.0	7.9

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of subsidiary companies.

29. Goodwill

The goodwill carried in the accounts is attributable to two cash generating units, as analysed below:

	2016	2015
	£m	£m
Asset finance	96.8	-
TBMC	1.6	1.6
	98.4	1.6

(a) Asset finance

The goodwill carried in the accounts relating to the asset finance cash generating unit was recognised on the acquisitions of PBAF and Premier in the year (notes 9 and 10).

An impairment review undertaken at 30 September 2016 indicated that no write down was required.

The recoverable amount of the asset finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 15.1% and cash flows beyond the five year budget are extrapolated assuming no lending growth beyond that point.

The key assumptions underlying the value in use calculation for the asset finance cash generating unit are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment
- Discount rate, which is based on the Group's cost of capital

The directors believe that no reasonably possible change in any of the key assumptions above would cause the carrying value of the unit to exceed its recoverable amount.

(b) TBMC

The goodwill carried in the accounts relating to the TBMC cash generating unit was recognised on the acquisition of The Business Mortgage Company Limited and its subsidiaries ('TBMC') in December 2008.

An impairment review undertaken at 30 September 2009 indicated a write down of £6.0m which was charged to the profit and loss account. Further reviews were undertaken at each year end up to 30 September 2016 each of which indicated no further impairment.

The recoverable amount of TBMC used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 5.0% and cash flows beyond the five year budget are extrapolated using a 2.0% growth rate, being the average long term growth rate in the UK economy over a twenty year period.

The key assumptions underlying the value in use calculation for the TBMC business are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment
- Discount rate, which is based on the Group's cost of capital

The directors believe that no reasonably possible change in any of the key assumptions above would cause the carrying value of the unit to exceed its recoverable amount.

30. Property, Plant and Equipment

(a) The Group

	Leased assets £m	Land and buildings £m	Plant and machinery £m	Total £m
Cost				
At 1 October 2014	-	22.9	7.0	29.9
Acquisitions	-	-	-	-
Additions	-	-	0.7	0.7
Disposals	-	-	-	-
At 30 September 2015	-	22.9	7.7	30.6
Acquisitions	10.6	-	1.8	12.4
Additions	8.7	0.2	1.3	10.2
Disposals	(0.4)	(0.4)	(0.7)	(1.5)
At 30 September 2016	18.9	22.7	10.1	51.7
Accumulated depreciation				
At 1 October 2014	-	1.6	5.4	7.0
Charge for the year	-	0.6	0.9	1.5
On disposals	-	-	-	-
At 30 September 2015	-	2.2	6.3	8.5
Charge for the year	3.0	0.6	1.3	4.9
On disposals	(0.1)	(0.4)	(0.4)	(0.9)
At 30 September 2016	2.9	2.4	7.2	12.5
Net book value				
At 30 September 2016	16.0	20.3	2.9	39.2
At 30 September 2015	-	20.7	1.4	22.1
At 30 September 2014	-	21.3	1.6	22.9

Plant and machinery shown above is used within the Group's business. Leased assets includes £11.4m in respect of assets leased under operating leases (2015: £nil) and £4.5m of assets available for hire (2015: £nil).

(b) The Company

	Land and buildings £m
Cost	
At 1 October 2014	19.9
Additions	-
Disposals	-
At 30 September 2015	19.9
Additions	-
Disposals	-
At 30 September 2016	19.9
Accumulated depreciation	
At 1 October 2014	0.3
Charge for the year	0.3
On disposals	-
At 30 September 2015	0.6
Charge for the year	0.4
On disposals	-
At 30 September 2016	1.0
Net book value	
At 30 September 2016	18.9
At 30 September 2015	19.3
At 30 September 2014	19.6

31. Investment in Subsidiary Undertakings

	Shares in Group companies	Loans to Group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 1 October 2014	320.4	604.4	3.2	928.0
Investments in subsidiaries	33.0	-	-	33.0
Disposal of subsidiaries	-	-	-	-
Loans advanced	-	188.5	8.3	196.8
Loans repaid	-	(124.6)	-	(124.6)
Provision movements	(6.9)	-	(8.0)	(14.9)
At 30 September 2015	346.5	668.3	3.5	1,018.3
Investments in subsidiaries	174.1	-	-	174.1
Disposal of subsidiaries	-	-	-	-
Loans advanced	-	30.2	9.8	40.0
Loans repaid	-	(246.6)	-	(246.6)
Provision movements	(1.2)	-	0.2	(1.0)
At 30 September 2016	519.4	451.9	13.5	984.8

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

During the year ended 30 September 2016 the Company received £82.0m in dividend income from its subsidiaries (2015: £70.5m) and £33.6m of interest on loans to Group companies (2015: £37.6m).

The company's subsidiaries, and the nature of its interest in them, are shown in note 67.

32. Financial Assets

	Note	2016	2015	2014
		£m	£m	£m
Loans and receivables	33	10,391.8	10,019.0	9,250.2
Finance lease receivables	34	345.7	43.4	5.7
Loans to customers	35	10,737.5	10,062.4	9,255.9
Fair value adjustments from portfolio hedging	37	12.5	5.2	0.5
Investments in structured entities	38	-	18.1	19.3
Derivative financial assets	39	1,366.4	660.1	693.9
		12,116.4	10,745.8	9,969.6

The Group's loan assets and investments in structured entities at 30 September 2016, analysed between the segments described in note 11 are as follows:

	Paragon Mortgages £m	Idem Capital £m	Paragon Bank £m	Total £m
At 30 September 2016				
First mortgages	8,620.4	13.7	1,015.6	9,649.7
Consumer loans	147.6	269.6	400.0	817.2
Asset finance	-	-	250.4	250.4
Other loans	-	-	20.2	20.2
Loans to customers	8,768.0	283.3	1,686.2	10,737.5
Investments in structured entities	-	-	-	-
Total investments in loans	8,768.0	283.3	1,686.2	10,737.5

At 30 September 2015				
First mortgages	9,046.7	14.5	349.6	9,410.8
Consumer loans	175.0	418.4	58.2	651.6
Asset finance	-	-	-	-
Other loans	-	-	-	-
Loans to customers	9,221.7	432.9	407.8	10,062.4
Investments in structured entities	-	18.1	-	18.1
Total investments in loans	9,221.7	451.0	407.8	10,080.5

Of the assets shown above, the balances acquired through the Group's Idem Capital debt purchase operation were as follows.

	Paragon Mortgages £m	Idem Capital £m	Paragon Bank £m	Total £m
At 30 September 2016				
Loans to customers	-	283.3	250.6	533.9
Investments in structured entities	-	-	-	-
Total investments in loans	-	283.3	250.6	533.9
At 30 September 2015				
Loans to customers	-	432.9	-	432.9
Investments in structured entities	-	18.1	-	18.1
Total investments in loans	-	451.0	-	451.0

33. Loans and Receivables

Loans and receivables at 30 September 2016, 30 September 2015 and 30 September 2014, which are all denominated and payable in sterling, were:

	2016	2015	2014
	£m	£m	£m
First mortgage loans	9,649.7	9,410.8	8,651.7
Secured loans	526.8	387.1	436.2
Other unsecured consumer loans	195.1	221.1	162.3
Other loans	20.2	-	-
	10,391.8	10,019.0	9,250.2

First mortgages are secured on residential property within the UK; secured loans enjoy second charges on residential property. The estimated value of the security held against those loans above which are considered to be impaired or past due, representing, for each such account, the lesser of the outstanding balance on the loan and the estimated valuation of the property was:

	2016	2015
	£m	£m
First mortgage loans	34.2	37.7
Secured loans	81.0	92.3
	115.2	130.0

Mortgage loans have a contractual term of up to thirty years, secured loans up to twenty five years, retail finance loans up to ten years and other unsecured loans up to ten years. In all cases the borrower is entitled to settle the loan at any point and in most cases early settlement does take place. All borrowers are required to make monthly payments, except where an initial deferred period is included in the contractual terms.

Certain of Paragon Bank's buy-to-let mortgage assets have been utilised as whole mortgage pools for the purpose of the FLS. This has enabled off balance sheet liquidity to be provided, based on the value of the assets pledged, subject to a haircut. The amount of the liquidity presently drawn is shown in note 7. Further mortgage assets of the Bank have been pre-positioned with the Bank of England for use in the FLS and other funding schemes.

The amount of these loans and of the loans pledged as collateral for the liabilities described in note 54 and of loans otherwise held within Paragon Bank, at 30 September 2016 and 30 September 2015 were:

	First Mortgages £m	Consumer Finance £m	Other loans £m	Total £m
30 September 2016				
In respect of:				
Asset backed loan notes	6,845.8	413.8	-	7,259.6
Warehouse facilities	1,762.1	-	-	1,762.1
Funding for lending	192.2	-	-	192.2
Total pledged as collateral	8,800.1	413.8	-	9,213.9
Prepositioned with Bank of England	428.1	-	-	428.1
Other Bank assets	395.3	304.7	20.2	720.2
Other assets not pledged as collateral	26.2	3.4	-	29.6
	9,649.7	721.9	20.2	10,391.8
30 September 2015				
In respect of:				
Asset backed loan notes	7,464.7	448.4	-	7,913.1
Warehouse facilities	1,566.5	-	-	1,566.5
Funding for lending	-	-	-	-
Total pledged as collateral	9,031.2	448.4	-	9,479.6
Prepositioned with Bank of England	-	-	-	-
Other Bank assets	349.6	15.0	-	364.6
Other assets not pledged as collateral	30.0	144.8	-	174.8
	9,410.8	608.2	-	10,019.0

34. Finance Lease Receivables

The Group's finance lease receivables are car finance and asset finance loans. The average contractual life of the car loans is 49 months (2015: 50 months) while that of the asset finance loans was 42 months (2015: N/A), but it is likely that a significant proportion of customers will choose to settle their obligations early.

The Group's finance leases can be analysed as shown below:

	2016 £m	2015 £m	2014 £m
Car Finance	95.3	44.0	6.5
Asset Finance	250.4	-	-
	345.7	44.0	6.5

The minimum lease payments due under these loan agreements are:

	2016	2015	2014
	£m	£m	£m
Amounts receivable			
Within one year	133.0	12.8	2.3
Within two to five years	255.8	36.1	4.9
After five years	7.6	-	-
	396.4	48.9	7.2
Less: future finance income	(47.7)	(4.9)	(0.7)
Present value	348.7	44.0	6.5

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

	2016	2015	2014
	£m	£m	£m
Amounts receivable			
Within one year	116.1	11.5	2.1
Within two to five years	225.8	32.5	4.4
After five years	6.8	-	-
Present value	348.7	44.0	6.5
Allowance for uncollectible amounts	(3.0)	(0.6)	(0.8)
Carrying value	345.7	43.4	5.7

The Group considers that the fair value of its finance lease receivables is not significantly different to their carrying values. Whilst on car finance cases the Group has the benefit of the underlying vehicle as security on these loans, no account of this is taken in the allowance for uncollectible amounts shown above. The Group has insufficient information on the current condition of finance leased vehicles to derive a reliable estimate of the value which could be realised from vehicles to offset against arrears accounts. Accordingly, no such disclosure is provided.

For the Group's asset finance loans, estimated valuations of security assets for balances in arrears are undertaken as part of the credit management process. These exercises suggest that the security value of assets under finance leases which are past due or impaired is £6.7m (2015: £nil).

The loans shown above pledged as collateral for liabilities or held within Paragon Bank at 30 September 2016 and 30 September 2015 were:

	2016	2015
	£m	£m
In respect of:		
Asset backed loan notes	0.1	0.2
Warehouse facilities	-	-
Total pledged as collateral	0.1	0.2
Bank assets	345.6	43.2
Other assets not pledged as collateral	-	-
	345.7	43.4

35. Loans to Customers

The movements in the Group's investment in loans to customers in the year ended 30 September 2016 and the year ended 30 September 2015 were:

	2016 £m	2015 £m
Cost		
At 1 October 2015	10,062.4	9,255.9
Acquisitions (note 8)	221.7	-
Additions	1,654.0	1,495.6
Effective Interest Rate ('EIR') adjustments	54.9	59.0
Other debits	326.6	279.1
Provision charge (note 36)	(7.7)	(5.6)
Repayments and redemptions	(1,574.4)	(1,021.6)
At 30 September 2016	10,737.5	10,062.4

'Other debits' includes primarily interest and fees charged to customers on loans outstanding.

The fair value of loans to customers is considered to be not materially different to the amortised cost value at which they are disclosed.

36. Impairment Provisions on Loans to Customers

The following amounts in respect of impairment provisions, net of allowances for recoveries of written off assets, have been deducted from the appropriate assets in the balance sheet.

	First Mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
At 1 October 2014	87.0	27.0	0.8	114.8
Charge for the year (note 22)	3.6	2.4	(0.4)	5.6
Amounts written off	(4.5)	(3.5)	0.2	(7.8)
Amounts recovered	(0.1)	(1.5)	-	(1.6)
At 30 September 2015	86.0	24.4	0.6	111.0
Charge for the year (note 22)	4.8	2.6	0.3	7.7
Amounts written off	(2.1)	(2.0)	(1.3)	(5.4)
Amounts recovered	0.1	(2.4)	1.6	(0.7)
At 30 September 2016	88.8	22.6	1.2	112.6

Of the above balances, the following provisions were held in respect of realised losses not charged off, which remain on the balance sheet and provided for in full.

	First Mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
At 30 September 2016	72.4	0.1	0.1	72.6
At 30 September 2015	70.7	0.3	0.1	71.1

37. Fair Value Adjustments from Portfolio Hedging

The Group applies fair value hedge accounting in respect of portfolios of loan assets and retail deposits where the appropriate criteria are met. In these circumstances the change in the fair value of the hedged items attributable to the hedged risk is shown under this heading next to the carrying value of the hedged assets or liabilities.

38. Investment in Structured Entities

Investments in structured entities represent the Group's contribution made to special purpose vehicle ('SPV') companies established and controlled by unrelated third parties to purchase pools of loan assets. All such investments are denominated in sterling, unlisted and are considered to be debt investments as defined by IFRS. The underlying loans are secured and unsecured consumer loans made to UK borrowers. The Group is under no obligation to make any further contribution to these entities.

The movements in the Group's investment in structured entities in the year ended 30 September 2016 and the year ended 30 September 2015 were:

	2016	2015
	£m	£m
Cost		
At 1 October 2015	18.1	19.3
Additions	-	-
Effective Interest Rate ('EIR') income (note 13)	2.4	3.2
Payments received	(20.5)	(4.4)
At 30 September 2016	-	18.1

The fair values of investments in structured entities are considered to be not materially different to the amortised cost value at which they are disclosed.

The Group administers the assets of the SPV companies on behalf of the owners. Fee income derived from this activity of £0.5m (2015: £2.1m) is included within third party servicing fees (note 15) and £nil (2015: £0.1m) is included in other debtors (note 40) in respect of unpaid fees at the year end.

39. Derivative Financial Assets and Liabilities

All of the Group's financial derivatives are held for economic hedging purposes, although not all may be designated for hedge accounting in accordance with the provisions of IAS 39. The analysis below therefore splits derivatives between those accounted for as hedges and those which, while representing an economic hedge, do not qualify for this treatment.

All of the financial assets and liabilities shown are valued using methodologies where the principal inputs are directly or indirectly derived from market data and are therefore classified within level two of the fair value hierarchy laid down by IFRS 7.

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate.

Derivative financial assets and liabilities are included within Financial Assets (note 32) and Financial Liabilities (note 53) respectively.

	2016 Notional amount £m	2016 Assets £m	2016 Liabilities £m	2015 Notional amount £m	2015 Assets £m	2015 Liabilities £m
Derivatives in accounting hedge relationships						
<i>Fair value hedges</i>						
Interest rate swaps	1,933.9	1.3	(14.5)	1,189.6	0.3	(5.4)
<i>Cash flow hedges</i>						
Cross currency basis swaps	3,833.6	1,364.8	-	4,059.5	659.8	-
	5,767.5	1,366.1	(14.5)	5,249.1	660.1	(5.4)
Other derivatives						
Interest rate swaps	347.7	0.3	(1.3)	448.8	-	(1.3)
Total recognised derivative assets / (liabilities)	6,115.2	1,366.4	(15.8)	5,697.9	660.1	(6.7)

At 30 September 2016 cash deposits of £1,184.2m had been pledged as collateral in respect of swaps shown above by the respective swap counterparties (2015: £753.5m) as described in note 7.

All fair value hedging items at 30 September 2016 and at 30 September 2015 relate to the hedging of the Group's loan assets and retail deposits on a portfolio basis.

40. Other Receivables

a) The Group

	<i>Note</i>	2016	2015	2014
		£m	£m	£m
Current assets				
Accrued interest income		0.3	0.4	0.3
Trade receivables		2.4	-	-
Prepayments		2.6	1.9	1.7
Bank borrowings	55	-	1.0	0.9
CSA Assets		3.7	0.9	-
Other tax		0.8	-	-
Other		2.9	2.0	3.6
		12.7	6.2	6.5

The Group uses the International Swaps and Derivatives Association ('ISDA') Master Agreement for documenting certain derivative activity within Paragon Bank. For certain counterparties a Credit Support Annex ('CSA') has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to such counterparties by the Group is shown in the table above.

Accrued interest income and other debtors fall within the definition of financial assets given in IAS 32.

The fair values of the above items are not considered to be materially different to their carrying values.

b) The Company

	2016	2015	2014
	£m	£m	£m
Current assets			
Amounts owed by Group companies	84.5	141.2	103.9
Accrued interest income	0.1	0.1	-
	84.6	141.3	103.9

Accrued interest income and other debtors fall within the definition of financial assets given in IAS 32.

The fair values of the above items are not considered to be materially different to their carrying values.

41. Short Term Investments

This amount represents fixed rate securities issued by the UK Government for which a liquid market exists and are held as part of the liquidity requirement of Paragon Bank PLC. As such they are designated as 'Available for Sale', as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement' and are consequently shown at fair value which corresponds to their market value.

The total nominal value of the securities at 30 September 2016 was £7.0m (2015: £40.0m), the weighted average coupon was 1.75% (2015: 4.41%) and their carrying value was £7.1m (2015: £41.1m).

42. Cash and Cash Equivalents

	2016	2015	2014
	£m	£m	£m
Balances with central banks	315.0	286.0	-
Balances with other banks	922.6	770.0	848.8
	1,237.6	1,056.0	848.8

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets is not immediately available, due to the terms of the warehouse facilities and the securitisations. Cash held in the Group's banking subsidiary is subject to regulatory rules covering liquidity and capital adequacy and is shown as 'Bank Cash' below.

'Cash and Cash Equivalents' also includes balances held by the Trustees of the Paragon Employee Share Ownership Plans which may only be used to invest in the shares of the Company, pursuant to the aims of those plans.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below:

	2016	2015	2014
	£m	£m	£m
Free cash	366.5	199.9	177.3
Securitisation cash	537.1	530.9	609.0
Bank cash	331.6	323.3	60.6
ESOP cash	2.4	1.9	1.9
	1,237.6	1,056.0	848.8

The 'Cash and Cash Equivalents' amount of £361.3m (2015: £196.8m) shown in the Company balance sheet is included in 'Free Cash'.

'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.

43. 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:

	2016 Number	2015 Number
Ordinary shares		
At 1 October 2015	309,349,316	307,308,283
Shares issued	218,872	2,041,033
Shares cancelled	(13,716,094)	-
At 30 September 2016	295,852,094	309,349,316

During the year the Company issued 163,045 shares at par (2015: 1,050,000) to the trustees of its Employee Share Ownership Plan ('ESOP') Trust in order that they could fulfil their obligations under the Group's share based award arrangements. It also issued 55,827 shares (2015: 991,033) to satisfy options granted under sharesave schemes for a consideration of £68,070 (2015: £1,365,944).

On 18 August 2016 13,716,094 shares held in treasury were cancelled by the Company.

44. Reserves

(a) The Group

	Note	2016 £m	2015 £m	2014 £m
Share premium account	45	64.6	64.6	64.1
Capital redemption reserve	46	13.7	-	-
Merger reserve	47	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	48	2.1	(1.9)	0.6
Profit and loss account	49	725.9	767.7	693.5
		736.1	760.2	688.0

(b) The Company

	Note	2016 £m	2015 £m	2014 £m
Share premium account	45	64.6	64.6	64.1
Capital redemption reserve	46	13.7	-	-
Merger reserve	47	(23.7)	(23.7)	(23.7)
Profit and loss account	49	415.5	456.6	416.0
		470.1	497.5	456.4

45. Share Premium Account

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Balance at 1 October 2015	64.6	64.1	64.6	64.1
Arising on issue of shares	-	0.5	-	0.5
Balance at 30 September 2016	64.6	64.6	64.6	64.6

46. Capital Redemption Reserve

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Balance at 1 October 2015	-	-	-	-
Arising on cancellation of shares	13.7	-	13.7	-
Balance at 30 September 2016	13.7	-	13.7	-

47. Merger Reserve

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Balance at 1 October 2015	(70.2)	(70.2)	(23.7)	(23.7)
Balance at 30 September 2016	(70.2)	(70.2)	(23.7)	(23.7)

The merger reserve arose, due to the provisions of UK company law at the time, on a group restructuring on 12 May 1989 when the Company became the parent entity of the Group.

48. Cash Flow Hedging Reserve

	Note	The Group		The Company	
		2016	2015	2016	2015
		£m	£m	£m	£m
At 1 October 2015		(1.9)	0.6	-	-
Movement in fair value of hedging derivatives		5.0	(3.1)	-	-
Deferred tax thereon	27	(1.0)	0.6	-	-
Balance at 30 September 2016		2.1	(1.9)	-	-

The cash flows to which these amounts relate result from the cross currency basis swaps described in note 7. The contractual life of these swaps, over which cash flows might take place and affect profit, extend over the next 28 years (2015: 29 years). However the cash flows in respect of these swaps will only continue for as long as the related notes remain outstanding, which is expected to be a much shorter period.

Foreign exchange losses of £699.9m on asset backed loan notes denominated in US dollars and euros (2015: gains of £30.8m) have been taken to the cash flow hedging reserve together with equal and opposite movements on the cross currency basis swaps used to hedge these liabilities.

49. Profit and Loss Account

	Note	The Group		The Company	
		2016	2015	2016	2015
		£m	£m	£m	£m
At 1 October 2015		767.7	693.5	456.6	416.0
Dividends paid	50	(33.9)	(29.1)	(33.9)	(29.1)
Share options exercised	51	(3.7)	(6.1)	-	-
Charge for share based remuneration	18	4.4	4.5	4.4	4.5
Cancellation of shares		(94.0)	-	(94.0)	-
Tax on share based remuneration	27	(0.2)	1.2	-	-
Actuarial (loss) on retirement benefit obligation	56	(30.4)	(3.4)	-	-
Profit for the year		116.0	107.1	82.4	65.2
At 30 September 2016		725.9	767.7	415.5	456.6

50. Equity Dividend

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2016	2015	2016	2015
	Per share	Per share	£m	£m
<i>Equity dividends on ordinary shares</i>				
Final dividend for the year ended 30 September 2015	7.4p	6.0p	21.7	18.3
Interim dividend for the year ended 30 September 2016	4.3p	3.6p	12.2	10.8
	11.7p	9.6p	33.9	29.1

Amounts paid and proposed in respect of the year:

	2016	2015	2016	2015
	Per share	Per share	£m	£m
Interim dividend for the year ended 30 September 2016	4.3p	3.6p	12.2	10.8
Proposed final dividend for the year ended 30 September 2016	9.2p	7.4p	25.5	21.8
	13.5p	11.0p	37.7	32.6

Dividends of £0.0m (2015: £0.0m) were paid by the Company in respect of shares held by ESOP trusts on which dividends had not been waived.

The proposed final dividend for the year ended 30 September 2016 will be paid on 13 February 2017, subject to approval at the Annual General Meeting, with a record date of 6 January 2017. The dividend will be recognised in the accounts when it is paid.

51. Transactions in Shares

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Awards from ESOP schemes				
Proceeds	-	-	-	-
Cost of shares transferred (note 52)	(3.7)	(6.1)	-	-
(Deficit) on exercise (note 49)	(3.7)	(6.1)	-	-
Shares issued				
Nominal value (note 43)	0.3	2.0	0.3	2.0
Premium on issue (note 45)	-	0.5	-	0.5
Proceeds of issue	0.3	2.5	0.3	2.5
(Deficit) / surplus on transactions in own shares	(3.4)	(3.6)	0.3	2.5

52. Own Shares

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Treasury shares				
At 1 October 2015	89.2	39.5	89.2	39.5
Shares purchased	51.0	49.7	51.0	49.7
Shares cancelled	(94.0)	-	(94.0)	-
At 30 September 2016	46.2	89.2	46.2	89.2
ESOP shares				
At 1 October 2015	10.8	8.7	-	-
Shares purchased	8.9	7.2	-	-
Shares subscribed for (note 43)	0.3	1.0	-	-
Options exercised (note 51)	(3.7)	(6.1)	-	-
At 30 September 2016	16.3	10.8	-	-
Balance at 30 September 2016	62.5	100.0	46.2	89.2
Balance at 1 October 2015	100.0	48.2	89.2	39.5

At 30 September 2016 the number of the Company's own shares held in treasury was 15,348,714 (2015: 12,401,400). These shares had a nominal value of £15,348,714 (2015: £12,401,400). These shares do not qualify for dividends.

The ESOP shares are held in trust for the benefit of employees exercising their options under the Company's share option schemes and awards under the Paragon Performance Share Plan, Matching Share Plan and Deferred Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

At 30 September 2016, the trusts held 3,594,175 ordinary shares (2015: 1,562,571) with a nominal value of £3,594,175 (2015: £1,562,571) and a market value of £11,267,738 (2015: £6,172,155). Options, or other share-based awards, were outstanding against 3,594,175 of these shares at 30 September 2016 (2015: 1,562,571). The dividends on all of these shares have been waived (2015: 1,160,866).

53. Financial Liabilities

(a) The Group

	<i>Note</i>	2016	2015	2014
		£m	£m	£m
Current liabilities				
Corporate bonds		110.0	-	-
Retail deposits	54	1,017.1	338.9	53.3
Bank loans and overdrafts		1.2	0.7	1.1
		1,128.3	339.6	54.4
Non-current liabilities				
Asset backed loan notes		8,374.1	8,274.6	8,115.0
Corporate bond		149.0	110.0	110.0
Retail bonds		295.3	294.9	183.2
Retail deposits	54	856.8	369.8	6.8
Fair value adjustments from portfolio hedging	37	0.8	-	-
Bank loans and overdrafts		1,573.0	1,425.4	1,397.9
Derivative financial instruments	39	15.8	6.7	1.1
		11,264.8	10,481.4	9,814.0

A maturity analysis of the above borrowings and further details of asset backed loan notes, bank loans, corporate and retail bonds are given in note 55.

b) The Company

	<i>Note</i>	2016	2015	2014
		£m	£m	£m
Current liabilities				
Corporate bonds		110.0	-	-
Non-current liabilities				
Corporate bond		149.0	110.0	110.0
Retail bonds		295.3	294.9	183.2
		444.3	404.9	293.2

A maturity analysis of the above borrowings and further details of corporate and retail bonds are given in note 55.

54. Retail Deposits

The Group's retail deposits, held by Paragon Bank PLC, 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:

	2016	2015	2014
	£m	£m	£m
Fixed rate	1,332.5	508.3	39.8
Variable rates	541.4	200.4	20.3
	1,873.9	708.7	60.1

The weighted average interest rate on retail deposits at 30 September 2016, analysed by charging method, was:

	2016	2015	2014
	%	%	%
Fixed rate	2.11	2.33	1.90
Variable rates	1.65	1.62	1.85

The contractual maturity of these deposits is analysed below.

	2016	2015	2014
	£m	£m	£m
Amounts repayable			
In less than three months	55.7	9.1	-
In more than three months but not more than one year	690.3	242.6	52.8
In more than one year, but not more than two years	572.9	181.7	6.8
In more than two years, but not more than five years	283.9	188.1	-
Total term deposits	1,602.8	621.5	59.6
Repayable on demand	271.1	87.2	0.5
	1,873.9	708.7	60.1
Total falling due in less than one year (note 53)	1,017.1	338.9	53.3
Total falling due in more than one year (note 53)	856.8	369.8	6.8
	1,873.9	708.7	60.1

55. Borrowings

Set out below is the contractual maturity profile of the Group's and the Company's borrowings at 30 September 2016 and 30 September 2015:

	Financial liabilities falling due:				Total
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	
	£m	£m	£m	£m	
The Group					
30 September 2016					
Bank overdrafts	1.2	-	-	-	1.2
Bank loans	-	-	1,573.0	-	1,573.0
Corporate bond	110.0	-	-	149.0	259.0
Retail bonds	-	-	59.5	235.8	295.3
Asset backed loan notes	-	-	136.8	8,237.3	8,374.1
	111.2	-	1,769.3	8,622.1	10,502.6
30 September 2015					
Bank overdrafts	0.7	-	-	-	0.7
Bank loans	-	112.9	139.0	1,173.5	1,425.4
Corporate bond	-	110.0	-	-	110.0
Retail bonds	-	-	-	294.9	294.9
Asset backed loan notes	-	63.7	-	8,210.9	8,274.6
	0.7	286.6	139.0	9,679.3	10,105.6
The Company					
30 September 2016					
Corporate bond	110.0	-	-	149.0	259.0
Retail bonds	-	-	59.5	235.8	295.3
	110.0	-	59.5	384.8	554.3
30 September 2015					
Corporate bond	-	110.0	-	-	110.0
Retail bonds	-	-	-	294.9	294.9
	-	110.0	-	294.9	404.9

The fair values of borrowings are not considered to be significantly different to their carrying values and the EIRs are not materially different to the rates charged.

(a) Asset backed loan notes

The asset backed loan notes are secured on portfolios comprising variable and fixed rate mortgages or personal, retail and car loans. The maturity date of the notes matches the maturity date of the underlying assets (except as noted below). The notes can be prepaid in part from time to time, but such prepayments are limited to the net capital received from borrowers in respect of the underlying assets. There is no requirement for the Group to make good any shortfall on the notes out of general funds. It is likely that a substantial proportion of these notes will be repaid within five years.

For its public issues, the Group has an additional option to repay all of the notes at an earlier date (the 'call date'), at their outstanding principal amount.

Interest is payable at a fixed margin above;

- The London Interbank Offered Rate ('LIBOR') on notes denominated in sterling
- The Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros
- The London Interbank Offered Rate ('US Dollar LIBOR') on notes denominated in US dollars

All payments in respect of the notes are required to be made in the currency in which they are denominated.

On 20 October 2015, a Group company, Idem Luxembourg (No. 8) entered into an agreement under which £117.3m of sterling floating rate notes have been issued to Citibank NA on a limited recourse basis. These notes bear interest at a rate of one month LIBOR plus 3.50%. The Group investment in this company to support these notes was £84.9m. The facility was used to refinance existing Idem Capital borrowings and to refinance further existing Idem Capital unsecured loan assets and is secured on those assets. During the period two further tranches of £4.1m and £70.8m of notes were issued under the facility. Both of these issues were used to fund the purchase of loan balances from third parties.

On 19 November 2015, a Group company, Paragon Mortgages (No. 24) PLC, issued €125.0m of euro mortgage backed floating rate notes and £253.0m of sterling mortgage backed floating rate notes to external investors at par. The euro notes were class A1 notes, rated AAA by Fitch and Aaa by Moody's and bearing interest at 1.10% above EURIBOR. £208.3m of the sterling notes were class A2 notes, rated AAA by Fitch and Aaa by Moody's, £19.3m were class B notes, rated AA by Fitch and Aa2 by Moody's and £25.4m were class C notes rated A by Fitch and A1 by Moody's. The interest margins above LIBOR on the sterling notes were 1.50% on the A2 notes, 2.45% on the B notes and 3.20% on the C notes. Cross-currency basis swaps were entered into at the time of the transaction, effectively translating the euro notes into a LIBOR linked sterling liability. The average interest margin on the transaction, taking swap costs into account was 1.75% and the proceeds were used to pay down existing warehouse debt. The Group retained £8.8m of class Z notes and also invested £8.7m in the first loss fund, bringing its total investment to £17.5m, or 5.0% of the issued notes.

Notes in issue at 30 September 2016 and 30 September 2015, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2016	2015	2016	2015
Sterling notes			£m	£m	%	%
Paragon Mortgages (No. 7) PLC	15/05/43	15/05/08	71.8	75.2	0.42	0.42
Paragon Mortgages (No. 8) PLC	15/04/44	15/10/08	190.5	204.4	0.59	0.59
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	117.4	126.1	0.38	0.38
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	214.4	173.5	0.44	0.55
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	73.6	78.8	0.29	0.29
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	111.1	117.9	0.40	0.39
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	541.3	576.1	0.27	0.27
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	117.0	122.3	0.31	0.30
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	150.6	161.3	0.29	0.29
Paragon Mortgages (No. 17) PLC	18/04/40	08/01/16	-	140.4	-	1.50
Paragon Mortgages (No. 18) PLC	15/03/41	15/12/16	66.4	163.8	1.54	1.31
Paragon Mortgages (No. 19) PLC	15/08/41	15/05/17	154.2	318.7	0.95	0.90
Paragon Mortgages (No. 20) PLC	15/11/41	15/08/18	198.5	305.6	0.72	0.71
Paragon Mortgages (No. 21) PLC	15/06/42	15/12/18	191.4	233.0	0.90	0.88
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	163.5	173.2	0.90	0.90
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	210.4	219.2	1.22	1.22
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	245.9	-	1.75	-
First Flexible No. 5 PLC	01/06/34	01/07/09	61.6	67.3	0.99	0.99
First Flexible No. 6 PLC	01/12/35	01/03/08	60.6	65.1	1.27	1.27
First Flexible (No. 7) PLC	15/09/33	15/03/11	21.2	30.5	0.27	0.26
Paragon Personal and Auto Finance (No. 3) PLC	15/04/36	15/04/09	35.8	43.4	0.95	0.95
Paragon Secured Finance (No. 1) PLC	15/11/35	15/11/08	52.7	64.4	0.98	1.01
Idem Capital Securities (No. 1) *	21/02/17	N/A	-	65.1	-	3.00
Idem First Finance Limited	05/04/21	N/A	-	39.8	-	3.75
Idem Luxembourg No. 8 *	15/10/18	N/A	137.6	-	3.50	-
US dollar notes			\$m	\$m	%	%
Paragon Mortgages (No. 7) PLC	15/05/43	15/05/08	207.5	217.9	0.74	0.74
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	19.1	20.5	0.36	0.36
Paragon Mortgages (No. 10) PLC †	15/06/41	15/12/09	-	112.8	-	0.09
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	386.8	414.0	0.10	0.10
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	863.3	948.4	0.24	0.24
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	179.1	192.3	0.18	0.18
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	1,060.9	1,156.5	0.20	0.20
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	733.2	792.1	0.19	0.19
First Flexible No. 6 PLC	01/12/35	01/03/08	9.4	10.1	0.56	0.56

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2016	2015	2016	2015
			€m	€m	%	%
Euro notes						
Paragon Mortgages (No. 7) PLC	15/05/43	15/05/08	211.0	220.9	0.66	0.66
Paragon Mortgages (No. 8) PLC	15/04/44	15/10/08	255.7	274.3	0.48	0.48
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	182.1	195.6	0.56	0.56
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	258.7	261.1	0.40	0.40
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	244.5	262.2	0.54	0.54
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	348.8	360.3	0.53	0.52
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	326.2	338.1	0.41	0.40
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	361.7	374.0	0.45	0.44
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	266.1	271.8	0.69	0.68
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	150.8	161.3	0.50	0.50
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	100.1	105.0	0.70	0.70
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	120.7	-	1.10	-
First Flexible No. 6 PLC	01/12/35	01/03/08	34.2	36.8	1.05	1.05
Paragon Personal and Auto Finance (No. 3) PLC	15/04/36	15/04/09	61.6	74.6	0.84	0.84

* Although the maturity date of these notes may be earlier than the potential final redemption date of the underlying loans, repayment cannot be enforced except to the extent that cash can be realised from those assets at that time.

† During the period certain trigger events, specified in the terms and condition of the notes, occurred which meant that all cash flows relating to the class a1 dollar notes issued by Paragon Mortgages (No. 10) PLC would in future be payable in sterling, as though they had been issued at the equivalent sterling amount (as described in note 7). The swap arrangements in the company mean that this change has no impact on the Group's exposure, but the loans are reported as sterling notes in the table above, whereas in 2015 they had been reported as US dollar notes.

All of the notes listed above are rated and publicly listed, except for those issued by Idem Capital Securities (No. 1), Idem First Finance Limited and Idem Luxembourg (No. 8), which were issued privately.

The notes outstanding at 30 September 2016 can be analysed as follows:

	2016			2015		
	Listed	Not listed	Total	Listed	Not listed	Total
	£m	£m	£m	£m	£m	£m
Secured on mortgage assets	8,095.6	-	8,095.6	8,008.8	-	8,008.8
Secured on other assets	141.7	136.8	278.5	162.9	102.9	265.8
	8,237.3	136.8	8,374.1	8,171.7	102.9	8,274.6

The details of the assets backing these securities are given in notes 33 and 34.

The Group publishes detailed information on the performance of all of its listed note issues on the Bond Investor Reporting section of its website at www.paragon-group.co.uk. A more detailed description of the securitisation structure under which these notes are issued is given in note 7.

(b) Bank borrowings

First mortgage assets are typically securitised within twelve months of origination. Prior to securitisation new first mortgage loans are financed by a bank loan, referred to as a 'warehouse facility', which is drawn down on completion of the loans and repaid when the assets are securitised or refinanced by an internal asset sale. More information on this process is given in note 7 and details of assets held within the warehouse facilities are given in note 33. Details of the Group's bank borrowings are given below.

	2016			2015		
	Principal value	Maximum available facility	Carrying value	Principal value	Maximum available facility	Carrying value
	£m	£m	£m	£m	£m	£m
i) Paragon Second Funding	1,086.3	1,086.3	1,086.3	1,173.5	1,173.5	1,173.5
ii) Paragon Fourth Funding	143.0	300.0	143.0	140.0	300.0	139.0
iii) Paragon Fifth Funding	223.0	350.0	221.3	114.0	350.0	112.9
iv) Paragon Sixth Funding	-	-	-	-	100.0	(0.3)
v) Paragon Seventh Funding	123.0	200.0	122.4	-	200.0	(0.7)
	1,575.3	1,936.3	1,573.0	1,427.5	2,123.5	1,424.4

- i) The Paragon Second Funding warehouse was available for further drawings until 29 February 2008 at which point it converted automatically to a term loan and no further drawings were allowed. This loan is a sterling facility provided to Paragon Second Funding Limited by a consortium of banks and is secured on all the assets of Paragon Second Funding Limited, Paragon Car Finance (1) Limited and Paragon Personal Finance (1) Limited. Its final repayment date is 28 February 2050 but it is likely that substantial repayments will be made within the next five years. Interest on this loan is payable monthly in sterling at 0.675% above LIBOR (2015: 0.675% above LIBOR). Repayments of this facility before the final repayment date are restricted to the amount of principal cash realised from the funded assets.
- ii) On 27 September 2010 the Group entered into a £200.0m committed sterling facility provided to Paragon Fourth Funding Limited by Macquarie Bank PLC to provide funding for new lending, which was increased to £250.0m in 2012 and to £300.0m on 8 May 2015. This facility is secured on all the assets of Paragon Fourth Funding Limited and is available for drawing for a period of two years and has a term of four years. Loans originated in this warehouse are refinanced in the mortgage backed securitisation market from time to time when appropriate or by an internal asset sale. Interest on this loan was payable monthly in sterling at 2.875% above LIBOR until the facility was renewed, on substantially the same terms, with a reduced margin of 1.750% above three month LIBOR, with effect from 12 December 2014 for a further two year period. The facility has a renewal process that allows the Group to agree a new two year commitment period prior to the expiry of the existing commitment period. Repayments on this facility are limited to principal cash received from the funded assets.
- iii) On 26 September 2012, the Group entered into a £200.0m committed sterling facility provided to Paragon Fifth Funding Limited by the wholesale division of Lloyds Bank, which was renewed in January 2014. On 15 May 2015 the facility was increased to £350.0m, and certain other changes were made to its terms. The facility was renewed in 2016, but without changes to its terms. This facility is secured on all the assets of Paragon Fifth Funding Limited and is structured with a three year term to permit drawings and re-drawings until June 2018. Loans originated in this warehouse are refinanced in the mortgage backed securitisation market from time to time when appropriate or by an internal asset sale. Interest on this loan was payable monthly in sterling at 2.75% above three month LIBOR until January 2014, when the margin was reduced to 1.75%. As part of the May 2015 amendment to the facility this margin will increase to 2.15% for advances on the facility between £300.0m and £350.0m. The facility had a renewal process that allows the Group to agree a new commitment period prior to the expiry of the existing commitment period. As with the other warehouses, repayments on this facility are limited to principal cash received from the funded assets.

- iv) On 30 April 2014, a Group company, Paragon Sixth Funding Limited, entered into an additional £100.0m committed sterling facility with Natixis. This facility was terminated in the period. The facility was secured on all the assets of Paragon Sixth Funding Limited and was available for a twelve month period, which was extended to 24 months when a refinancing target was met. Loans originated in this warehouse were refinanced in the mortgage backed securitisation market from time to time when appropriate. This facility bore interest at a rate of three month LIBOR plus 1.40%. As with the other warehouses, repayments on this facility were limited to principal cash received from the funded assets. At 30 September 2015 no amounts were drawn on this facility, therefore unamortised debit EIR adjustments were included in other receivables (note 40).
- v) On 26 September 2015, a Group company, Paragon Seventh Funding Limited, entered into an additional £200.0m committed sterling facility with Bank of America Merrill Lynch International Limited. This facility is secured on all the assets of Paragon Seventh Funding Limited and is available for drawings and redrawings until 8 October 2017. Loans originated in this warehouse are refinanced in the mortgage backed securitisation market from time to time when appropriate or by an internal asset sale. This facility bears interest at a rate of three month LIBOR plus 1.30%. The facility has a renewal process that allows the Group to agree a new commitment period prior to the expiry of the existing commitment period. As with the other warehouses, repayments on this facility are limited to principal cash received from the funded assets. At 30 September 2015 no amounts were drawn on this facility, therefore unamortised debit EIR adjustments were included in other receivables (note 40).

The weighted average margin above LIBOR on bank borrowings at 30 September 2016 was 0.974% (2015: 0.866%).

(c) Corporate bonds

A summary of the Company's corporate bonds is set out below:

Maturity date	Current Interest terms	Currency	2016 £m	2015 £m
20 April 2017	3.729% p.a. fixed	GBP	110.0	110.0
9 September 2026	7.250% p.a. fixed	GBP	150.0	-
			260.0	110.0

On 9 September 2016 the Company issued £150.0m of 7.25% Fixed Rate Reset Callable Subordinated Tier 2 Notes at par to provide long term capital for the Group. These bonds bear interest at a fixed rate of 7.25% per annum until 9 September 2021, after which interest will be payable at a fixed rate which is 6.731% over the sterling 5-year mid-market swap rate at that time. These bonds are unsecured and subordinated to any other creditors of the Company. At issue the Notes were rated BB+ by Fitch. At 30 September 2016 £149.0m (2015: £nil, 2014: £nil) was included within the financial liabilities of the Company and the Group in respect of these bonds. Cash received on the issue of these bonds was £149.0m net of issue costs (note 63).

On 20 April 2005 the Company issued £120.0m of 7% Callable Subordinated Notes at an issue price of 99.347% to provide long term capital for the Group. These bonds bore interest at a fixed rate of 7% per annum until 20 April 2012, after which interest was payable at a fixed rate of 3.729% per annum. The bonds are repayable on 20 April 2017. They are unsecured and subordinated to any other creditors of the Company. At 30 September 2016 £110.0m (2015: £110.0m, 2014: £110.0m) was included within the financial liabilities of the Company and the Group in respect of these bonds.

(d) Retail bonds

On 11 February 2013 the Company inaugurated a £1,000.0m Euro Medium Term Note Programme under which it may issue retail bonds, or other notes, within a twelve month period. The prospectus was updated, renewing the programme for a further twelve month period on 22 January 2016.

The terms of issue for each tranche of notes are separately determined. These bonds are listed on the London Stock Exchange and have a fixed term, but are callable at the option of the Company. A summary of the retail bonds outstanding under this programme is given below.

Maturity date	Interest terms	Issue price	Currency	2016 £m	2015 £m
5 December 2020	6.000% p.a. fixed	par	GBP	60.0	60.0
30 January 2022	6.125% p.a. fixed	par	GBP	125.0	125.0
28 August 2024	6.000% p.a. fixed	par	GBP	112.5	112.5
				297.5	297.5

The notes are unsubordinated unsecured liabilities of the Company and the amount included in Financial Liabilities in the accounts of the Group and the Company in respect of these bonds is £292.8m (2015: £294.9m).

56. Retirement Benefit Obligations

(a) Defined benefit plan - description

The Group operates a funded defined benefit pension scheme in the UK (the 'Plan'). The Plan assets are held in a separate fund, administered by a corporate trustee, to meet long-term pension liabilities to past and present employees. The Trustee of the Plan is required by law to act in the best interests of the Plan's beneficiaries and is responsible for the investment policy adopted in respect of the Plan's assets. The appointment of directors to the Trustee is determined by the Plan's trust documentation. The Group has a policy that one third of all directors of the Trustee should be nominated by active and pensioner members of the Plan.

Employees who are members of the Plan are entitled to receive a pension of 1/60 of their final basic annual salary for every year of eligible service (to a maximum of 2/3). Dependants of members of the Plan are eligible for a dependant's pension and the payment of a lump sum in the event of death in service.

The principal actuarial risks to which the Plan is exposed are:

- **Investment risk** – The risk that income is generated on the Plan's investments at a rate lower than the rate at which the defined benefit liability is calculated, which would cause an increased deficit in the Plan. The Trustee keeps the allocation of the Plan's investments under review to manage this risk on a long term basis
- **Interest risk** – A decrease in bond yields will reduce the discount rate used in valuing the deficit and hence increase the Plan liability
- **Inflation risk** – A rise in inflation will increase the benefits payable to Plan members, which would increase the Plan liability

- **Longevity risk** – The value of the Plan deficit is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would increase the deficit in the Plan
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on a premium over the expected rate of inflation. Should the salaries of Plan members increase at a higher rate then the deficit will be higher

The risks relating to death in service payments are insured with an external insurance company.

As a result of the Plan having been closed to new entrants since February 2002, the service cost as a percentage of pensionable salaries is expected to increase as the average age of active members rises over time. However the membership is expected to reduce so that the service cost in monetary terms will gradually reduce.

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2013, by Mercer, an independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with section 224 of the Pensions Act 2004 was £144.5m, with a shortfall against the assets of £67.2m. A further actuarial valuation, as at 31 March 2016 is currently in progress.

Following the 2013 actuarial valuation, the Trustee put in place a recovery plan. The Trustee's recovery plan aims to meet the statutory funding objective within six years and five months from the date of valuation, that is by 31 August 2019.

(b) Defined benefit plan – financial impact

For accounting purposes the valuation at 31 March 2013 was updated to 30 September 2016 in accordance with the requirements of IAS 19 (revised) by Mercer.

The major categories of assets in the Plan at 30 September 2016, 30 September 2015 and 30 September 2014 and their fair values were:

	2016	2015	2014
	£m	£m	£m
Cash	9.7	0.4	0.9
Equity instruments	56.0	56.3	56.4
Debt instruments	29.5	25.7	24.0
Real estate	8.9	8.7	7.4
Total fair value of Plan assets	104.1	91.1	88.7
Present value of Plan liabilities	(162.5)	(112.6)	(106.0)
(Deficit) in the Plan	(58.4)	(21.5)	(17.3)

At 30 September 2016 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets. All investments of the Plan have quoted market prices in an active market, and are thus considered to be Level 1 financial instruments as defined by IFRS 13.

The movement in the fair value of the Plan assets during the year was as follows:

	2016	2015
	£m	£m
At 1 October 2015	91.1	88.7
Interest on Plan assets	3.6	3.6
Cash flows		
Contributions by Group	3.2	3.2
Contributions by Plan members	0.2	0.3
Benefits paid	(1.3)	(2.2)
Administration expenses paid	(0.4)	(0.7)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	7.7	(1.8)
At 30 September 2016	104.1	91.1

The actual return on Plan assets in the year ended 30 September 2016 was £11.3m (2015: £1.8m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2016	2015
	£m	£m
At 1 October 2015	112.6	106.0
Current service cost	1.7	1.7
Funding cost	4.4	4.3
Cash flows		
Contributions by Plan members	0.2	0.3
Benefits paid	(1.3)	(2.2)
Remeasurement loss / (gain)		
Arising from demographic assumptions	-	-
Arising from financial assumptions	44.9	2.5
Arising from experience adjustments	-	-
At 30 September 2016	162.5	112.6

The liabilities of the Plan are measured by discounting the best estimate of future cash flows to be paid out by the Plan using the Projected Unit method. This amount is reflected in the liability in the balance sheet. The Projected Unit method is an accrued benefits valuation method in which the Plan liabilities are calculated based on service up until the valuation date allowing for future salary growth until the date of retirement, withdrawal or death, as appropriate. The future service rate is then calculated as the contribution rate required to fund the service accruing over the next year again allowing for future salary growth. The major weighted average assumptions used by the actuary were (in nominal terms):

	30 September 2016	30 September 2015	30 September 2014
In determining net pension cost for the year			
Discount rate	3.90%	4.10%	4.50%
Rate of compensation increase	3.55%	3.65%	3.80%
Rate of price inflation	3.05%	3.15%	3.30%
Rate of increase of pensions	3.00%	3.05%	3.20%
In determining benefit obligations			
Discount rate	2.40%	3.90%	4.10%
Rate of compensation increase	3.50%	3.55%	3.65%
Rate of price inflation	3.00%	3.05%	3.15%
Rate of increase of pensions	2.95%	3.00%	3.05%
Further life expectancy at age 60			
- Male member aged 60	29	29	29
- Female member aged 60	31	31	31
- Male member aged 40	32	32	32
- Female member aged 40	34	34	34

The amounts charged in the consolidated income statement in respect of the Plan are:

	<i>Note</i>	2016	2015
		£m	£m
Current service cost	<i>18</i>	1.7	1.7
Administration expenses		0.4	0.7
Included within operating expenses		2.1	2.4
Funding cost of Plan liabilities		4.4	4.3
Interest on Plan assets		(3.6)	(3.6)
Net interest expense	<i>14</i>	0.8	0.7
Components of defined benefit costs recognised in profit or loss		2.9	3.1

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	<i>Note</i>	2016	2015
		£m	£m
Return on Plan assets (excluding amounts included in interest)		7.7	(1.8)
Actuarial (losses) / gains			
Arising from demographic assumptions		-	-
Arising from financial assumptions		(44.9)	(2.5)
Arising from experience adjustments		-	-
Total actuarial (loss)		(37.2)	(4.3)
Tax thereon	27	6.8	0.9
Net actuarial (loss)	49	(30.4)	(3.4)

(c) Defined benefit plan – future cash flows

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2016, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

Assumption	Increase in assumption	Impact on scheme liabilities
Discount rate	0.1% p.a.	2.3% decrease
Rate of inflation *	0.1% p.a.	2.3% decrease
Rate of salary growth	0.1% p.a.	0.4% increase
Rates of mortality	1 year of life expectancy	2.8% increase

* maintaining a 0.5% assumption for real salary growth

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years.

In conjunction with the Trustee, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan. There have been no changes in the processes by which the Plan manages its risks from previous periods.

The target asset allocations for the year ending 30 September 2017 are 62% growth assets (primarily equities), 30% bonds and 8% real estate.

The rate of employee contributions to the Plan is 5.0% of pensionable salaries. Before 8 October 2013 the agreed rate of employer contributions was 26.6% of gross salaries for participating employees with an additional contribution of £1.5m per annum paid by monthly instalments. After 8 October 2013, following the finalisation of the March 2013 valuation, employer contributions rose to 27.0% of gross salaries for participating employees, the £1.5m per annum contribution remained in place and a further additional contribution of £0.4m per annum to cover administration and life cover was agreed.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2017 is £3.2m. This is based on the current rates of contribution and may change following the completion of the ongoing 2016 triennial valuation.

The average duration of the benefit obligations in the Plan at the year end are shown in the table below:

Category of member	2016 Years	2015 Years
Active members	26	24
Deferred pensioners	26	25
Current pensioners	16	15
All members	24	23

(d) Defined contribution arrangements

The Group sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Group successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme.

The acquired PBAF business also sponsors a number of defined contribution pension plans and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2016, which represent the total cost charged against income, were £1.8m (2015: £0.6m) (note 18).

57. Deferred Tax

(a) The Group

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

	<i>Note</i>	2016 £m	2015 £m	2014 £m
Net liability at 1 October 2015		11.3	10.1	9.9
Acquisitions	8	(3.5)	-	-
Income statement charge	24	(0.4)	1.8	1.1
(Credit) / charge to equity	27	(5.4)	(0.6)	(0.9)
Net liability at 30 September 2016		2.0	11.3	10.1

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

	2016	2015	2014
	£m	£m	£m
Accelerated tax depreciation	(4.2)	(0.4)	(0.5)
Retirement benefit obligations	(11.1)	(4.3)	(3.5)
Impairment and other provisions	16.4	16.6	15.8
Tax (losses)	(0.2)	(0.3)	(0.5)
Other timing differences	1.1	(0.3)	(1.2)
Net deferred tax liability	2.0	11.3	10.1

As stated in note 24 legislation has been introduced to reduce the standard rate of UK corporation tax firstly to 19.0% with effect from 1 April 2017 and subsequently to 17.0% from 1 April 2020. The temporary differences have been provided at the rate prevailing when the Group anticipates the temporary difference to reverse. 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 Group's control (eg the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (eg the level of redemptions of finance leases).

If temporary differences reverse within Paragon Bank PLC in a period in which it is subject to the banking surcharge, then the impact of the reversal will be at a tax rate that includes the surcharge. The deferred tax numbers above do not include any material temporary differences in Paragon Bank PLC.

In addition, the Group has tax losses of £1.7m (2015: £1.7m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

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

	2016	2015	2014
	£m	£m	£m
Net liability at 1 October 2015	1.9	1.8	1.8
Income statement charge	-	0.1	-
Net liability at 30 September 2016	1.9	1.9	1.8

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

	2016	2015	2014
	£m	£m	£m
Other timing differences	1.9	1.9	1.8
Net deferred tax liability	1.9	1.9	1.8

58. Current Tax Liabilities

(a) The Group

	2016	2015	2014
	£m	£m	£m
UK Corporation Tax	16.7	12.5	11.9
	16.7	12.5	11.9

b) The Company

	2016	2015	2014
	£m	£m	£m
UK Corporation Tax	0.4	2.6	2.3
	0.4	2.6	2.3

59. Other Liabilities

(a) The Group

	2016	2015	2014
	£m	£m	£m
Current liabilities			
Accrued interest	26.1	23.9	23.1
Deferred income	1.3	0.1	0.1
Deferred consideration	1.9	-	-
Trade creditors	3.8	-	-
Conduct (note 60)	1.9	-	-
Other accruals	19.6	17.7	16.0
Other taxation and social security	1.7	1.3	0.9
	56.3	43.0	40.1
Non-current liabilities			
Accrued interest	6.5	-	-
Deferred income	1.7	0.1	0.2
Contingent liabilities	13.7	-	-
Other accruals	0.5	-	-
	22.4	0.1	0.2

Accrued interest, contingent liabilities and other accruals fall within the definition of 'other financial liabilities' set out in IAS 32 and IAS 39 and their fair values are not considered to be materially different to their carrying values.

b) The Company

	2016	2015	2014
	£m	£m	£m
Current liabilities			
Amounts owed to Group companies	168.5	244.7	193.1
Accrued interest	4.7	4.0	3.4
	173.2	248.7	196.5

Accrued interest and other accruals fall within the definition of 'other financial liabilities' set out in IAS 32 and IAS 39 and their fair values are not considered to be materially different to their carrying values.

60. Conduct

Over recent years, in common with other financial services firms, the Group has followed guidance issued by the FCA in respect of redress to customers in respect of the misselling of payment protection insurance ('PPI'), though the sums involved have not been material.

In November 2014 the UK Supreme Court handed down its decision in *Plevin v Paragon Personal Finance Limited* ('Plevin'), which addressed potential liability in respect of PPI claims under section 140 of the Consumer Credit Act 1974, where commission charged to the customer was particularly high. On 2 October 2015 the FCA published a statement outlining proposed rules addressing the handling of PPI cases in the light of the Plevin decision and including a deadline beyond which no further new PPI claims would be required to be considered.

A balance of £1.9m is recognised in other liabilities (note 59) in respect of such claims and other section 140 related issues.

The Group has reviewed its current exposure to such matters in the light of the Court's judgement in Plevin and the FCA proposals and its current expectation is that it will suffer no material additional costs from such claims. However, this assessment is based on our current interpretation of both the Plevin judgement and the draft rules, which may be revised before they are expected to be finalised and brought into force at the end of December 2016, while interpretations may develop as both the judgement and the rules are implemented. Therefore it is possible that the maximum possible liability may be greater.

61. Net Cash Flow from Operating Activities

(a) The Group

	2016	2015
	£m	£m
Profit before tax	143.2	134.2
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	1.9	1.5
Profit on disposal of operating property, plant and equipment	(0.1)	-
Amortisation of intangible assets	1.6	1.4
Foreign exchange movement on borrowings	699.9	(30.8)
Other non-cash movements on borrowings	14.3	4.8
Impairment losses on loans to customers	7.7	5.6
Charge for share based remuneration	4.4	4.5
Net (increase) / decrease in operating assets:		
Operating lease assets	(5.4)	-
Loans to customers	(443.0)	(810.9)
Derivative financial instruments	(706.3)	33.8
Fair value of portfolio hedges	(7.3)	(4.7)
Other receivables	(2.1)	0.4
Net decrease / (increase) in operating liabilities:		
Retail deposits	1,165.2	648.6
Derivative financial instruments	9.1	5.6
Fair value of portfolio hedges	0.8	-
Other liabilities	4.9	2.7
Cash generated / (utilised) by operations	888.8	(3.3)
Income taxes (paid)	(23.6)	(22.6)
	865.2	(25.9)

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

(b) The Company

	2016	2015
	£m	£m
Profit before tax	82.9	67.7
Non-cash items included in profit and other adjustments:		
Depreciation of property, plant and equipment	0.4	0.3
Non-cash movements on borrowings	0.4	0.4
Impairment (losses) on investments in subsidiaries	1.0	14.9
Charge for share based remuneration	4.4	4.5
Net decrease / (increase) in operating assets:		
Other receivables	56.7	(37.4)
Net (decrease) / increase in operating liabilities:		
Other liabilities	(75.5)	52.2
Cash generated by operations	70.3	102.6
Income taxes (paid)	(2.7)	(2.1)
	67.6	100.5

62. Net Cash Flow from Investing Activities

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Proceeds from sales of property, plant and equipment	0.4	-	-	-
Purchases of property, plant and equipment	(1.5)	(0.7)	-	-
Purchases of intangible assets	(1.4)	(1.2)	-	-
Decrease / (increase) in short term investments	34.0	(1.7)	-	-
Movement in loans to subsidiary undertakings	-	-	206.6	(72.2)
Acquisitions (Note 8)	(310.1)	-	-	-
Investment in subsidiary undertakings	-	-	(174.1)	(33.0)
Net cash (utilised) / generated by investing activities	(278.6)	(3.6)	32.5	(105.2)

63. Net Cash Flow from Financing Activities

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Shares issued (note 43)	-	1.5	0.3	2.5
Dividends paid (note 50)	(33.9)	(29.1)	(33.9)	(29.1)
Issue of asset backed floating rate notes	531.0	823.8	-	-
Repayment of asset backed floating rate notes	(1,137.2)	(638.3)	-	-
Issue of retail bonds	-	111.3	-	111.3
Issue of corporate bonds	149.0	-	149.0	-
Movement on bank facilities	145.5	24.8	-	-
Purchase of shares (note 52)	(59.9)	(56.9)	(51.0)	(49.7)
Net cash (utilised) / generated by financing activities	(405.5)	237.1	64.4	35.0

64. Reconciliation of Net Debt

This disclosure is provided in response to the work of the Financial Reporting Council's Financial Reporting Lab.

a) The Group

	Cash flows			Non-cash movements			Closing debt
	Opening debt	Debt issued	Other	Acquisition	Foreign exchange	Other	
	£m	£m	£m	£m	£m	£m	£m
30 September 2016							
Asset backed loan notes	8,274.6	531.0	(1,137.2)	-	699.9	5.8	8,374.1
Bank borrowings	1,425.4	-	145.5	-	-	2.1	1,573.0
Bank borrowing debits	(1.0)	-	-	-	-	1.0	-
Corporate bonds	110.0	149.0	-	-	-	-	259.0
Retail bonds	294.9	-	-	-	-	0.4	295.3
Bank overdrafts	0.7	-	-	0.5	-	-	1.2
Gross debt	10,104.6	680.0	(991.7)	0.5	699.9	9.3	10,502.6
Cash	(1,056.0)	(680.0)	504.0	(5.6)	-	-	(1,237.6)
Net debt	9,048.6	-	(487.7)	(5.1)	699.9	9.3	9,265.0
30 September 2015							
Asset backed loan notes	8,115.0	823.8	(638.3)	-	(30.8)	4.9	8,274.6
Bank borrowings	1,397.9	-	24.8	-	-	2.7	1,425.4
Bank borrowing debits	(0.9)	-	-	-	-	(0.1)	(1.0)
Corporate bonds	110.0	-	-	-	-	-	110.0
Retail bonds	183.2	111.3	-	-	-	0.4	294.9
Bank overdrafts	1.1	-	(0.4)	-	-	-	0.7
Gross debt	9,806.3	935.1	(613.9)	-	(30.8)	7.9	10,104.6
Cash	(848.8)	(935.1)	727.9	-	-	-	(1,056.0)
Net debt	8,957.5	-	114.0	-	(30.8)	7.9	9,048.6

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the facilities concerned.

(b) The Company

	Opening debt	Cash flows		Non-cash movements		Closing debt
		Debt issued	Other	Foreign exchange	Other	
	£m	£m	£m	£m	£m	£m
30 September 2016						
Corporate bonds	110.0	149.0	-	-	-	259.0
Retail bonds	294.9	-	-	-	0.4	295.3
Gross debt	404.9	149.0	-	-	0.4	554.3
Cash	(196.8)	(149.0)	(15.5)	-	-	(361.3)
Net debt	208.1	-	(15.5)	-	0.4	193.0
30 September 2015						
Corporate bonds	110.0	-	-	-	-	110.0
Retail bonds	183.2	111.3	-	-	0.4	294.9
Gross debt	293.2	111.3	-	-	0.4	404.9
Cash	(166.5)	(111.3)	81.0	-	-	(196.8)
Net debt	126.7	-	81.0	-	0.4	208.1

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds.

65. Operating Lease Arrangements

(a) As Lessor

The Group, through its asset finance business, leases assets under operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Assets subject to these arrangements are shown in note 30 and the income from these activities is shown in note 16.

The future minimum lease payments under these arrangements may be analysed as follows:

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Amounts falling due:				
Within one year	2.5	-	-	-
Between two and five years	4.7	-	-	-
After more than five years	-	-	-	-
	7.2	-	-	-

(b) As Lessee

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Minimum lease payments under operating leases recognised in operating expenses for the year				
Office buildings	2.1	1.7	-	-
Motor vehicles	0.3	0.3	-	-
Office equipment	0.2	0.2	-	-
	2.6	2.2	-	-

At 30 September 2016 the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	The Group		The Company	
	2016	2015	2016	2015
	£m	£m	£m	£m
Amounts falling due:				
Within one year	2.3	2.0	-	-
Between two and five years	3.4	3.4	-	-
After more than five years	-	0.2	-	-
	5.7	5.6	-	-

Operating lease payments represent rents payable by the Group in respect of certain of its office premises and lease payments on company vehicles and equipment. The average term of the current building leases from inception or acquisition is 5 years (2015: 11 years) with rents subject to review every five years, while the average term of the vehicle leases and office equipment is 3 years (2015: 3 years).

66. Related Party Transactions

(a) The Group

Mr A K Fletcher, an independent non-executive director of the Company, is a director of Paragon Pension Plan Trustees Limited, which acts as the corporate trustee of the Paragon Pension Plan ('the Plan'). Mr Fletcher was appointed a trustee of the Plan on 27 May 2010, and a director of Paragon Pension Trustees Limited on 7 November 2011. The Plan moved to corporate trusteeship in the first quarter of 2013 at which point all individuals ceased to be trustees of the Plan on their own account. In respect of this appointment he was paid £10,000 in the year ended 30 September 2016 by Paragon Finance PLC, the sponsoring company of the plan (2015: £10,000).

The Plan is a related party of the Group. Transactions with the Plan are described in note 56.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 19.

(b) The Company

During the year the parent company entered into transactions with its subsidiaries, which are related parties. Management services were provided to the Company by one of its subsidiaries and the Company granted awards under the share based payment arrangements described in note 20 to employees of subsidiary undertakings. The Company also issued shares to the trustees of its ESOP trusts, as described in note 43.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 31 and 67.

Outstanding current account balances with subsidiaries are shown in notes 40 and 59.

During the year the Company incurred interest costs of £8.9m in respect of borrowings from its subsidiaries (2015: £9.4m).

67. Details of Subsidiary Undertakings

Subsidiary undertakings of the Group at 30 September 2016, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that:

- for the shareholdings marked * the Company holds only 74% of the share capital
- for the shareholdings marked † the Company holds only 66.7% of the share capital

In all these cases the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except that those companies marked § have additional preference share capital held within the Group.

Company	Holding	Principal Activity
Direct subsidiaries of The Paragon Group of Companies PLC		
Paragon Finance PLC	100%	Residential mortgages and asset administration
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
SPV Securities Limited	100%	Asset investment
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Fourth Funding Limited	100%	Residential mortgages
Paragon Mortgages (No. 7) PLC	100%	Residential mortgages
Paragon Mortgages (No. 8) PLC	100%	Residential mortgages
Paragon Mortgages (No. 9) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 10) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 11) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 12) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 13) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 14) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 15) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 16) PLC	100%	Residential mortgages
Paragon Mortgages (No. 17) PLC	100%	Residential mortgages
Paragon Personal and Auto Finance (No. 3) PLC	100%	Loan and vehicle finance
Paragon Secured Finance (No. 1) PLC	100%	Loan finance
First Flexible (No. 7) PLC	100% *	Residential mortgages
Collateralised Mortgage Securities (No. 12) PLC	100%	Non-trading
Colonial Finance (UK) Limited	100%	Non-trading

Company	Holding	Principal Activity
Direct subsidiaries of The Paragon Group of Companies PLC		
Earlswood Finance Limited	100%	Non-trading
Earlswood Finance (No. 2) PLC	100%	Non-trading
Epsom Trustees Limited	100% †	Non-trading
Finance for People (No. 3) Limited	100%	Non-trading
Finance for People (No. 4) PLC	100% §	Non-trading
Herbert (1) PLC	100%	Non-trading
Herbert (2) PLC	100%	Non-trading
Herbert (4) PLC	100%	Non-trading
Herbert (5) PLC	100%	Non-trading
Herbert (6) PLC	100%	Non-trading
Herbert (7) PLC	100%	Non-trading
Herbert (8) PLC	100%	Non-trading
Herbert (9) PLC	100%	Non-trading
Herbert (10) PLC	100%	Non-trading
Highlands Loan Servicing Limited	100%	Non-trading
Homeloans (No. 4) PLC	100% §	Non-trading
Homeloans (No. 5) PLC	100%	Non-trading
Homeloans (No. 6) PLC	100%	Non-trading
Homer Funding Limited	100%	Non-trading
Idem Luxembourg (No. 4) ‡	100%	Non-trading
Idem Luxembourg (No. 5) ‡	100%	Non-trading
Idem Luxembourg (No. 9) ‡	100%	Non-trading
Moorgate Mortgage Servicing Limited	100%	Non-trading
Mortgage Funding Corporation PLC	100%	Non-trading
NHL Second Funding Corporation PLC	100%	Non-trading
NHL Third Funding Corporation PLC	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Credit Management Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Finance Holdings Limited	100%	Non-trading
Paragon Holdings Group Limited	100%	Non-trading
Paragon Loan Finance (No. 1) Limited	100% §	Non-trading
Paragon Loan Finance (No. 2) Limited	100% §	Non-trading
Paragon Mortgages (No. 1) PLC	100% §	Non-trading
Paragon Mortgages (No. 2) PLC	100% §	Non-trading
Paragon Mortgages (No. 4) PLC	100%	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Mortgages (No. 26) PLC	100% *	Non-trading
Paragon Mortgages (No. 27) Limited	100%	Non-trading
Paragon Mortgages (No. 31) Limited	100%	Non-trading
Paragon Mortgages (No. 32) Limited	100%	Non-trading
Paragon Mortgages (No. 33) Limited	100%	Non-trading

Company	Holding	Principal Activity
Direct subsidiaries of The Paragon Group of Companies PLC		
Paragon Mortgages (No. 34) Limited	100%	Non-trading
Paragon Mortgages (No. 35) Limited	100%	Non-trading
Paragon Mortgages (No. 36) Limited	100%	Non-trading
Paragon Mortgages (No. 37) PLC	100%	Non-trading
Paragon Mortgages (No. 38) PLC	100%	Non-trading
Paragon Pension Plan Trustees Limited	100%	Non-trading
Paragon Personal and Auto Finance (No. 2) Limited	100%	Non-trading
Paragon Personal Finance (1) Limited	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
PGC Capital Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading
Plymouth Limited	100%	Non-trading
Redbrick Real Estate Services Limited	100%	Non-trading
Sancopia Capital Limited	100%	Non-trading
Sancopia Limited	100%	Non-trading
TBMC (2) Limited	100%	Non-trading
Tegic Capital Limited	100%	Non-trading
Tegic Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading

Company	Holding	Principal Activity
Direct and indirect subsidiaries of Paragon Bank PLC		
Paragon Bank Asset Finance Limited	100%	Holding company and portfolio administration
City Business Finance Limited	100%	Asset finance
Dash Commercial Finance Limited	80%	Asset finance
Paragon Bank Business Finance PLC	100%	Asset finance
Paragon Bank Technology Finance Limited	100%	Asset finance
Premier Asset Finance Limited	100%	Asset finance broker
Specialist Fleet Services Limited	100%	Asset finance and contract hire
Capital Professions 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
PBAF (No. 1) Limited	100%	Non-trading
Print Finance Limited	100%	Non-trading
State Securities Holding Limited	100%	Non-trading
State Security Limited	100%	Non-trading

Company	Holding	Principal Activity
Direct and indirect subsidiaries of Idem Capital Holdings Limited		
Moorgate Loan Servicing Limited	100%	Asset administration
Idem (No. 3) Limited	100%	Asset investment
Idem Capital Securities Limited	100%	Asset investment
Idem First Finance Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Arden Credit Management Limited	100%	Non-trading
Idem (No. 5) Limited	100%	Non-trading
Idem (No. 6) Limited	100%	Non-trading
Idem Asset Management Limited	100%	Non-trading
Idem Capital Acquisitions Limited	100%	Non-trading
Idem Capital Limited	100%	Non-trading
Idem Consumer Loans Limited	100%	Non-trading
Idem Luxembourg (No. 10) ‡	100%	Non-trading
Paragon Personal Finance (2) Limited	100%	Non-trading
Sancopia Portfolios Limited	100%	Non-trading

Company	Holding	Principal Activity
Other indirect subsidiary undertakings		
First Flexible No. 6 PLC	100% §	Residential mortgages
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Customer Solutions Limited	100%	Non-trading
Landlordcentre.co.uk Limited	100%	Non-trading
LOM Recoveries Limited	100%	Non-trading
First Resolution Limited	100%	Non-trading
Moorgate Asset Administration Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading
Tidford Cottages Management Limited	100%	Non-trading

The financial year end of all of the Group's subsidiary companies is 30 September. They are all registered in England and Wales and they all operate in the UK except those entities marked ‡ which are registered in the Grand Duchy of Luxembourg.

The 20% of the equity of Dash 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.

As part of the Group's financing arrangements certain mortgage and consumer loans originated by Paragon Mortgages (2010) Limited and Mortgage Trust Limited or acquired by Idem Capital Securities Limited have been sold to special purpose entity companies, which had raised non-recourse finance to fund these purchases. The shares of these companies are ultimately beneficially owned through independent trusts and are considered to be controlled by the Group, as defined by IFRS 10 and hence they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2016 comprise:

Company	Principal Activity
First Flexible No. 4 PLC	Residential mortgages
First Flexible No. 5 PLC	Residential mortgages
Idem Capital Securities (No. 1)	Asset investment
Idem Luxembourg (No. 8)	Asset investment
Paragon Fifth Funding Limited	Residential mortgages
Paragon Sixth Funding Limited	Residential mortgages
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 18) Holdings Limited	Holding company
Paragon Mortgages (No. 18) PLC	Residential mortgages
Paragon Mortgages (No. 19) Holdings Limited	Holding company
Paragon Mortgages (No. 19) PLC	Residential mortgages
Paragon Mortgages (No. 20) Holdings Limited	Holding company
Paragon Mortgages (No. 20) PLC	Residential mortgages
Paragon Mortgages (No. 21) Holdings Limited	Holding company
Paragon Mortgages (No. 21) PLC	Residential mortgages
Paragon Mortgages (No. 22) Holdings Limited	Holding company
Paragon Mortgages (No. 22) PLC	Residential mortgages
Paragon Mortgages (No. 23) Holdings Limited	Holding company
Paragon Mortgages (No. 23) PLC	Residential mortgages
Paragon Mortgages (No. 24) Holdings Limited	Holding company
Paragon Mortgages (No. 24) PLC	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 Limited	Non-trading
Arianty Services Limited	Non-trading
First Flexible No. 1 Limited	Non-trading
First Flexible No. 2 Limited	Non-trading
First Flexible No. 3 Limited	Non-trading

All of these companies are registered and operate in the UK except Idem Capital Securities (No. 1) and Idem Luxembourg (No. 8) which are registered in the Grand Duchy of Luxembourg.

Homeloans (No. 7) LLP and Homeloans (No. 8) LLP are limited liability partnerships, established under English law, in which all of the members are Group companies. They are therefore considered to be subsidiary entities. Both are registered in England and Wales and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The Group accounts include the results of two Jersey companies, which are ultimately beneficially owned by a charitable trust, but are considered to be controlled by the Group, using the definition contained in IFRS 10 'Consolidated Financial Statements'. These companies, Idem Jersey (No. 1) Limited and Idem Jersey (No. 2) Limited are registered in the Bailiwick of Jersey and operate in the UK.

The share capital of Idem Jersey (No. 1) Limited is divided into A shares and B shares. All of the 600 B shares are held by Group companies 100 by the parent company and 500 by other Group companies.

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

68. Country-by-Country Reporting

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

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

The Paragon Group of Companies PLC is a UK registered entity. Details of its subsidiaries are given in note 67 and the activities of the Group are described in section A2.1.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2016 were:

	United Kingdom
	£m
<hr/>	
Year ended 30 September 2016	
Total operating income	244.0
Profit before tax	143.2
Tax on profit	27.2
Public subsidies received	-
Average number of full time equivalent employees	1,175
<hr/>	
	United Kingdom
	£m
<hr/>	
Year ended 30 September 2015	
Total operating income	211.5
Profit before tax	134.7
Tax on profit	27.1
Public subsidies received	-
Average number of full time equivalent employees	935

E. APPENDICES TO THE ANNUAL REPORT

Additional financial information supporting amounts shown in the Strategic Review (Section A), but not forming part of the Statutory Accounts.

A. Income Statement Ratios

The average net interest margin is calculated as follows:

	<i>Note</i>	2016	2015
		£m	£m
Opening loans to customers	35	10,062.4	9,255.9
Closing loans to customers	35	10,737.5	10,062.4
Average loans to customers		10,400.0	9,659.2
Net interest		223.2	197.4
Net interest margin		2.15%	2.04%

Impairment provision	22	7.7	5.6
Impairment as a percentage of average loan balance		0.07%	0.06%

B. Cost:income Ratio

Cost:income ratio is derived as follows:

	<i>Note</i>	2016	2015
		£m	£m
Cost – operating expenses	17	92.5	71.2
Total operating income		244.0	211.5
Cost income		37.9%	33.7%

Underlying cost:income ratio excluding the impact of acquisition costs is derived as follows:

	<i>Note</i>	2016	2015
		£m	£m
Cost – operating expenses	17	92.5	71.2
Acquisition related costs		(2.7)	-
		89.8	71.2
Total operating income		244.0	211.5
Acquisition related charges in income		0.4	-
		244.4	211.5
Cost / Income		36.7%	33.7%

Cost:income ratio excluding the impact of the acquired business is derived as follows:

	<i>Note</i>	2016	2015
		£m	£m
Cost – operating expenses	17	92.5	71.2
Operating expenses of PBAF	11	(18.2)	-
		74.3	71.2
Total operating income		244.0	211.5
Operating income of PBAF	11	(24.9)	-
		219.1	211.5
Cost / Income		33.9%	33.7%

C. Underlying Profit

Underlying profit is determined by excluding from the operating result one off costs relating to the acquisitions in the period, and fair value accounting adjustments arising from the Group's hedging arrangements.

	<i>Note</i>	2016	2015
		£m	£m
Paragon Mortgages			
Profit before tax for the period	<i>11</i>	89.5	93.6
Less: Acquisition related costs		-	-
Less: Fair value (losses) / gains		0.4	0.4
		89.9	94.0
Idem Capital			
Profit before tax for the period	<i>11</i>	45.4	49.3
Less: Acquisition related costs		-	-
Less: Fair value (losses) / gains		-	-
		45.4	49.3
Paragon Bank			
Profit / (loss) before tax for the period	<i>11</i>	8.3	(8.7)
Less: Acquisition related costs		3.1	-
Less: Fair value (losses) / gains		0.2	0.1
		11.6	(8.6)
Total			
Profit before tax for the period	<i>11</i>	143.2	134.2
Less: Acquisition related costs		3.1	-
Less: Fair value (losses) / gains		0.6	0.5
		146.9	134.7

D. Underlying Return On Tangible Equity (Excluding Acquisition Costs)

The underlying RoTE excluding acquisition costs is calculated as follows:

	<i>Note</i>	2016	2015
		£m	£m
Profit for the year		116.0	107.1
Amortisation of intangible assets	<i>17</i>	1.6	1.4
		117.6	108.5
Acquisition costs	<i>11</i>	3.1	-
Tax on allowable costs at effective rate		(0.2)	-
Adjusted profit after tax		120.5	108.5
Average tangible equity	<i>6</i>	913.0	950.5
Underlying Return on Tangible Equity excluding acquisition costs		13.2%	11.4%

E. NET ASSET VALUE

	<i>Note</i>	2016	2015
Total equity (£m)		969.5	969.5
Outstanding issued shares (m)	43	295.8	309.3
Treasury shares (m)	52	(15.3)	(12.4)
Shares held by ESOP schemes (m)	52	(3.6)	(1.6)
		276.9	295.3
Net asset value per £1 ordinary share		£3.50	£3.28
Tangible equity (£m)	6	864.1	961.8
Tangible net asset value per £1 ordinary share		£3.12	£3.26

F. USEFUL INFORMATION

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

F1	Glossary <i>A summary of abbreviations used in the Annual Report and Accounts.</i>	Page 306
F2	Shareholder Information <i>Information about dividends, meetings and managing shareholdings.</i>	Page 308
F3	Contacts <i>Names and addresses of the Group's advisers.</i>	Page 310

F1 GLOSSARY

AGM	Annual General Meeting	FCA	Financial Conduct Authority
ALCO	Asset and Liability Committee	FLA	Finance and Leasing Association
BCBS	Basel Committee on Banking Supervision	FLS	Funding for Lending Scheme
CAP	CAP Automotive Limited	FPC	Financial Policy Committee (of the Bank of England)
CBTL	Consumer Buy-to-Let requirements	FRC	Financial Reporting Council
CEO	Chief Executive Officer	FSC	Forest Stewardship Council
CET1	Common Equity Tier 1	GHG	Greenhouse Gases
CGU	Cash Generating Unit	HMRC	Her Majesty's Revenue and Customs
CMI	Chartered Management Institute	HQLA	High Quality Liquid Assets
CML	Council of Mortgage Lenders	IAS	International Accounting Standard(s)
CO2	Carbon Dioxide	IASB	International Accounting Standards Board
Code	UK Corporate Governance Code	ICAAP	Internal Capital Adequacy Assessment Process
CONC	Consumer Credit Regime	ICG	Individual Capital Guidance
CPI	Consumer Price Index	ICR	Interest Cover Ratio
CRD IV	Capital Requirements Regulation and Directive	IFRS	International Financial Reporting Standard(s)
CSA	Credit Support Annex	ILAAP	Individual Liquidity Adequacy Assessment Process
DECC	Department of Energy and Climate Change	ILG	Individual Liquidity Guidance
DEFRA	Department for Environment, Food and Rural Affairs	IMLA	Intermediary Mortgage Lenders Association
Deloitte	Deloitte LLP, the Group's former auditor	IRB	Internal Ratings Basis
DSBP	Deferred Share Bonus Plan	ISA	Individual Savings Accounts
EIR	Effective Interest Rate	ISDA	International Swaps and Derivatives Association
EPS	Earnings per Share	KPMG	KPMG LLP, the Group's current auditor
ERC	Estimated Remaining Collections	LIBOR	London Interbank Offered Rate
ESOP	Employee Share Ownership Plan	Ltd	Limited (company)
ESOS	Energy Savings and Opportunities Scheme	LTI	Long Term Incentive
EU	European Union	LTV	Loan To Value
EURIBOR	Euro Interbank Offered Rate		

MCoB	Mortgage Conduct of Business	The Plan	The Paragon Pension Plan
MMR	Mortgage Market Review	TSR	Total Shareholder Return
MSP	Matching Share Plan	UK	United Kingdom
NBS	New Bridge Street	US	United States of America
NI	National Insurance	VAT	Value Added Tax
PAYE	Pay As You Earn	WEEE	Waste Electrical and Electronic Equipment
PBAF	Paragon Bank Asset Finance		
PGC	The Paragon Group of Companies PLC		
PIDA	Public Interest Disclosure Act 1998		
PLC	Public Limited Company		
PPI	Payment Protection Insurance		
PRA	Prudential Regulation Authority (of the Bank of England)		
Premier	Premier Asset Finance Limited		
PRS	Private Rented Sector		
PSP	Performance Share Plan		
RNS	The Regulatory News Service of the London Stock Exchange		
ROTE	Return on Tangible Equity		
RPI	Retail Price Index		
SDLT	Stamp Duty Land Tax		
SFS	Specialist Fleet Services Limited		
SME	Small or Medium-sized Enterprise(s)		
SPV	Special Purpose Vehicle company		
TBMC	The Business Mortgage Company		
The Bank	Paragon Bank PLC		
The Company	The Paragon Group of Companies PLC		
The Group	The Company and all of its subsidiary undertakings		
The Order	The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014		

F2 SHAREHOLDER INFORMATION

Electronic communications

You can view and manage your shareholding online by registering with Computershare's Investor Centre Service. To register:

- Visit www.computershare.com
- Go to 'Manage my shareholdings'; and
- Register using your Shareholder Reference Number and your postcode

We actively encourage our shareholders to receive communications via email and view documents electronically on our website, including our Annual Report and Accounts, as this has significant environmental and cost benefits. Should you wish to receive electronic documents please contact Computershare by telephone or on-line.

Website

You can find further useful information on our website, www.paragon-group.co.uk, including:

- Regular updates about our business
- Comprehensive share price information
- Financial results and reports; and
- Historic dividend dates and amounts

Shareholder fraud warning

Shareholders are advised to be very wary of any suspicious or unsolicited advice or offers, whether over the telephone, through the post or by email. If you receive any such unsolicited communication please check the company or person contacting you is properly authorised by the Financial Conduct Authority ('FCA') before getting involved. You can check at www.fca.org.uk/consumers/protect-yourself and can report calls from unauthorised firms to the FCA by calling 0800 111 6768.

Duplicate documents and communications

If you receive more than one copy of shareholder documents, it is likely that you have multiple accounts on the share register, perhaps with a slightly different name or address. To combine your shareholdings, please contact Computershare and provide your Shareholder Reference Numbers.

Want more information or help?

The Company's share register is maintained by our Registrar, Computershare, who you should contact directly if you have questions about your shareholding or wish to update your address details.

**Computershare Investor Services PLC,
The Pavilions,
Bridgwater Road,
Bristol BS99 6ZZ**

**Telephone: 0370 707 1244 *
and outside the UK +44 (0)370 707 1244**

Online: www.investorcentre.co.uk

* Calls are charged at the standard geographic rate and will vary by provider.
Calls outside the UK will be charged at the applicable international rate. Lines are open 8:30am to 5:30pm, Monday to Friday, excluding UK public holidays.

Financial calendar

January 2017

Trading update

July / August 2017

Trading update

23 May 2017

Half year results

November 2017

Full year results

Dividend calendar

5 January 2017

Ex-dividend date for 2016 final dividend

6 July 2017

Ex-dividend date for 2017 interim dividend

6 January 2017

Record date for 2016 final dividend

7 July 2017

Record date for 2017 interim dividend

13 February 2017

Payment date for 2016 final dividend

28 July 2017

Payment date for 2017 interim dividend

Annual General Meeting

9 February 2017

To be held at 9:00am at the offices of Jefferies International Limited at Vintners Place, 68 Upper Thames Street, London EC4V 3BJ.

F3 CONTACTS

Registered and head office	51 Homer Road Solihull West Midlands B91 3QJ Telephone: 0121 712 2323	
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London office	Tower 42 Level 12 25 Old Broad Street London EC2N 1HQ Telephone: 020 7786 8474	
Internet	www.paragon-group.co.uk	
Auditor	KPMG LLP One Snowhill Snow Hill Queensway Birmingham B4 6GH	
Solicitors	Slaughter and May One Bunhill Row London EC1Y 8YY	
Registrar	Computershare Investor Services PLC The Pavilions Bridgwater Road Bristol BS99 6ZZ Telephone: 0370 707 1244	
Brokers	Jefferies Hoare Govett Vintners Place 68 Upper Thames Street London EC4V 3BJ	UBS Limited 5 Broadgate London EC2M 2AN
Remuneration consultants	Deloitte LLP Four Brindleyplace Birmingham B1 2HZ	
Consulting actuaries	Mercer Limited Four Brindleyplace Birmingham B1 2JQ	



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