



# GREEN BOND FRAMEWORK

Paragon Banking Group PLC

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paragon

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# INTRODUCTION

## CLIMATE CHANGE PUTS AT RISK OUR COLLECTIVE FUTURE AND IS ONE OF THE BIGGEST CHALLENGES FACED BY THE WORLD TODAY.

Paragon Banking Group (“Paragon” or “the Group”) supports the UK’s ambition to reduce greenhouse gas emissions to net zero by 2050 and we believe that Paragon and the rest of the financial services industry have a vital role to play in achieving this target by mobilising capital to support the transition to a low carbon economy and doing so in a manner that is fair, just and inclusive.

Paragon was founded in 1985 and we are a FTSE 250 company listed on the London Stock Exchange, employing 1,400 people. As a specialist banking group, Paragon’s purpose is to support the ambitions of the people and businesses of the UK by delivering specialist financial services. We offer a range of savings products and provide finance for landlords operating in the UK’s Private Rented Sector (“PRS”), SMEs and small corporates across a wide range of commercial lending markets and experienced residential property developers in the UK, as well as motor finance products for consumers and structured lending products for non-bank lenders.

We have a deep understanding of our customers and their markets, designing products to meet our customers’ needs and continually striving to exceed their expectations. Our Green Bond Framework represents our commitment to helping our customers achieve more sustainable environmental outcomes through the products we offer and the allocation of our capital.

### Sustainability at Paragon

Sustainability is core to our strategy: to focus on specialist customers, delivering long-term sustainable growth and returns through a low risk and robust business model. Sustainability influences every aspect of our business and means:

- Reducing the impact that our operations have on the environment
- Ensuring we have a positive effect on our stakeholders and communities
- Delivering sustainable lending through the products we offer and markets in which we operate





Paragon's Green Charter<sup>1</sup> stipulates we must ensure all buildings we occupy are managed efficiently and we encourage our employees to conserve energy. We also liaise with the local community through our Responsible Business initiatives and we have in place environmental and supply chain and procurement policies providing us with a framework for continuous improvement.

In line with our aims, the Group uses 100% renewable energy at sites where we are the sole occupant and 84% of our total energy comes from renewable sources. We are committed to energy conservation, low waste and recycling throughout our business and across all our sites. We follow international standards for waste management at our local authority vehicle leasing and maintenance business.

Through our supplier code of conduct, the Group is committed to identifying, targeting and addressing inefficiencies in our supply chain and we continuously work with our suppliers to become more efficient in our use of resources and reduce our environmental impact.

Paragon is part of the FTSE4Good Index Series. FTSE4Good assesses the ESG performance of thousands of different companies every year, measuring how well they perform on environmental, social and governance matters, before sharing their view with investors. We have been accredited by the Living Wage Foundation as a UK Living Wage Employer since 2016, ensuring our employees are paid wages that meet the cost of living in the United Kingdom. As part of our diversity programme we are accredited by the Inclusive Employers Standard, and we are members of HM Treasury's Women in Finance Charter, the Women's Association and the 30% Club, promoting growth through diversity. Paragon is also a Mindful Employer, supporting mental health at work.

## Addressing the impacts of climate change

During 2020 the Board designated climate change as a principal risk within the Group's Risk Management Framework: information and measures on climate change risks are considered at board level and the Group's responses are considered within the Board's overall strategy. The Chief Financial Officer is the designated director responsible for climate change.

A climate change working group has been established, working under the oversight of the Sustainability Committee. The Sustainability Committee, which has a broader ESG perspective, reports to the Executive Risk Committee ("ERC") and the Board on a regular basis. The objective of the climate change working group is to embed Climate Change Risk into the Group's operational culture, initially focussing on the Credit and Operational Risk Committees, recognising the impact of our lending activities on both current and future business activities and also the wider environment.

Assessment of current environmental risks and forward-looking climate change risks are already factored into the Group's business.

We lend conservatively, based on detailed credit assessments of the customer and underlying loan collateral, to minimise the risk of non-payment and portfolio losses. When assessing the appropriateness of a property as security on a buy-to-let mortgage, we consider factors such as the energy performance certificate ("EPC") rating of the property, flood risk, risk of coastal erosion and ground stability.

**We continuously work with our suppliers to become more efficient in our use of resources and reduce our environmental impact...**



<sup>1</sup>Caring for the Environment | Paragon Banking Group

The Group had EPC records for 85% of its mortgage book at 30 September 2020 with 37.7% of these covered by certificates of grade C and higher (on a scale of A to G), and 7.8% covered by certificates of grades of A and B. Work is currently taking place to enable the Group to collect additional and more detailed environmental data as part of the underwriting process.

Through products such as our green further advance, which links to the Government's Green Homes Grant Scheme, we can encourage landlords to enhance the energy efficiency of their properties and support landlords in their transition to a low carbon economy. Landlords use this finance to improve the quality of their rental properties, which includes insulating the home to reduce energy use or installing low-carbon heating to lower the amount of carbon dioxide produced.

In our SME lending business, limited company customers have been broadly analysed by SIC codes to identify those operating in high carbon intensive industries (water, sewerage and waste, extractive industries, and power generation) and, as at 30 September 2020, 5.3% of companies were in this category.

Measures addressing the environmental impact of other business streams, such as motor vehicle finance and residential property development finance are also under development. These will be aligned to the UK's Green Taxonomy, recently announced at the Green Horizon Summit.

Other priorities of our climate change strategy include:

- Developing climate change scenario analysis and embedding this in stress testing programmes, leveraging Bank of England scenarios
- Continued engagement with external climate change initiatives
- Development of formal climate related risk appetites and a full suite of Key Risk Indicators and Key Performance Indicators

We expect to report our climate change exposures in accordance with the recommendations of the Taskforce on Climate-related Financial Disclosure ("TCFD"). These are being introduced into UK listing requirements from our financial year ending 30 September 2022.

Paragon is working with the Green Finance Institute to develop new products across our businesses which would encourage energy and carbon efficiency for the future. We took an active role in the drafting of the UK Finance 'Sustainable Finance – establishing a principles-based framework for the measurement and reporting of multi-year commitments' paper published in November 2020, which sets out recommendations on the Principles that should underpin the measurement of multi-year commitments to sustainable finance<sup>2</sup>.

Our Green Bond Framework reflects our commitment to embed sustainability throughout our strategy, operations, and product offerings including our funding and capital raising activities. The recently established Sustainability Committee, under the oversight of the ERC is responsible for the Framework.



**Our Green Bond Framework reflects our commitment to embed sustainability throughout our strategy, operations, and product offerings...**

<sup>2</sup>UK Finance Sustainable Finance White Paper

# GREEN BOND PRINCIPLES

**PARAGON'S GREEN BOND FRAMEWORK (THE "FRAMEWORK") PROVIDES A CLEAR AND TRANSPARENT CRITERIA TO IDENTIFY INVESTMENTS WHICH SUPPORT THE TRANSITION TO A LOW CARBON ECONOMY AND CREATE LONG-TERM VALUE FOR OUR STAKEHOLDERS.**

The ICMA Green Bond Principles ("GBP") represent a set of voluntary guidelines that recommend transparency, disclosure and promote integrity in the development of the Green Bond market by clarifying the approach for issuing a Green Bond. Consistent with the ICMA GBP, Paragon's Green Bond Framework has four key components:

- Use of proceeds
- Process for project evaluation and selection
- Management of proceeds
- Reporting

Our Framework is prepared by the Sustainability Committee and will be applied to any Green Bond issued by Paragon and may, from time to time, be updated for future issues.

## Use of Proceeds

The proceeds of any Green Bond issued by Paragon under the Framework will be exclusively allocated to an eligible loan portfolio of new and existing green loans (together the "Eligible Green Loan Portfolio").

The Eligible Green Loan Portfolio includes Eligible Green Loans disbursed by Paragon during the 24 months prior to the respective Green Bonds issuance date.

The Eligibility Criteria used to define the Eligible Green Loan Portfolio for Paragon's Green Bonds are strictly based on the ICMA GBP and on the good market practice of **Green Residential Real Estate**, where new or existing residential buildings belonging to the top 15% low carbon buildings in the region, include buildings certified, or to be certified, with an Energy Performance Certificate (EPC) label "A" or "B" in England and Wales.

## Process for Project Evaluation and Selection

The Sustainability Committee comprises cross-divisional stakeholders including representatives from the External Relations, Treasury and Structured Finance and Balance Sheet Risk teams.



The Sustainability Committee meets on a quarterly basis within its broader ESG remit and is specifically responsible for the oversight of the following processes:

- Selection and approval of the appropriate ICMA GBP Eligibility Green Project Categories and Criteria for the evaluation and selection of Eligible Green loans
- The Treasury and Structured finance team will identify and allocate loans as Use of Proceeds of each Green Bond issued by Paragon under the Framework.
- Reviewing and approving, as appropriate, Eligible Green Loans based on the defined Eligible Categories listed by the Use of Proceeds
- Managing the Eligible Green Loan Portfolio over the lifetime of the Green Bond, to ensure that proceeds are allocated exclusively against the financing and refinancing of the Eligible Green Loans
- Monitoring developments in the wider Green Bond sector and updating this Framework and Eligibility Categories and Criteria accordingly

An updated Second Party Opinion will be obtained in the event of material changes.

## Management of Proceeds

Paragon intends to allocate an amount equal to the proceeds from the issue of Green Bonds to an Eligible Green Loan Portfolio, selected in accordance with the Eligibility Criteria set out in “Use of Proceeds” and “Process for Project Evaluation and Selection” above. Paragon intends to fully allocate the proceeds from any Green Bonds within 24 months of the date that the respective bonds were issued.

Paragon will strive, over time, to achieve a level of allocation for the Eligible Green Loan Portfolio which, matches or exceeds the balance of proceeds from its outstanding Green Bonds. Additional Eligible Green Loans will be added to the Eligible Green Loan Portfolio whenever required such that the amount equals or exceeds the proceeds from outstanding Green Bonds.

Pending the full allocation of the proceeds, or in case of an insufficient Eligible Green Loan Portfolio, Paragon will hold and/or invest, at our own discretion, the balance of proceeds not yet allocated to the Eligible Green Loan Portfolio in its liquidity portfolio. The unallocated proceeds will be held and/or invested in cash or other short term liquid instruments in accordance with Paragon’s liquidity policy until additional Eligible Green loans become available.

In case of divestment, early loan reimbursement or if a loan no longer meets the Eligibility Criteria, Paragon will use the proceeds to finance other Eligible Green Loans which are compliant with the Eligibility Criteria of the Framework.



## Reporting

### Allocation Reporting

Paragon will publish a Green Bond Report (the “Report”) annually, at least until full allocation of all the proceeds, and thereafter in case of any material change to the allocation, on its website. Our first Report will be published within the first year of issuance and it will be verified by the annual external assurance process – see External Review section below for more details.

The Report will include the following:

- Bond details: ISIN, pricing date, maturity date, etc
- Total amount of proceeds allocated to Eligible Green Loans
- Category and Number of Eligible Green Loans
- Balance of unallocated proceeds (if any) and how they are held and/or invested
- Amount or the percentage of new financing and refinancing
- Geographical distribution of the loans (at country and regional level)

### Impact Reporting

Where feasible, Paragon intends to annually report as part of the Report, the impact of the Eligible Green Loan Portfolio, including :

- Breakdown of the Eligible Green Loan Portfolio by EPC band
- Metrics regarding the Eligible Green Loan Portfolio's environmental impacts as described below

Green Bond Principles Eligible Category	Indicative Quantitative metrics
Green Residential Real Estate	<ul style="list-style-type: none"><li>• Estimated ex-ante annual avoided emissions (tCO<sub>2</sub>/year)</li><li>• Estimated average annual CO<sub>2</sub> emission intensity (KgCO<sub>2</sub>/m<sup>2</sup>/year)</li><li>• Estimated annual carbon emissions avoided per every £1m of proceeds allocated (tCO<sub>2</sub>/year/£1m)</li></ul>

Information on methodology and calculations for impact assessments will be disclosed in the impact report.



## External Review

Paragon's Green Bond issuance is supported by external reviews as described below.

### Second Party Opinion (pre-issuance)

Sustainalytics, a provider of environmental, social and governance (ESG) research and analysis, has evaluated Paragon's Green Bond Framework and its alignment with relevant industry standards and has provided views on the robustness and credibility of the Green Bond Framework within the meaning of the ICMA GBP, in its Second Party Opinion.

The Second Party Opinion as well as this Framework will be made available on [webpage].

### External Verification (post-issuance)

Paragon will release on an annual basis, at least until full allocation of all the proceeds, starting one year after issuance, a verification or assurance report, by Sustainalytics, including the allocation of the bond proceeds to Eligible Green Loans and compliance of the allocated loans with the selection process and reporting metrics.



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