Paragon Banking Group PLC

Pillar III Disclosures - 30 September 2017

paragon

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CAUTIONARY STATEMENT
Sections of this document 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 Paragon Banking Group PLC and its subsidiaries ('the Group'). These have been made by the directors in good faith using information available up to the date on which they approved this document. 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.

1
INTRODUCTION

This section sets out

- An introduction to the Group
- An overview of the disclosure framework under which this document is prepared
- A summary of the Group's Pillar III disclosure policies
- A summary of the scope and basis of preparation for this document
- A summary of changes made since the Group's last Pillar III disclosures
- A summary of the approval process for the document

Paragon Banking Group PLC ('the Company') is a UK banking group, sourcing funds in the retail deposit market and lending to consumers and smaller corporates. It is subject to banking regulation and therefore is required, by European Regulation, to publicly report on risk and governance matters for each financial year. This expands on the disclosures already required to be given in an entity's annual report and accounts.

This document, referred to a Pillar III report, is intended satisfy those requirements. An overview of the disclosures given by theme is shown on page 6.

THE GROUP

The Company controls a group of companies ('the Group') including a regulated bank, Paragon Bank PLC ('the Bank'). Following a reorganisation announced in the year, the Group now analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

- Mortgages, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities.
- Commercial Lending, including the Group's motor finance and other equipment leasing activities, together with other offerings targeted towards SME ('Small and / or Medium Sized Enterprises') customers.
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them.

Each division is responsible for the generation of new business with servicing and the majority of other support functions managed on a group-wide basis. These divisions form the segments used by the Group to describe its business in its public reporting.

On 18 February 2014 the Bank was authorised by the Prudential Regulation Authority ('PRA') and is regulated by the PRA and the Financial Conduct Authority ('FCA'). The PRA sets requirements for the Bank relating to capital and liquidity adequacy.

DISCLOSURE FRAMEWORK

The Group is regulated for prudential capital purposes under the Basel III regime which is implemented in the European Union ('EU') through the Capital Requirements Directive IV ('CRD IV'). The CRD IV text was formally published in the Official Journal of the EU in June 2013 and became effective from 1 January 2014. It is made up of the Capital Requirements Regulation ('CRR') (EU Regulation 575/2013), which is directly applicable to firms across the EU, together with the Capital Requirements Directive ('CRD'), which must be implemented through national law.

The PRA, as prudential regulator of the Company, is the body responsible for implementing CRD IV in the UK. The Company has been operating under the Basel III regime since the authorisation of the Bank.

The Group has adopted the Standardised Approach ('SA') for credit risk and the Basic Indicator Approach ('BIA') for operational risk.

CRD IV consists of three elements, or 'Pillars', which represent the key principles of the Basel III regime:

Pillar I	This covers the minimum capital requirements of Basel III. The calculation is based on a risk based approach. It focuses on credit, operational and market risk in determining the Group's Minimum Capital Requirement ('MCR').
Pillar II	This requires that the Group conducts an Internal Capital Adequacy Assessment Process ('ICAAP') which is subject to review by the PRA under the Supervisory Review and Evaluation Process ('SREP'). In the ICAAP the Company's Board undertakes an assessment of the key risks facing the Company's business against which capital has not been provided under Pillar I to determine whether additional regulatory capital should be held, based on the identified risks and the risk management processes in place. A firm's Individual Capital Requirement ('ICR') is set by the PRA based on the ICAAP.
Pillar III	Pillar III complements Pillars I and II and aims to encourage market discipline by setting out disclosure requirements which should allow market participants to assess key pieces of information on a firm's capital, risk exposures, risk management processes and remuneration. These requirements are set out in Part 8 of the CRR ('Part 8') as supplemented by secondary EU legislation and guidance issued by appropriate bodies.

PILLAR III DISCLOSURE POLICY

The Company's Pillar III disclosures cover the Group as a whole, comprising the Company and its subsidiary undertakings. They are therefore prepared on the same basis as the Group's consolidated accounts. These bodies are regulated on a consolidated basis and this disclosure treats them as such. References to the Group in this document therefore include Paragon Bank PLC.

The Company's Disclosure Policy for its Pillar III disclosures is based on its Board of Directors' interpretation of the requirements of Part 8, having taken appropriate expert advice. The directors have regard to the guidelines on materiality issued, pursuant to Article 432(1) of the CRR, by the European Banking Authority ('EBA') in December 2014 (EBA/GL/2014/14). Disclosures which are required by the CRR, but which are considered to be immaterial in the context of the Group's operations and business model are not included.

The Pillar III disclosures are updated on an annual basis using the Group's year end date of 30 September, following publication of the Annual Report and Accounts. The annual reporting process will include consideration of regulatory changes and developing best practice, to ensure that disclosures remain appropriate. More frequent disclosures will be made if there is a material change in the nature of the Group's risk profile during any particular year.

Pillar III disclosures are prepared with input from the Finance, Risk and Human Resources functions and from regulatory specialists. They are reviewed at senior and executive management level and approved by the Board of Directors in the same way as the Group's Annual Report and Accounts for the year.

Pillar III regulatory capital disclosures each year are published on the investor relations section of the Group's corporate website www.paragonbankinggroup.co.uk, alongside the Annual Report and Accounts for the year. Both documents are published on the website at approximately the same time, in accordance with the requirement in Article 433 of Part 8 to publish the Pillar III disclosures in conjunction with the date of publication of the financial statements.

The Company's Pillar III disclosure policy is considered annually to ensure that it remains appropriate in the light of new regulations and emerging best practice.

The Company's Pillar III regulatory capital disclosure policies were approved by the Board of Directors in January 2014 and confirmed in January 2018 on the approval of this document.

SCOPE AND BASIS OF DISCLOSURE

This Pillar III disclosure has been drawn up in conjunction with the Annual Report and Accounts of the Group for the year ended 30 September 2017 ('the Group Accounts'). In accordance with Article 434 of the CRR, where a disclosure required by Part 8 is made in the Group Accounts it need not be repeated in this document.

The figures in this Pillar III disclosure are consistent with the Group Accounts, but do not form part of the Group Accounts. The disclosures presented have been reviewed internally but have not been externally audited.

The Group consolidation for regulatory purposes is the same as that used for statutory purposes and hence all subsidiary undertakings within the Group have been consolidated in the Pillar III disclosures. The names of all of these entities, and the basis on which they are considered to be subsidiaries of the Group are set out in note 65 to the Group Accounts.

The Pillar III disclosures have been prepared for the Group as a whole, in accordance with the rules laid out in Articles 431 to 451 of Part 8 and having regard to materiality as described above.

The disclosures provide information on the capital adequacy and risk management processes of the Group. These disclosures have been compiled on the most appropriate basis for this purpose and, as such, may not agree directly to similar disclosures presented in the Group Accounts.

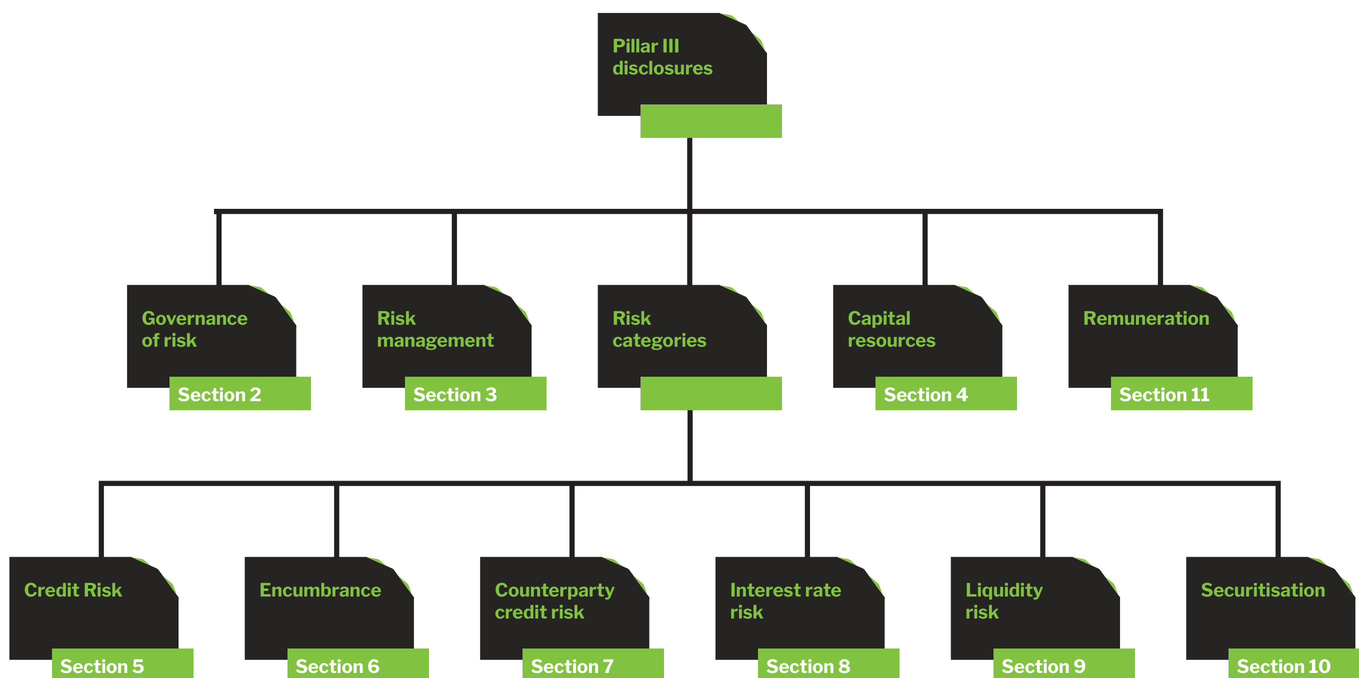
The Bank's requirement to maintain regulatory capital and liquid resources above a level determined by the PRA could restrict its ability to make dividend payments or make loan repayments to other Group entities. There are no other current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities between the Company and its subsidiary undertakings.

The Bank is required to prepare Remuneration Code Pillar III disclosures. These disclosures are the subject of a separate, stand-alone document and are published on the Bank's website, www.paragonbank.co.uk, on an annual basis.

The Pillar III disclosures are published annually. The EBA guidelines on frequency of disclosures contained in EBA/GL/2014/14 contain a number of size-based indicators which are relevant in considering whether more frequent reporting is necessary. The Group is substantially below these thresholds. Notwithstanding this, the need for more frequent disclosures is considered by the Board.

OVERVIEW OF DISCLOSURES

Part 8 sets out a series of disclosures which firms are required to make. For the purpose of this document these disclosures have been grouped thematically, as illustrated below.



Where the CRR and its supporting technical standards require the publication of detailed templates as part of the document, these have generally been included in appendices and the useful information summarised in the main document.

DEVELOPMENT IN DISCLOSURES

The Group's Pillar III disclosures have been reviewed in the light of new regulations and market practice and a benchmarking exercise comparing the Group's disclosures to a number of similar sized firms has been undertaken in conjunction with external advisors.

This Pillar III report presents similar disclosures to those published in respect of 2016, except that additional information mandated by the EU is set out in the liquidity risk section to this document. This covers further information on liquidity risk including NSFR and LCR measures.

Further background information has been provided to users in a number of areas.

In drawing up these disclosures the Group has considered Pillar III reports made by comparable UK lenders including those in the challenger bank and larger building society sectors to ensure that the level of detail given was broadly comparable.

The Group will continue to review market practice for Pillar III disclosures. It is considering the revised Pillar III disclosure requirements which were published by the BCBS in January 2015 and revised and enhanced in March 2017. The date from which these rules will apply to the Group and similar sized entities has yet to be set by the PRA.

IFRS 9 – Financial Instruments, will be applicable for the financial year ending 30 September 2019 and will impact capital figures. Transition relief is available for the Group and it is considered likely that advantage will be taken of this, dependent on emerging market practice. A final decision will be made during the next twelve months.

Other technical pronouncements under development relate to liquidity and interest rate risk, and the Group will monitor developments in these areas as they emerge.

APPROVAL

The Board of Directors considered this document in the light of, amongst other things:

- The Board's consideration of the Group Accounts
- The ICAAP and the directors' input into this process
- The ILAAP and the directors' input into this process
- The Board's overall understanding of the Group's risk profile and operations

The Group Accounts include audited and unaudited disclosures addressing the Group's risk exposure, mitigation and appetites. In approving the Group Accounts the directors had to consider the appropriateness of those disclosures and the overall adequacy of the Group's risk management framework.

The Group prepared its third formal ICAAP document following the authorisation of the Bank as at 30 September 2016. It was prepared under the direction of the CFO and the executive management of the Group, with appropriate input and challenge from other areas of the business. The ICAAP was reviewed and challenged by the Group's executive and was formally approved by the Board in March 2017. Throughout the ICAAP's preparation, the Board was kept up-to-date with its progress and key findings, and the directors have received regulatory training sessions to ensure that they are able to provide the appropriate level of challenge.

The Group will review the ICAAP on at least an annual basis. The update process will occur more frequently if there is a significant change in the Group's business model (potentially following a major acquisition) or in the economic environment within which the Group operates.

The Group's regulator carried out a Supervisory Review and Evaluation Process ('SREP') based on the ICAAP submitted in 2017, the conclusion of which was that the actual level of the Group's capital is significantly in excess of the minimum requirements. Future ICAAPs will be subject to SREP reviews periodically, particularly in the event of significant changes in the business.

This document was considered by the executive directors and by the Board and the Audit Committee and non-executive directors prior to publication, having regard to their understanding of the business and appropriate external advice.

In particular, they considered whether:

- As a whole, taken with the Group Accounts, the document properly represented the Group's position for the purposes of Part 8 of the CRR
- The use of materiality for disclosure purposes was appropriate
- The Group's formal Pillar III disclosure policy remained appropriate
- Annual publication of the disclosures remained appropriate

The directors were able to satisfy themselves on these matters and the Pillar III disclosures were therefore approved for publication by the Board of Directors of Paragon Banking Group PLC in January 2018.

2
GOVERNANCE

This section sets out

- The Group's approach to corporate governance
- Details of the governance framework operated by the Company

Good corporate governance is essential to the ethos of the Group. The Board is responsible for overall Group strategy and for the delivery of that strategy within a strong corporate governance and corporate responsibility 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 UK Corporate Governance Code issued by the Financial Reporting Council ('FRC') in April 2016 ('the Code') which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2017 the Company complied with the principles and provisions of the Code.

As part of its governance arrangements, the Group has a defined risk management framework. This is designed to support the achievement of the Group's strategic objectives by ensuring that it is not exposed to material unexpected losses. In this way, the Group is able to protect the interests of both its customers and shareholders and maintain an effective balance between risk and reward. Further details of the risk management framework are provided below.

THE BOARD

The schedule of matters reserved for the Board, which was reviewed during the year 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
- Agreeing the Group's risk appetite
- 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 majority of the year the Board consisted of the Chairman, three executive directors and four non-executive directors. On 20 September 2017, an additional four non-executive directors were appointed. All the directors bring to the Company a broad and valuable range of experience.

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 and with the Group's strategic reorganisation.

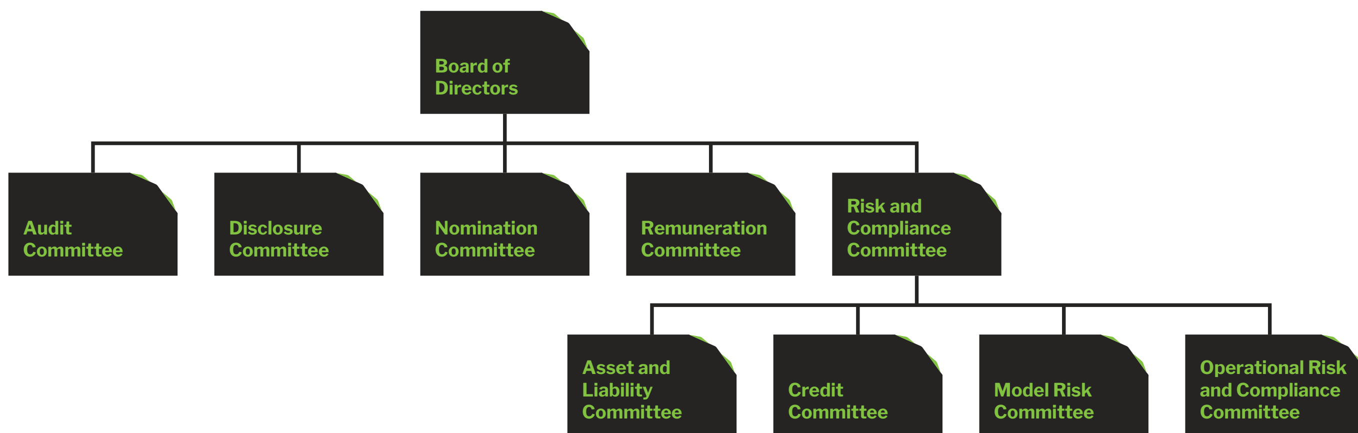
There is a strong non-executive representation on the Board, including the Senior Independent Director, Fiona Clutterbuck. This provides effective balance and challenge.

The Chairman's other business commitments are set out in the Annual Report. During the year, the Chairman has ceased to undertake his role with Axa which he held for a number of years.

The Board has agreed a set of guiding principles on managing conflicts and a process to identify and authorise any conflicts which might arise. 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 committee structure



Board committees

The board committees and their members are detailed below.

Committee		Audit	Remuneration	Risk and Compliance	Nomination
Chair	From 20/09/17	P J N Hartill	F J Clutterbuck	F F Williamson	R G Dench
	To 20/09/17	P J N Hartill	A K Fletcher	F J Clutterbuck	R G Dench
Minimum number of meetings		3	3	4	2

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
R G Dench	-	No	Yes	Yes	Yes
N S Terrington	-	No	No	No	Yes
F J Clutterbuck	✓	Yes	Yes	Yes	Yes
A K Fletcher†	✓	Yes	Yes	Yes	Yes
P J N Hartill	✓	Yes	Yes	Yes	Yes
H R Tudor	✓	Yes	Yes	Yes	Yes
P J Newberry	✓	Yes*	No	Yes*	Yes*
B A Ridpath	✓	Yes*	No	Yes*	No
F F Williamson	✓	Yes*	No	Yes*	No
G H Yorston	✓	Yes*	No	Yes*	No

*Member from appointment to the Board on 20 September 2017.

†Alan Fletcher will cease to be a member of all board committees from 25 February 2018.

The Board has considered the requirements of the Code with respect to the composition of audit committees and is satisfied that all members of the Audit 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.

Further information on each of these committees is set out in Section B of the Group Accounts.

In addition to the committees listed above a further standing committee, the Disclosure Committee was established in 2016. 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 CEO or CFO.

EXECUTIVE RISK COMMITTEES

Four executive committees report to the Risk and Compliance Committee ('RCC'). These committees are the Asset and Liability Committee ('ALCO'), the Credit Committee, the Operational Risk and Compliance Committee ('ORCC') and the Model Risk Committee ('MRC'). The membership of each committee comprises executive directors and appropriate senior members of staff. Details of each committee's purpose and activities are given below.

- The ALCO, comprising the heads of relevant functions and chaired by the CFO.

  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. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the risk appetites to the RCC

- The Credit Committee comprising senior managers from the risk, finance and collections functions and chaired by the CRO.

  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. The committee oversees the management of the credit portfolio, the post origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites to the RCC

- The MRC, comprising senior managers from the risk, finance and main business areas and chaired by the CRO.

  The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to credit and finance models

- The ORCC, comprising heads of relevant functions and chaired by the CRO.

  The ORCC is responsible for overseeing the Group's operational risk, conduct risk and business risk management and compliance arrangements. The Committee considers key operational risk information such as loss events, emerging risks and control failures. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the RCC. With respect to compliance, the ORCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct related regulatory obligations, including 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 Compliance function, including the annual Compliance Monitoring Plan

Outside directorships

The number of other directorships of Board members, outside the Group, disclosed in accordance with Article 235(2) of Part 8 are set out below. For the purposes of this disclosure directorships of related entities (e.g. two subsidiaries of the same group) are counted as a single appointment.

Director	Position	Number of external appointments
Robert G Dench	Chairman	-
Nigel S Terrington	Chief Executive	-
Richard J Woodman	Chief Financial Officer	-
John A Heron	Director – Mortgages	-
Alan K Fletcher	Non-executive director	3
Peter J N Hartill	Non-executive director	3
Fiona J Clutterbuck	Non-executive director	2
Hugo R Tudor	Non-executive director	2
Patrick J Newberry	Non-executive director	2
Barbara A Ridpath	Non-executive director	-
Finlay F Williamson	Non-executive director	-
Graeme H Yorston	Non-executive director	-

Directorships in organisations which do not pursue predominantly commercial objectives are not required to be included.

Further information

The Corporate Governance Section (Section B) of the Group Accounts includes a detailed review of the system of governance in the Group and the activities of the Board and its committees in the year. In particular, in the report of the Nomination Committee it addresses:

- The process for selecting members of the Board

- The Company's policy on diversity with regard to the selection of members of the Board

3
RISK MANAGEMENT

This section sets out

- An overview of the Group's risk management system
- The principal risks to which the Group is exposed and the main steps taken to mitigate against them
- A summary of the Group's risk appetite with regard to those risks
- Details of the Board's assessment of the Group's risk management processes

INTRODUCTION

The Group regards the effective identification, monitoring and control of risk as an integral part of its management processes.

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance and could cause actual results to differ materially from previous or expected results. To identify and control these risks the Group utilises a risk management framework which analyses its risks under the categories of Business Risk, Credit Risk, Liquidity and Capital Risk, Market Risk, Operational Risk, Conduct Risk and Pension Obligation Risk. The Group maintains a defined risk appetite for each of these risk categories, further information on which is provided below.

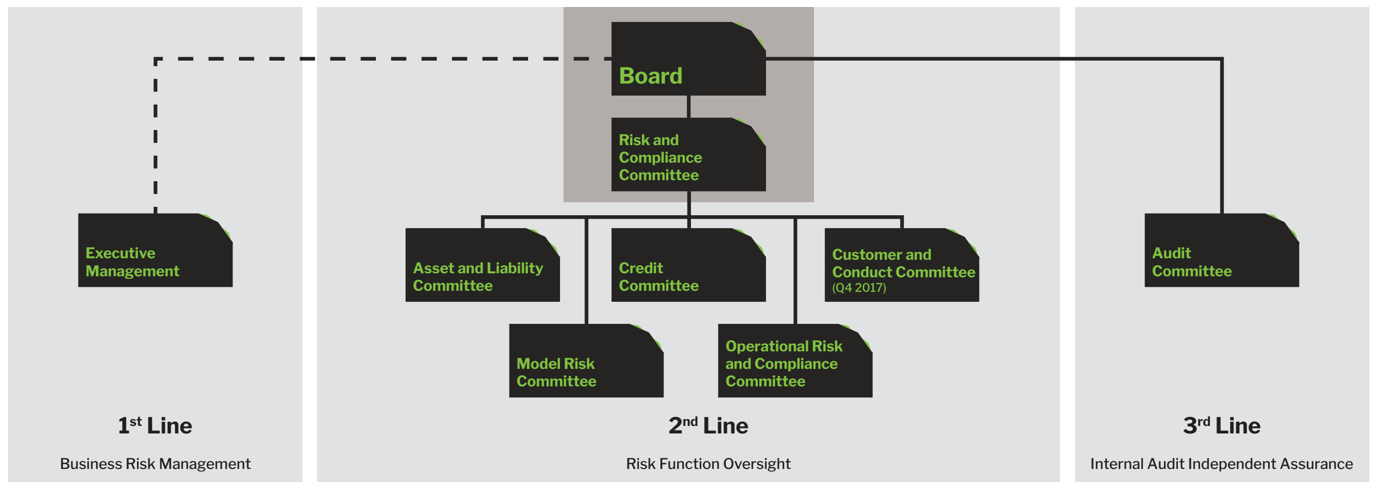
The Group's risk management framework operates within a 'Three Lines of Defence' model:

- The first line of defence, comprising the executive directors, their managers and people, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The second line of defence, which is provided by the executive risk committees described above supported by the Risk and Compliance division, headed by the Chief Risk Officer ('CRO'), which is responsible for providing risk oversight and guidance to the first line. The Risk and Compliance division has been further expanded during the year and now includes dedicated functions responsible for the oversight of Credit Risk, Property Risk, Compliance and Conduct Risk, Operational Risk, IT and Cyber Security and Financial Crime. In addition, the Group has now appointed a director with specific responsibility for prudential risk
- The third line of defence, which is provided by an Internal Audit function and the Audit Committee which are responsible for reviewing the effectiveness of the first and second lines of defence in the overall management of risk

Additional external levels of control complement the three internal layers. These are represented by the Group's external auditors and the various regulatory bodies to whom the Group is accountable.

The way in which the Three Lines of Defence model aligns with the wider governance framework and the way in which information on risk matters ultimately flows to the Group Board is illustrated below:

Risk Management Model



The Customer and Conduct Committee will be established the first quarter of 2018 and as such is not referred to in other sections of this document. It is shown above in order to provide information on the future structure of the oversight system.

The Group's risk management framework promotes a structured and disciplined approach to the management of risk across all categories of risk. The key objectives of the 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 and ILAAP
- 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, consistent with its aim of operating as a prudent, risk focussed, specialist lender

The Group Accounts includes the report of the Risk and Compliance Committee, in Section B6. This report sets out:

- The activities of the Committee in the year
- A more detailed description of the risk management framework and the structure, organisation and activities of the Group's risk function
- A summary of the Group's risks, together with the mitigants in place to control these risks and the movement in these risks in the year

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. The common risk categorisations used, and the committees responsible for them, from a second line governance perspective, are set out in the diagram below:

Risk governance responsibilities

Responsibility for conduct risk will pass to the Customer and Conduct Committee when it is established.

PRINCIPAL RISKS

The Group is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy, which could prevent the achievement of its strategic objectives. They are summarised briefly below.

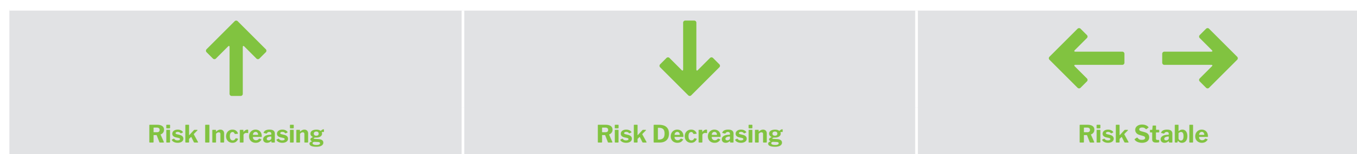
CATEGORY	RISK	DESCRIPTION
Business	Economic	The Group could be materially affected by a severe downturn in the UK economy as its income is wholly derived from activities within the country. This is more difficult to forecast given current uncertainties on the terms on which the UK will leave the EU in March 2019. This 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.
	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 manage major internal reorganisations or 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 credit decisions effectively could result in customers becoming less able to service debt, exposing the Group to unexpected material 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 fair outcomes for its customers 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 and strategic objectives.
	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 damage and financial loss.
	Regulation	The Group operates in highly regulated sectors in which 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	If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines.
	Capital	Proposals by the BCBS to change 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.

A more detailed discussion of those risks and uncertainties, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year ended 30 September 2017 is set out 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.

The changes 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
The potential for a deterioration in the UK's economic conditions is harder to forecast given current uncertainties as to the terms on which the UK will leave the European Union in March 2019. However, 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. This 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.	The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic advisors. Using this information as part of an established governance process, the Group's senior management undertake a review of strategic objectives each year. This helps to inform the development of detailed business plans for each of the Group's principal trading operations within which account is taken of key strategic risks. Whilst the Group's role as a lender and acquirer of credit portfolios inevitably exposes it to any material deterioration in economic conditions, the Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise. Robust underwriting and monitoring processes are employed throughout the Group which reflect prudent credit policies designed to be maintained through economic cycles. 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 market leading experience and understanding of the sector. The Group also 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.

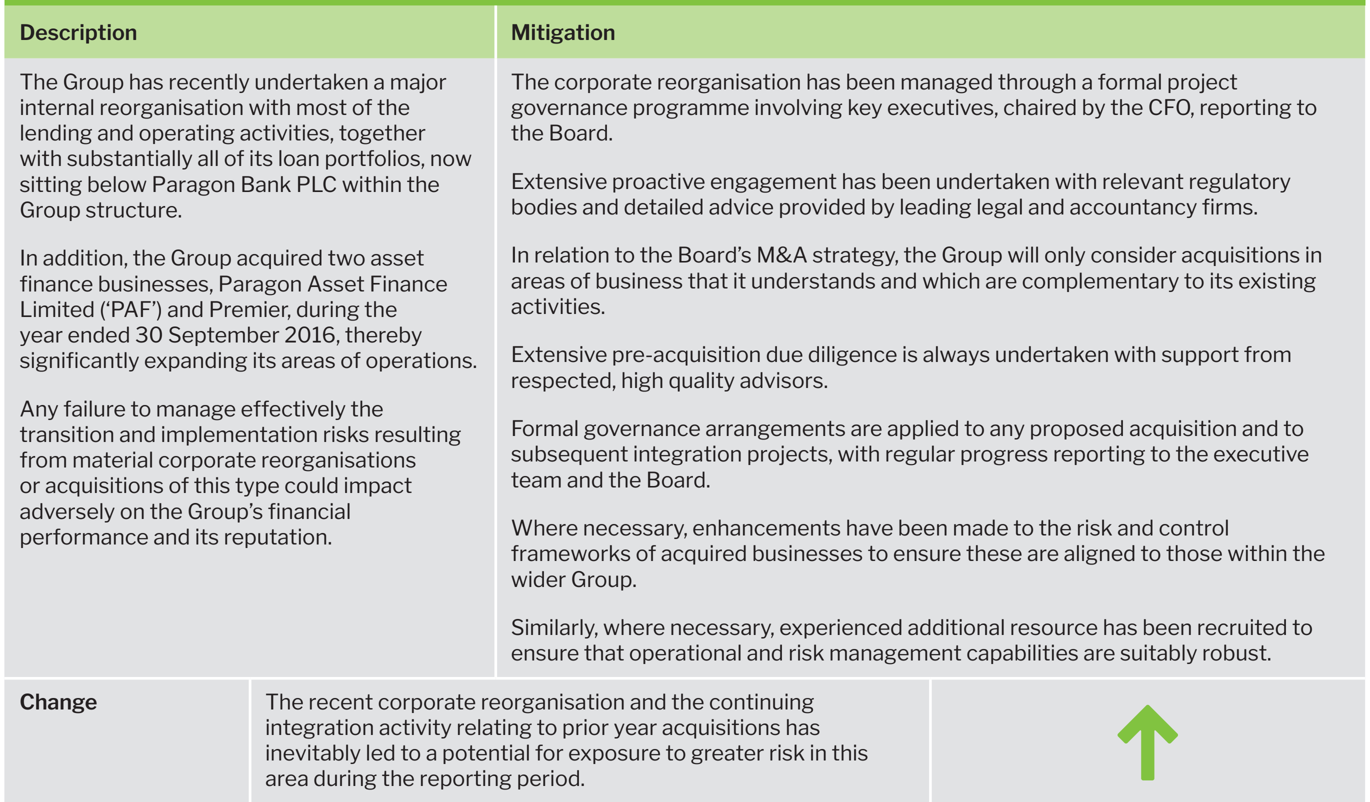
Change		
	Whilst UK economic performance has remained broadly stable in the last financial year, the near-term outlook remains uncertain given recent political developments in the UK and a continuing lack of clarity as to the basis of the UK's future relationship with the European Union. Given this heightened level of economic and political uncertainty, the overall risk assessment is considered to have increased in the last year.	↑

BUSINESS RISK

Concentration Risk

Description	Mitigation
Lending to customers investing in the UK private rented sector forms a substantial part of the Group's advances and assets. 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. 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.	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. 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 relevant groups within UK Finance (formerly the Council of Mortgage Lenders), the Intermediary Mortgage Lenders Association and the National Landlords Association. Given its specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond promptly and effectively to recent regulatory changes relating to buy-to-let lending. As a result, it has been able to provide appropriate products to the full spectrum of buy-to-let borrowers operating in the new environment. The Group also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed specialist lender. This has been illustrated in recent years by the acquisition of its asset finance business and diversification into new product areas such as residential mortgages and property development finance.

Change		
	The Group continues to have significant exposure to buy-to-let lending but, due to its specialist knowledge of the sector, it has been able to respond promptly and positively to the regulatory changes introduced during the last year. The implementation of these changes is likely to refocus the market towards larger portfolio landlords with more complex needs. Given its expertise and extensive experience, the Group already has the ability to service this area of the market effectively. In the longer term, it is possible that recent changes to the UK taxation regime for private landlords and greater regulatory intervention in the sector will reduce demand and availability of buy-to-let lending products. However, the Group continues to be confident in its ability to operate successfully in this evolving environment. It has therefore assessed the overall risk resulting from its reliance on the buy-to-let exposure in the last 12 months as stable.	



BUSINESS RISK

Transition Risk

Description	Mitigation
The Group has recently undertaken a major internal reorganisation with most of the lending and operating activities, together with substantially all of its loan portfolios, now sitting below Paragon Bank PLC within the Group structure. In addition, the Group acquired two asset finance businesses, Paragon Asset Finance Limited ('PAF') and Premier, during the year ended 30 September 2016, thereby significantly expanding its areas of operations. Any failure to manage effectively the transition and implementation risks resulting from material corporate reorganisations or acquisitions of this type could impact adversely on the Group's financial performance and its reputation.	The corporate reorganisation has been managed through a formal project governance programme involving key executives, chaired by the CFO, reporting to the Board. Extensive proactive engagement has been undertaken with relevant regulatory bodies and detailed advice provided by leading legal and accountancy firms. In relation to the Board's M&A strategy, the Group will only consider acquisitions in areas of business that it understands and which are complementary to its existing activities. Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors. 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. 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. Similarly, where necessary, experienced additional resource has been recruited to ensure that operational and risk management capabilities are suitably robust.

Change		
Change	The recent corporate reorganisation and the continuing integration activity relating to prior year acquisitions has inevitably led to a potential for exposure to greater risk in this area during the reporting period.	↑

CREDIT RISK

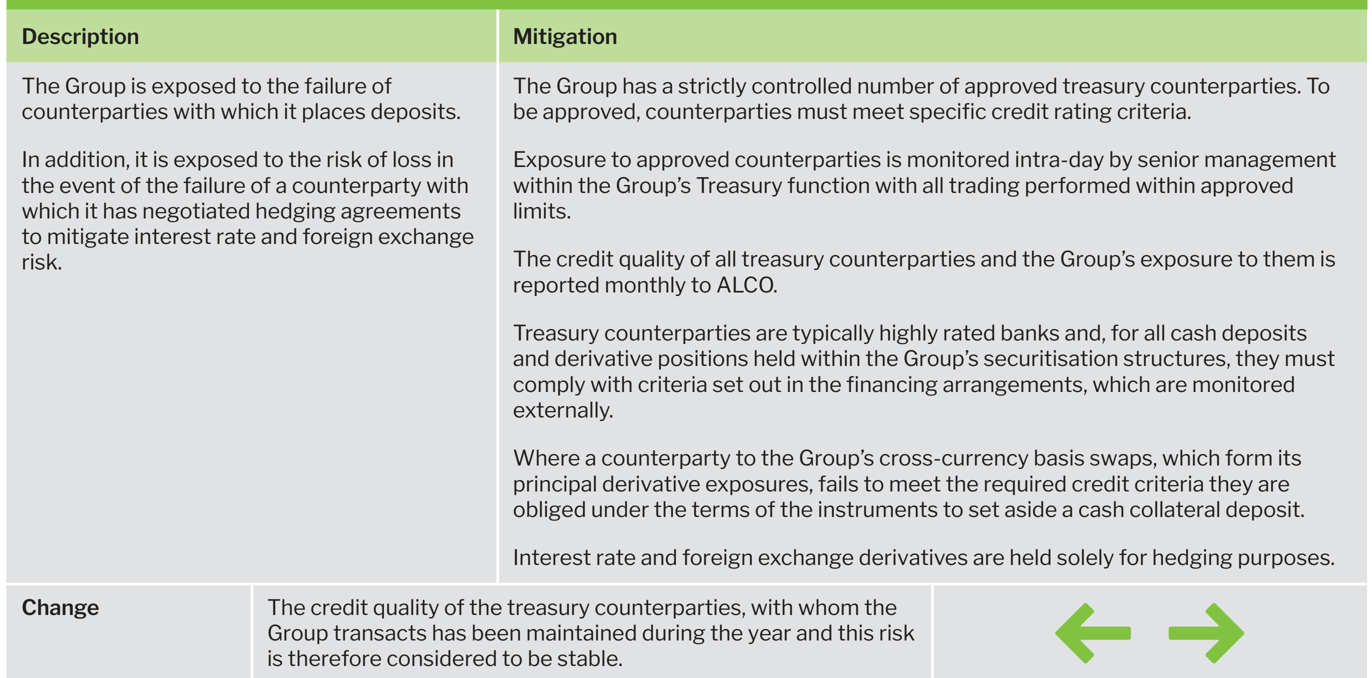
Customer Risk

Description	Mitigation
As a lender, a failure to target and underwrite credit decisions effectively could expose the Group to the risk of unexpected material losses in the event of customers being unable to repay their debts. Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.	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 risks arising from factors such as large exposures to counterparties, geographical areas or types of lending. Exceptions to these policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee. The Group uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting. The 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. Originated loan assets are subject to individual underwriting approval with robust control and support provided in most areas by well-established decision tools, while purchased assets are subject to extensive pre-contract due diligence and rigorous ongoing analysis and monitoring. In terms of supporting collateral, the majority of the Group's loans by value continue to be secured against residential property in England and Wales at conservative loan-to-value levels. Rigorous and timely collections and arrears management processes are in place which are consistent with the Group's principle of treating customers in financial difficulty fairly and supportively. These processes benefit from specialist staff. 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.

Change		
	The Group's impairment rate has remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration due to changing economic conditions, particularly given current uncertainties regarding the UK's future relationship with the European Union, is being monitored closely across all Group portfolios. No material change has been seen in actual performance, nor underlying customer profile during the last year. 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 further described in note 9 to the Group Accounts.	

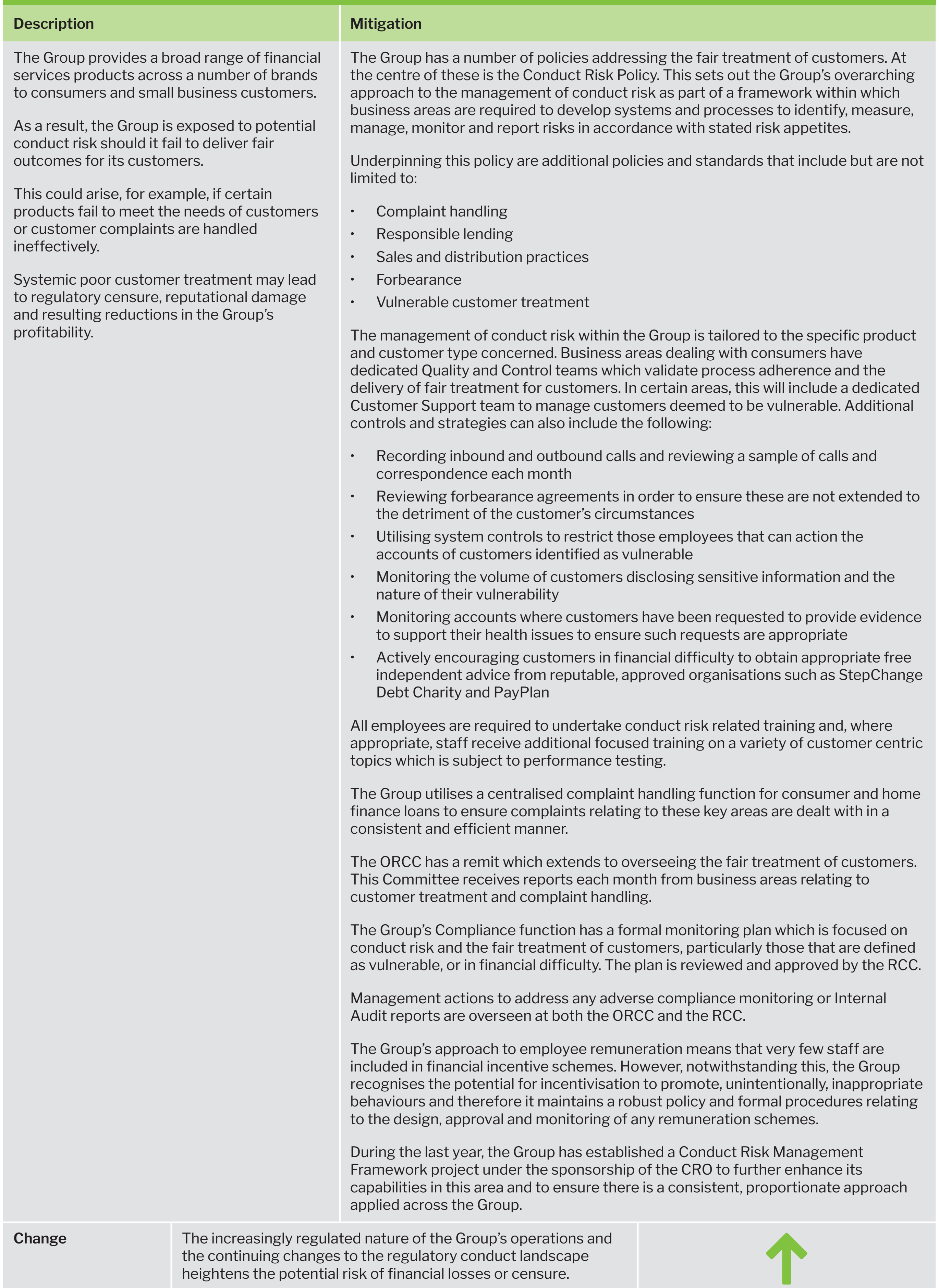
CREDIT RISK

Counterparty Risk



Description	Mitigation
The Group is exposed to the failure of counterparties with which it places deposits. 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.	The Group has a strictly controlled number of approved treasury counterparties. To be approved, counterparties must meet specific credit rating criteria. Exposure to approved counterparties is monitored intra-day by senior management within the Group's Treasury function with all trading performed within approved limits. The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO. 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. 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. Interest rate and foreign exchange derivatives are held solely for hedging purposes.

Change		
Change	The credit quality of the treasury counterparties, with whom the Group transacts has been maintained during the year and this risk is therefore considered to be stable.	



CONDUCT RISK

Customer Fair Outcomes

Description

The Group provides a broad range of financial services products across a number of brands to consumers and small business customers.

As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers.

This could arise, for example, if certain products fail to meet the needs of customers or customer complaints are handled ineffectively.

Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in the Group's profitability.

Mitigation

The Group has a number of policies addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy. This sets out the Group's overarching approach to the management of conduct risk as part of a framework within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites.

Underpinning this policy are additional policies and standards that include but are not limited to:

- Complaint handling
- Responsible lending
- Sales and distribution practices
- Forbearance
- Vulnerable customer treatment

The management of conduct risk within the Group is tailored to the specific product and customer type concerned. Business areas dealing with consumers have dedicated Quality and Control teams which validate process adherence and the delivery of fair treatment for customers. In certain areas, this will include a dedicated Customer Support team to manage customers deemed to be vulnerable. Additional controls and strategies can also include the following:

- Recording inbound and outbound calls and reviewing a sample of calls and correspondence each month
- Reviewing forbearance agreements in order to ensure these are not extended to the detriment of the customer's circumstances
- Utilising system controls to restrict those employees that can action the accounts of customers identified as vulnerable
- Monitoring the volume of customers disclosing sensitive information and the nature of their vulnerability
- Monitoring accounts where customers have been requested to provide evidence to support their health issues to ensure such requests are appropriate
- Actively encouraging customers in financial difficulty to obtain appropriate free independent advice from reputable, approved organisations such as StepChange Debt Charity and PayPlan

All employees are required to undertake conduct risk related training and, where appropriate, staff receive additional focused training on a variety of customer centric topics which is subject to performance testing.

The Group utilises a centralised complaint handling function for consumer and home finance loans to ensure complaints relating to these key areas are dealt with in a consistent and efficient manner.

The ORCC has a remit which extends to overseeing the fair treatment of customers. This Committee receives reports each month from business areas relating to customer treatment and complaint handling.

The Group's Compliance function has a formal monitoring plan which is focused on conduct risk and the fair treatment of customers, particularly those that are defined as vulnerable, or in financial difficulty. The plan is reviewed and approved by the RCC.

Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at both the ORCC and the RCC.

The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. However, notwithstanding this, the Group recognises the potential for incentivisation to promote, unintentionally, inappropriate behaviours and therefore it maintains a robust policy and formal procedures relating to the design, approval and monitoring of any remuneration schemes.

During the last year, the Group has established a Conduct Risk Management Framework project under the sponsorship of the CRO to further enhance its capabilities in this area and to ensure there is a consistent, proportionate approach applied across the Group.

Change		
Change	The increasingly regulated nature of the Group's operations and the continuing changes to the regulatory conduct landscape heightens the potential risk of financial losses or censure.	↑

OPERATIONAL RISK

People Risk

Description

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.

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.

Mitigation

The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies. These include:

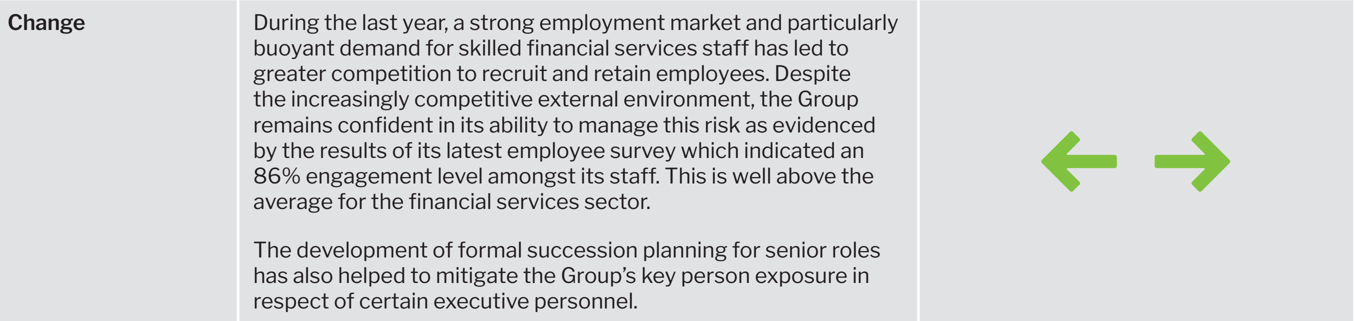
- Undertaking formal succession planning reviews covering all key roles
- Monitoring external remuneration and reward structures to ensure it remains competitive and is able to recruit and retain key personnel
- Offering a range of employee benefits in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related performance scheme for most employees
- Maintaining an effective performance appraisal system to identify and provide appropriate training and development opportunities for employees
- Providing regular internal training for all employees and financial support to employees undertaking relevant external professional qualifications
- Creating Manager and Team Leader Academies to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business

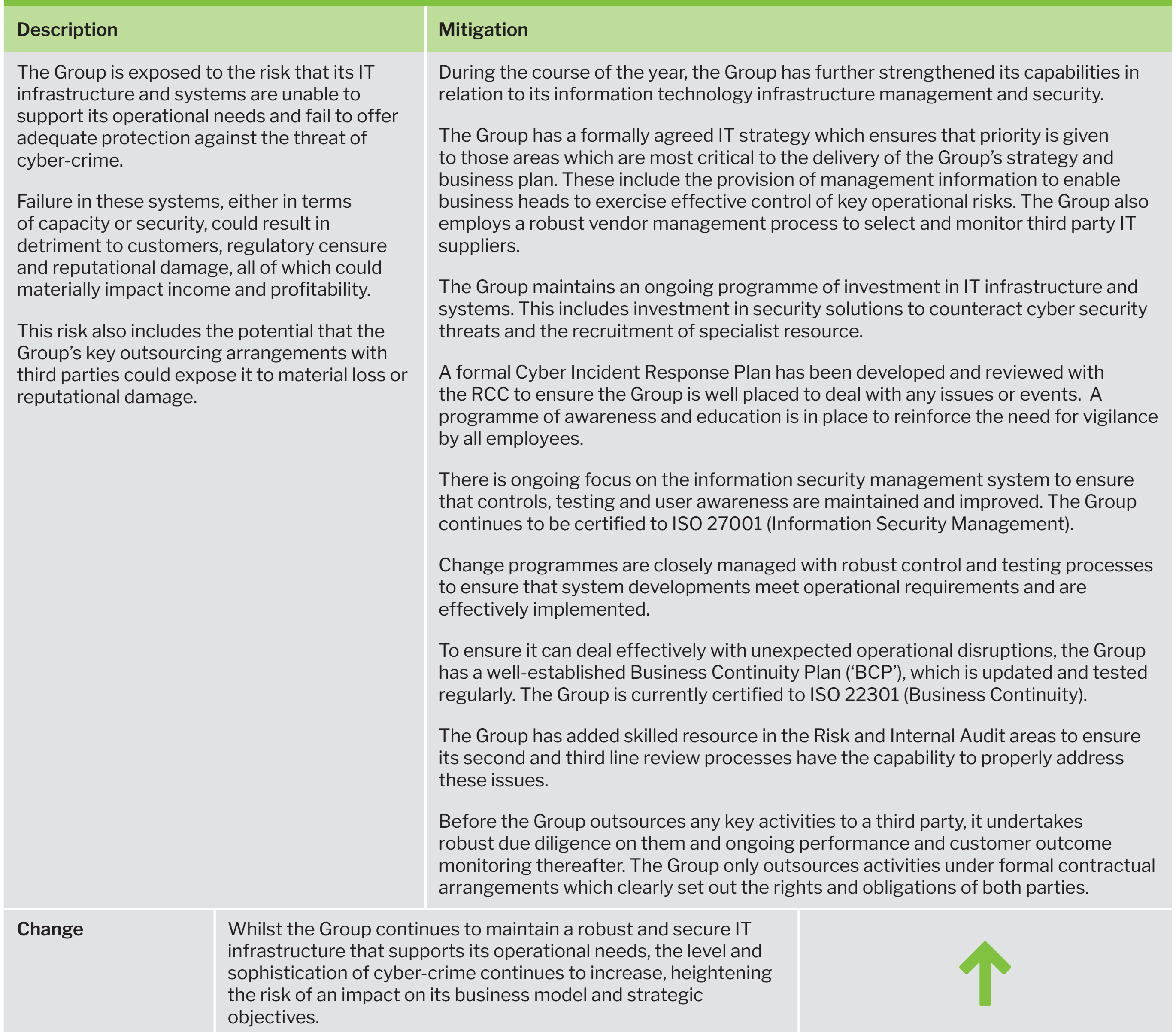
The Group has been accredited under the 'Investors in People' scheme since 1997 and retains the Champion status which it achieved in May 2014. This accreditation is awarded to a very small proportion of organisations who are seen as pioneers in people management practices and role models in strategic leadership.

Change

During the last year, a strong employment market and particularly buoyant demand for skilled financial services staff has led to greater competition to recruit and retain employees. Despite the increasingly competitive external environment, the Group remains confident in its ability to manage this risk as evidenced by the results of its latest employee survey which indicated an 86% engagement level amongst its staff. This is well above the average for the financial services sector.

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.





OPERATIONAL RISK

Systems Risk

Description	Mitigation
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. 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. This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.	During the course of the year, the Group has further strengthened its capabilities in relation to its information technology infrastructure management and security. 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. The Group maintains an ongoing programme of investment in IT infrastructure and systems. This includes investment in security solutions to counteract cyber security threats and the recruitment of specialist resource. A formal Cyber Incident Response Plan has been developed and reviewed with the RCC to ensure the Group is well placed to deal with any issues or events. A programme of awareness and education is in place to reinforce the need for vigilance by all employees. There is ongoing focus on the information security management system to ensure that controls, testing and user awareness are maintained and improved. The Group continues to be certified to ISO 27001 (Information Security Management). Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented. To ensure it can deal effectively with unexpected operational disruptions, the Group has a well-established Business Continuity Plan ('BCP'), which is updated and tested regularly. The Group is currently certified to ISO 22301 (Business Continuity). The Group has added skilled 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. 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.

Change	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.	↑

OPERATIONAL RISK

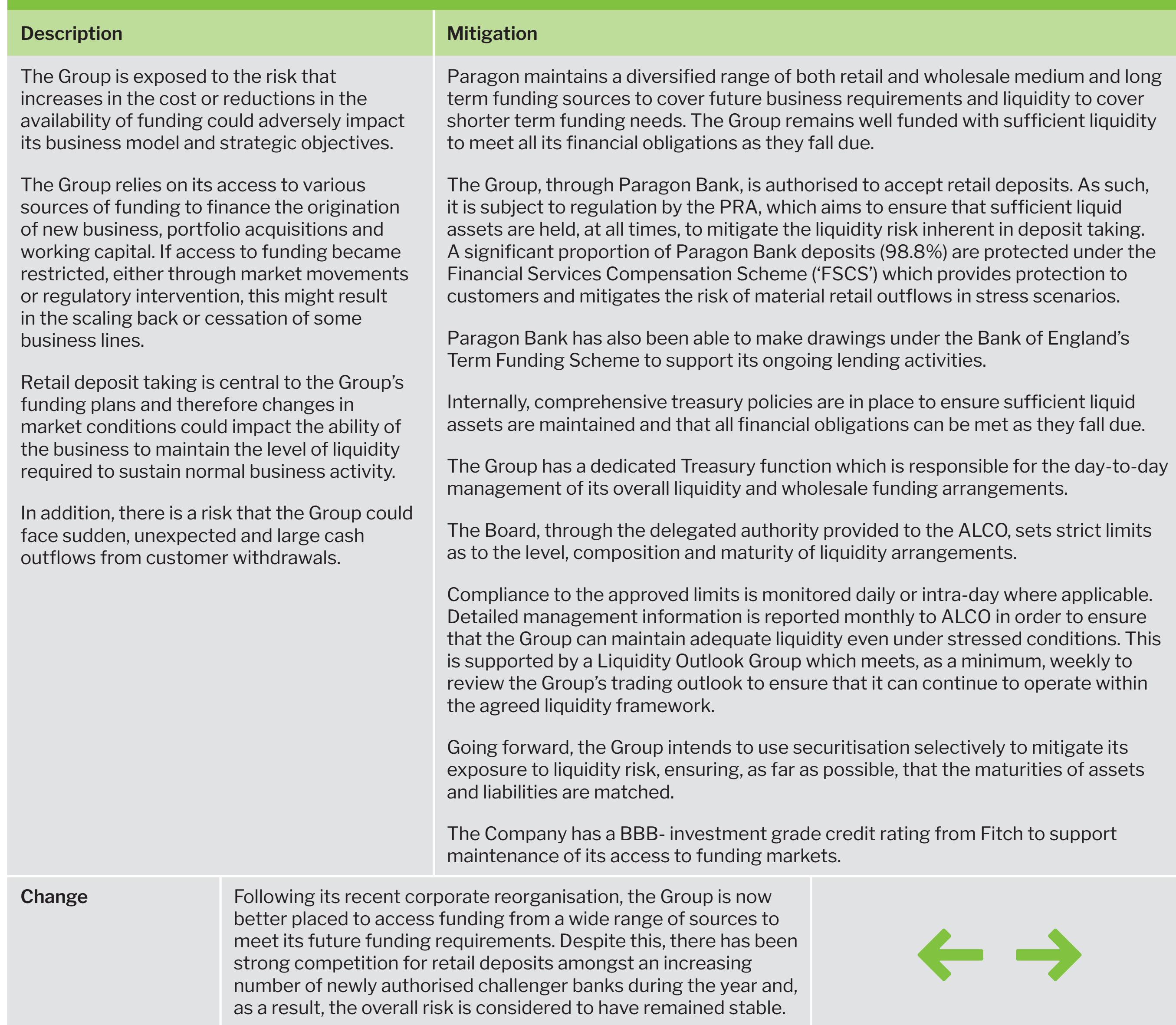
Regulatory Risk

Description	Mitigation
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. The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains some of its funding, have been subject to increasing legislative and regulatory intervention over recent years. The overwhelming majority of the Group's own business activities are now subject to direct and increasing levels of regulation.	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 external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the RCC. All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes. The Compliance function has developed a formal monitoring plan which is reviewed by the ORCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded. Similarly, the Financial Crime function provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements. The Financial Crime function has also overseen work required to ensure the Group is compliant with the Fourth Money Laundering Directive which was implemented during the year. In anticipation of the introduction of the General Data Protection Regulation in May 2018, the Group has initiated a formal project, under the sponsorship of the CRO, to affect any required changes to employee training, policies, procedures and systems. In addition, the Group has appointed an experienced specialist as its Data Protection Officer, reporting directly to the CRO.

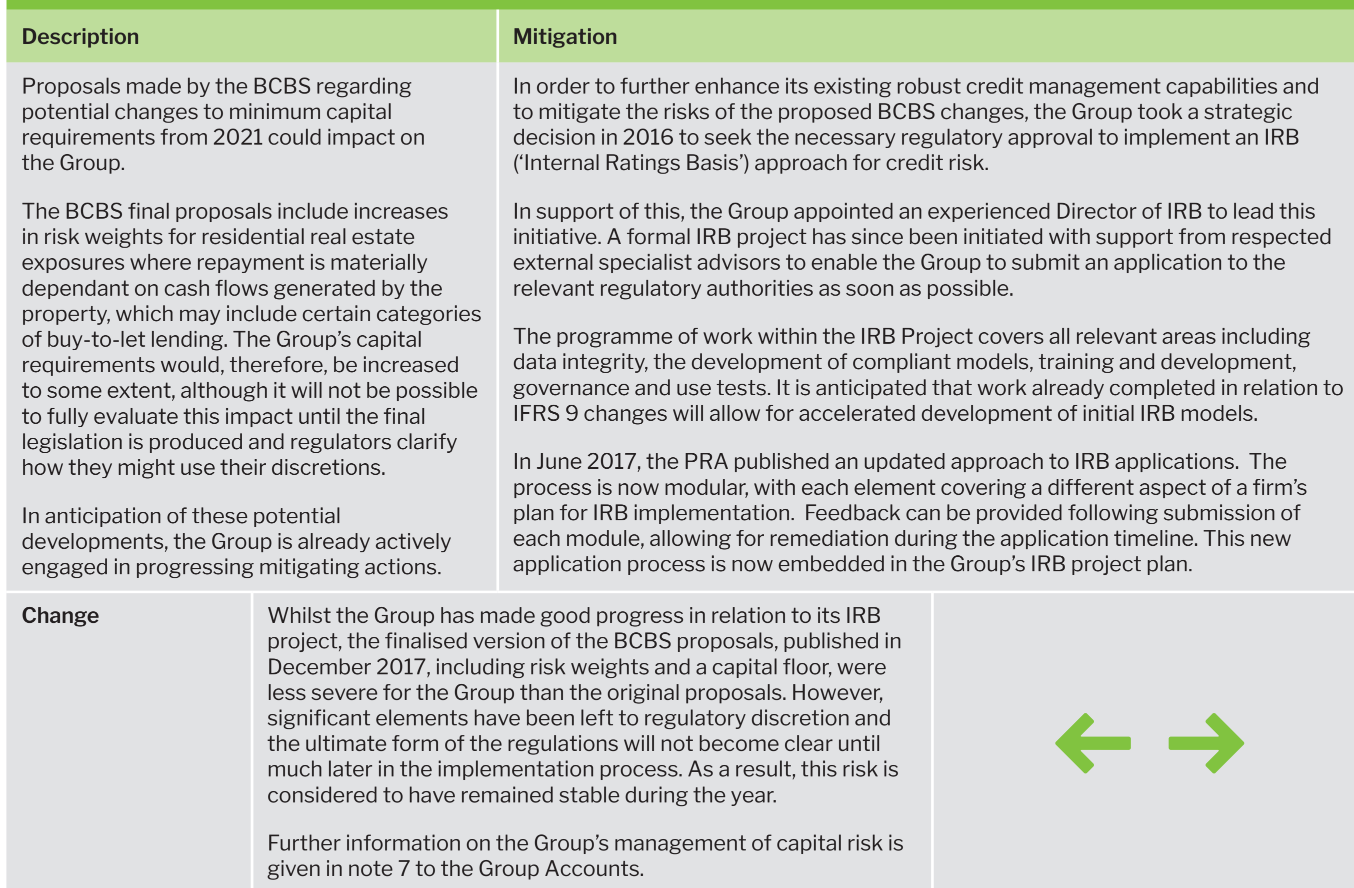
Change	Whilst the Group considers that it continues to have robust arrangements in place, the increasingly regulated nature of its operations heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging regulations.	↑

LIQUIDITY AND CAPITAL RISK

Funding Risk



Description	Mitigation
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 intervention, this might result in the scaling back or cessation of some business lines. Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions 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.	Paragon 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. The Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. The Group, through Paragon Bank, is authorised to accept retail deposits. As such, it is subject to regulation by the PRA, which aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking. A significant proportion of Paragon Bank deposits (98.8%) are protected under the Financial Services Compensation Scheme ('FSCS') which provides protection to customers and mitigates the risk of material retail outflows in stress scenarios. Paragon Bank has also been able to make drawings under the Bank of England's Term Funding Scheme to support its ongoing lending activities. Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due. The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements. The Board, through the delegated authority provided to the ALCO, sets strict limits as to the level, composition and maturity of liquidity arrangements. Compliance to the approved limits is monitored daily or intra-day where applicable. Detailed management information is reported monthly to ALCO in order to ensure that the Group can maintain adequate liquidity even under stressed conditions. This is supported by a Liquidity Outlook Group which meets, as a minimum, weekly to review the Group's trading outlook to ensure that it can continue to operate within the agreed liquidity framework. Going forward, the Group intends to use securitisation selectively to mitigate its exposure to liquidity risk, ensuring, as far as possible, that the maturities of assets and liabilities are matched. The Company has a BBB- investment grade credit rating from Fitch to support maintenance of its access to funding markets.
Change	Following its recent corporate reorganisation, the Group is now better placed to access funding from a wide range of sources to meet its future funding requirements. Despite this, there has been strong competition for retail deposits amongst an increasing number of newly authorised challenger banks during the year and, as a result, the overall risk is considered to have remained stable.

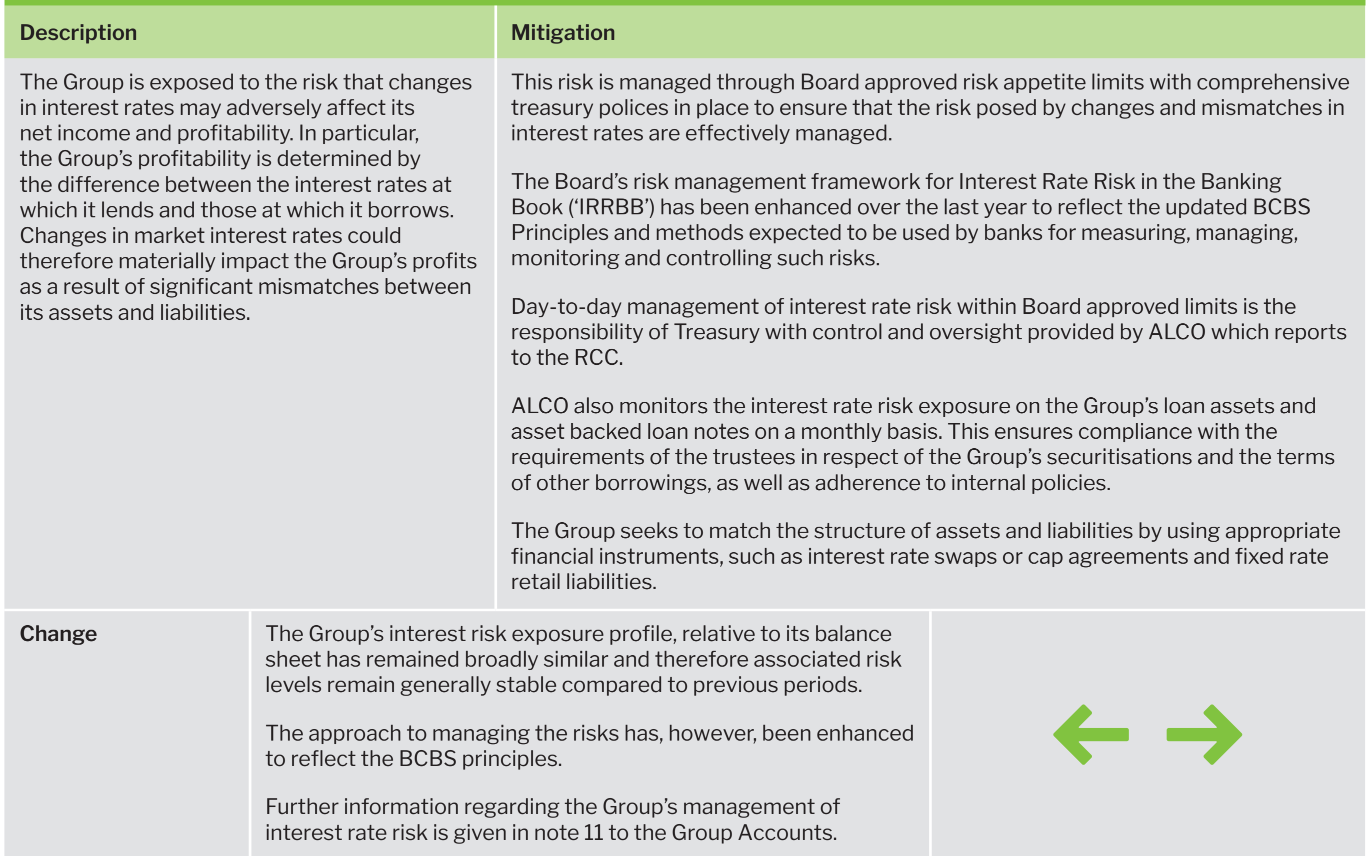


LIQUIDITY AND CAPITAL RISK

Capital Risk

Description	Mitigation
Proposals made by the BCBS regarding potential changes to minimum capital requirements from 2021 could impact on the Group. The BCBS final proposals include increases in risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by the property, which may include certain categories of buy-to-let lending. The Group's capital requirements would, therefore, be increased to some extent, although it will not be possible to fully evaluate this impact until the final legislation is produced and regulators clarify how they might use their discretions. In anticipation of these potential developments, the Group is already actively engaged in progressing mitigating actions.	In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB ('Internal Ratings Basis') approach for credit risk. In support of this, the Group appointed an experienced Director of IRB to lead this initiative. A formal IRB project has since been initiated with support from respected external specialist advisors to enable the Group to submit an application to the relevant regulatory authorities as soon as possible. The programme of work within the IRB Project covers 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. In June 2017, the PRA published an updated approach to IRB applications. The process is now modular, with each element covering a different aspect of a firm's plan for IRB implementation. Feedback can be provided following submission of each module, allowing for remediation during the application timeline. This new application process is now embedded in the Group's IRB project plan.

Change		
	Whilst the Group has made good progress in relation to its IRB project, the finalised version of the BCBS proposals, published in December 2017, including risk weights and a capital floor, were less severe for the Group than the original proposals. However, significant elements have been left to regulatory discretion and the ultimate form of the regulations will not become clear until much later in the implementation process. As a result, this risk is considered to have remained stable during the year. Further information on the Group's management of capital risk is given in note 7 to the Group Accounts.	← →



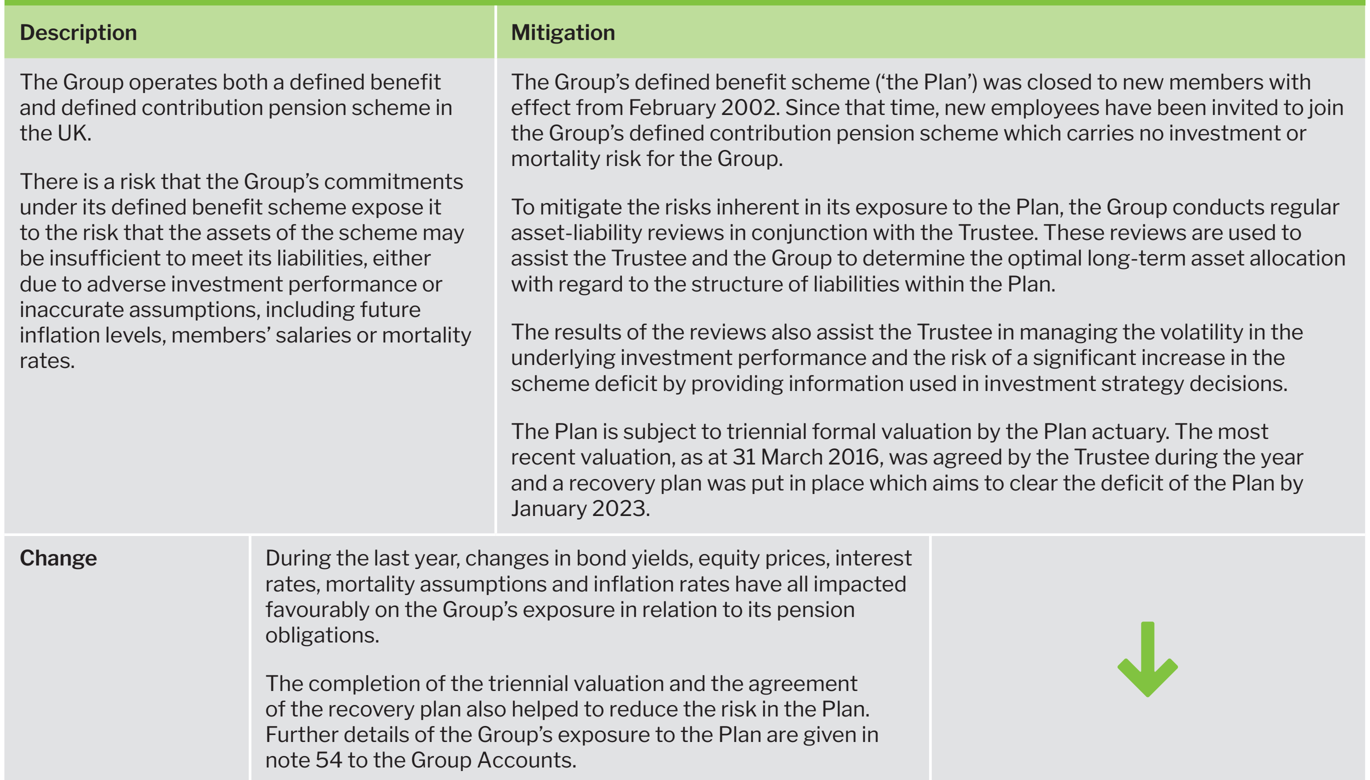
MARKET RISK

Interest Rate Risk

Description	Mitigation
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.	This risk is managed through Board approved risk appetite limits with comprehensive treasury polices in place to ensure that the risk posed by changes and mismatches in interest rates are effectively managed. The Board's risk management framework for Interest Rate Risk in the Banking Book ('IRRBB') has been enhanced over the last year to reflect the updated BCBS Principles and methods expected to be used by banks for measuring, managing, monitoring and controlling such risks. Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO which reports to the RCC. ALCO also 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. The Group seeks to match the structure of assets and liabilities by using appropriate financial instruments, such as interest rate swaps or cap agreements and fixed rate retail liabilities.

Change	The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. The approach to managing the risks has, however, been enhanced to reflect the BCBS principles. Further information regarding the Group's management of interest rate risk is given in note 11 to the Group Accounts.	← →

PENSION OBLIGATION RISK



Pension Obligation Risk

Description	Mitigation
The Group operates both a defined benefit and defined contribution pension scheme in the UK. There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates.	The Group's defined benefit scheme ('the Plan') 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. To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews 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 reviews also assist the Trustee in managing the volatility in the underlying investment performance and the risk of a significant increase in the scheme deficit by providing information used in investment strategy decisions. The Plan is subject to triennial formal valuation by the Plan actuary. The most recent valuation, as at 31 March 2016, was agreed by the Trustee during the year and a recovery plan was put in place which aims to clear the deficit of the Plan by January 2023.

Change		
	During the last year, changes in bond yields, equity prices, interest rates, mortality assumptions and inflation rates have all impacted favourably on the Group's exposure in relation to its pension obligations. The completion of the triennial valuation and the agreement of the recovery plan also helped to reduce the risk in the Plan. Further details of the Group's exposure to the Plan are given in note 54 to the Group Accounts.	↓

Introduction

The Group is committed to maintaining an effective Risk Management Framework that is responsive to both internal and external events and stresses. As part of this framework, the Board has set statements of risk appetite, consistent with its desire to be a prudent, risk focussed, specialist lender which places the delivery of fair outcomes for its customers at the heart of its activities. These statements were reviewed and updated during the year as part of the preparations for the Group's reorganisation.

Risk appetite is defined as the amount and type of risk which the Group is prepared to seek, accept or tolerate in pursuit of its long-term business objectives. By setting defined risk appetites, the Board communicates the level of acceptable risk and mandates that the risk is proactively managed within those parameters.

Risk Appetite Principles

In determining its approach to the setting of risk appetite, the Board has agreed a number of core principles.

In summary these are that risk appetite must:

- Be defined and owned by the Board with periodic reviews to ensure the risk appetites remain up to date, relevant and appropriate
- Include quantitative and qualitative measures which are at sufficiently granular level to be meaningful to the Board and to the business, but not be too numerous or broad to obscure key elements that may require attention
- Be robust and subjected to stress testing and scenario analysis, considering recent economic, political and regulatory developments
- Be reviewed at the ALCO, ORCC and Credit Committee against performance measures with any immediate findings escalated to the Board

Qualitative Risk Appetite Measures

In defining its risk appetite, the Board has established a number of core high level qualitative requirements that are intended to describe the overall risk landscape within which it wishes the Group to operate. These include:

- The Group's strategic objective is to be a prudent, risk focussed, specialist lender operating predominantly in the UK with a closely controlled, cost efficient operating model which places the delivery of fair customer outcomes at its core
- The Board expects executive management to develop and maintain a culture in relation to the management of risk that is consistent with its stated risk appetite
- The Board regards the Group's strong specialist underwriting capabilities as a competitive advantage but it has no appetite for the origination of unaffordable loans to borrowers
- The Board expects the overwhelming majority of originated loans to be secured on assets located within the UK
- The Board requires all treasury investment counterparties to be reputable, high quality institutions as defined by the minimum external rating criteria documented within the Group's treasury policy
- The Board requires the Group to maintain access to a range of alternative funding markets in order to ensure the sustainability of its business model
- The Board has no appetite for any risk arising from a material failure to deliver fair outcomes for customers. The fair treatment of customers is viewed as central to the achievement of the Group's strategic business objectives
- The Board has no appetite for material breaches to regulatory compliance or for accepting business than contravenes regulation or legislation
- The Board has limited appetite for any uncovered exposure to interest rate or foreign currency movement which could materially impact earnings
- The Board wishes to maintain capital, in terms of both quantity and quality, at a level sufficient to cover all known current and anticipated future risks and to cover a range of severe but plausible stressed scenarios
- The Board wishes to utilise capital to generate a strong, stable return for shareholders. As a banking group, its ongoing viability is dependent upon the level of confidence in its future held by its customers, shareholders, regulators and employees
- The Board therefore has no appetite for exposing itself to levels of risk that could lead to losses which would erode the Group's existing capital base

Quantitative Risk Appetite Measures

In setting its key quantitative risk appetite statements, the Board has sought to ensure that:

- The Group's strategic objectives are aligned to its risk appetite
- Quantitative measures are consistent with the Group's overarching qualitative risk appetite statements
- The principal risks to which the Group is exposed are appropriately covered by risk appetite measures

The Board's key quantitative risk appetite statements have been structured in line with the Group's standard risk categorisation. In each case, the key quantitative risk appetite statements indicate the following:

- The respective risk category within which the measure sits
- The specific limits, triggers and targets
- An identified executive management owner for each measure

The key measures used to define the Group's most material quantitative risk appetite statements are set out below:

	CAPITAL RISK						
Key capital ratios	**CET1 / Total Capital ratios** **The key capital ratios above form the basis of all strategic decisions. The risks identified below are considered in conjunction with the capital ratios in order to determine other business decisions.**						
	OTHER RISKS						
	Credit	**Business**	**Pension**	**Market**	**Liquidity**	**Operational**	**Conduct**
Key quantitative measures	Buy-to-let credit profile	RoTE target	Pension Plan Exposure	Interest rate risk management	LCR	Material operational risk events	Complaint levels
	Buy-to-let affordability				NSFR	Issue management	Complaint resolution
	Buy-to-let collateral quality				Encumbrance	IT resilience	Quality assurance testing
	Buy-to-let large exposures				Wholesale deposit ratio	Cyber security	Borrower credit/ affordability profiles
	Idem portfolio performance				Parent company liquidity	Resource capacity	Collateral quality
	Asset finance arrears / losses				OLAR		
Key qualitative measures	Prudent lending standards	Specialist markets	Support for plan while protecting capital	Limited exposure to interest rate movements	Availability of funding	Controlled costs	Fair outcomes
	Strong specialist underwriting	Income diversification		Very limited exposure to foreign exchange risk		Risk culture	No compliance breaches
	UK focus	Acquisition integration					
	High quality institutional obligors	New business development					

BOARD ASSESSMENT OF RISK MANAGEMENT ARRANGEMENTS

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

During the year, the directors also carried out a high-level exercise to identify the most significant risks facing the Group and their relative importance. The results of this exercise were fed back into the Group's risk management process.

The directors specifically considered the impact on risk and viability presented by the reorganisation which took place in September before it was approved. This included reviewing risk appetites and concluding ICAAP and ILAAP exercises for the reorganised Group.

At the year end the directors reviewed their on-going risk management activities and the most recent risk information available, including the risk register and risk measures, to confirm the position of the Group at the balance sheet date.

The directors concluded that those activities, taken together, constituted a robust assessment of all of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency and liquidity. These risks are those set out earlier in this section.

4
CAPITAL RESOURCES

This section sets out

- An overview of the Group's capital position
- A description of the nature and composition of the Group's regulatory capital
- Analysis of the adequacy of capital compared to regulatory requirements
- The calculation of the Group's leverage ratio
- The regulatory capital buffers applying to the Group

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's regulatory capital is monitored by the Board of Directors and ALCO, 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.

Both the Group and the Bank's capital risk appetite are linked to their wider risk appetite statements and ultimately their strategy.

The Group's overriding objective in managing its capital is to generate a strong return for shareholders while operating within the risk appetite set by the Board which requires it to:

- Maintain capital quantity and quality to cover current and future risks within the Group;
- Maintain sufficient capital to be able to survive a range of severe but plausible stressed scenarios; and
- Utilise capital in order to generate a strong return for shareholders.

The Group's approach to defining capital risk appetite takes into account its prudent approach to operations and strong control environment. The risk appetite is described in both quantitative and qualitative terms:

- Quantitatively, by describing the overall risk limits numerically. These limits cover the quantity and quality of capital to be held
- Qualitatively, by outlining core principles in managing or mitigating risk and ensuring that the Group and the Bank have the necessary capabilities to prudently manage capital risks, and provide management with sufficient information to effectively oversee operations and risk levels

It should be noted that the regulatory capital disclosures in this section 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.

CAPITAL RESOURCES

At 30 September 2017, the Group's regulatory capital of £1,030.5m (2016: £1,005.6m), was comfortably in excess of that required by the regulator. Throughout the period from authorisation to that date the Group's regulatory capital also complied with these requirements.

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 2017 is set out below.

	2017	2016
	£m	£m
Total equity	**1,009.4**	969.5
Deductions		
Proposed final dividend	**(28.9)**	(25.5)
Intangible assets	**(104.4)**	(105.4)
Common Equity Tier 1 ('CET1') capital	**876.1**	838.6
Other Tier 1 capital	**-**	-
Total Tier 1 capital	**876.1**	838.6
Corporate bond	**150.0**	260.0
Less: amortisation adjustment†	**-**	(97.8)
	150.0	162.2
Collectively assessed credit impairment allowances	**4.4**	4.8
Total Tier 2 capital	**154.4**	167.0
Total regulatory capital	**1,030.5**	1,005.6

† 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 matured in 2017, this adjustment was required in respect of this instrument in the 2016 capital calculation. No such adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026.

The Group's tier 1 capital arises from the equity represented by its ordinary shares, which are listed on the London Stock Exchange. These shares all rank pari passu and carry no special features.

The tier 2 capital instruments are fixed term corporate bonds, listed on the London Stock Exchange. £110.0m of these bonds matured in 2017, while the other £150.0m, issued in 2016, mature in 2026. Further details of these bonds are given in note 48 to the Group Accounts.

The detailed information on these instruments required by Article 437 of Part 8 as applied by EU Commission Implementing Regulation 1423/2013, is set out in Appendix A.

The movements in the Group's capital resources in the year can be analysed as follows:

	2017			2016		
	CET 1	Tier 2	Total	CET 1	Tier 2	Total
	£m	£m	£m	£m	£m	£m
Capital at 1 October 2016	**838.6**	**167.0**	**1,005.6**	939.7	36.6	976.3
Trading transactions						
Profit after tax	**117.2**	**-**	**117.2**	116.0	-	116.0
Other comprehensive income	**23.9**	**-**	**23.9**	(26.4)	-	(26.4)
Charge for share based payment	**4.2**	**-**	**4.2**	4.4	-	4.4
Tax on share based payment	**0.8**	**-**	**0.8**	(0.2)	-	(0.2)
Movement in collectively assessed impairment allowances	**-**	**(0.4)**	**(0.4)**	-	2.4	2.4
Intangible assets arising on acquisition	**0.3**	**-**	**0.3**	(97.9)	-	(97.9)
Purchase of intangible assets	**(0.9)**	**-**	**(0.9)**	(1.4)	-	(1.4)
Amortisation of intangible assets	**1.6**	**-**	**1.6**	1.6	-	1.6
Utilisation of tax losses	**-**	**-**	**-**	0.3	-	0.3
Capital transactions						
Proposed dividend at year end	**(28.9)**	**-**	**(28.9)**	(25.5)	-	(25.5)
Interim dividend paid in year	**(12.5)**	**-**	**(12.5)**	(12.1)	-	(12.1)
Share buy-backs	**(65.5)**	**-**	**(65.5)**	(51.0)	-	(51.0)
Shares issued	**1.5**	**-**	**1.5**	0.3	-	0.3
Shares purchased by ESOP	**(4.2)**	**-**	**(4.2)**	(9.2)	-	(9.2)
Issue of Tier 2 instruments	**-**	**-**	**-**	-	150.0	150.0
Amortisation of Tier 2 instruments	**-**	**(12.2)**	**(12.2)**	-	(22.0)	(22.0)
Capital at 30 September 2017	**876.1**	**154.4**	**1,030.5**	838.6	167.0	1,005.6

The amount shown above for other comprehensive income principally represents actuarial gains / (losses) on the Group's defined benefit pension plan.

TOTAL RISK EXPOSURE

The total risk exposure 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.

	2017	2016
	£m	£m
Credit risk		
Balance sheet assets	**4,907.7**	4,728.4
Off balance sheet	**68.3**	51.5
Total credit risk	**4,976.0**	4,779.9
Operational risk	**464.9**	445.7
Market risk	**-**	-
Other	**67.8**	61.9
Total risk exposure	**5,508.7**	5,287.5

	%	%
Solvency ratios		
CET1	**15.9**	15.9
Total regulatory capital	**18.7**	19.0

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 causes of movements in risk weighted assets ('RWA') in the year at the Group level, analysed by those movements caused by changes in the average risk weightings applied to portfolios ('Portfolio Quality') and changes in the unweighted value of the portfolios ('Portfolio Size').

	2016 RWA	Portfolio Quality	Portfolio Size	2017 RWA
	£m	£m	£m	£m
First mortgages	3,448.7	(14.4)	103.5	**3,537.8**
Second charge mortgages	202.9	(17.1)	80.0	**265.8**
Development finance	13.7	-	49.8	**63.5**
Exposures secured on real estate	3,665.3	(31.5)	233.3	**3,867.1**
Retail exposures	360.4	13.1	(28.8)	**344.7**
Asset finance exposures	204.8	-	62.2	**267.0**
Exposure on loans to customers	4,230.5	(18.4)	266.7	**4,478.8**
Institutions	475.2	-	(40.1)	**435.1**
Other assets	74.2	-	(12.1)	**62.1**
	4,779.9	(18.4)	214.5	**4,976.0**

Credit RWAs have increased by approximately 4.0% since 30 September 2016. The principal cause of this increase has been asset growth from increased levels of advances across the Group's business lines. However, the impact on RWA from asset growth was mitigated by an improvement in book quality due to increased house prices and better performance.

Exposure on retail assets has reduced due to portfolios paying down, and also to the transfers of some purchased assets to the second charge category, following investigation of their security characteristics. The increase in counterparty credit risk RWAs has arisen due to the growth in swap fair values resulting from exchange rate movements.

Changes in operational risk requirements reflect income growth within the regulatory prescribed income streams, as the Group calculates risk exposure from operating risk using the Basic Indicator Approach.

LEVERAGE RATIOS

The Group monitors its leverage exposure on the basis set out by the PRA ('UK basis'). Firms are required to report in their Pillar III disclosures on the basis prescribed by the EBA, which differs in the treatment of central bank balances. Accordingly, both measures are presented in this document.

The table below shows the calculation of the leverage ratios at the year end, based on the consolidated balance sheet assets, adjusted for amounts already provided in the Group Accounts and the post offer pipelines of loan assets at 30 September 2017.

		UK Basis		EBA Basis	
		2017	2016	**2017**	2016
		£m	£m	**£m**	£m
Total balance sheet assets		**13,682.2**	13,518.4	**13,682.2**	13,518.4
Less:	Derivative assets	**(906.6)**	(1,366.4)	**(906.6)**	(1,366.4)
	Central bank deposits	**(615.0)**	(315.0)	**-**	-
	CRDs	**(1.6)**	(0.6)	**-**	-
On-balance sheet items		**12,159.0**	11,836.4	**12,775.6**	12,152.0
Less:	Intangible assets	**(104.4)**	(105.4)	**(104.4)**	(105.4)
Total on balance sheet exposures		**12,054.6**	11,731.0	**12,671.2**	12,046.6
Derivative assets		**906.6**	1,366.4	**906.6**	1,366.4
Potential future exposure on derivatives		**191.3**	68.6	**191.3**	68.6
Total derivative exposures		**1,097.9**	1,435.0	**1,097.9**	1,435.0
Post offer pipeline at gross notional amount		**417.9**	273.8	**417.9**	273.8
Adjustment to convert to credit equivalent amounts		**(208.9)**	(136.9)	**(208.9)**	(136.9)
Off balance sheet items		**209.0**	136.9	**209.0**	136.9
Tier 1 capital		**876.1**	838.6	**876.1**	838.6
Total leverage exposure		**13,361.5**	13,302.9	**13,978.1**	13,618.5
Leverage ratio		**6.6%**	6.3%	**6.3%**	6.2%

The increase in the leverage ratio in the year relates principally to profits made by the Group in the year, together with the reduction in the deficit recorded on the Group's defined benefit pension plan. The Group has reviewed its capital position following its reorganisation and expects to see the leverage ratio reduce over time as capital efficiency is improved.

The disclosure of the EBA leverage ratio calculation in accordance with the template published in EU Commission Implementing Regulation 2016/200 is shown in Appendix B.

CAPITAL BUFFERS

CRD IV establishes a number of capital buffers to be met with CET1 capital, in addition to the Group's funds requirement set through Pillar 1 and Pillar 2 (together referred to as the 'CRD IV Buffers'). These new buffers were introduced from 1 January 2016 and changes were made to the Group's ICR to allow for this.

These changes converted the existing ICR, expressed as a percentage of the Pillar 1 requirement, to a percentage of Total Risk Exposure ('TRE'), plus an add-on for pension risk. At the same time the existing capital buffer (which was expressed as an absolute amount) was retired and a PRA buffer was set as a percentage of TRE.

The buffers which apply to the Group at 30 September 2017 and which are expected to apply in the near term are:

- A Capital Conservation Buffer ('CCoB') which is currently 1.25% of TRE at 30 September 2017, rising to 1.875% at 1 January 2018 and 2.50% at 1 January 2019.
- A Counter Cyclical Buffer ('CCyB'), controlled by the Financial Policy Committee ('FPC'). The CCyB is currently 0.00% of TRE, but in June 2017 it was decided that this would increase to 0.50% from 27 June 2018. In November 2017, the FPC decided to further increase the UK CCyB to 1.00% with effect from 28 November 2018. The FPC have previously indicated that their expectation is that this will be the level of the CCyB in a 'standard risk environment', but have announced their intention to review this conclusion in early 2018.
- The PRA buffer, set for firms on an individual basis. The PRA and FPC have indicated their expectation that the PRA buffer will decrease in line with increases in the CCoB and CCyB, until it reaches zero, for most firms. It should be noted that the PRA buffer is set as a percentage of TRE, rather than an absolute amount, so will vary with the balance sheet.

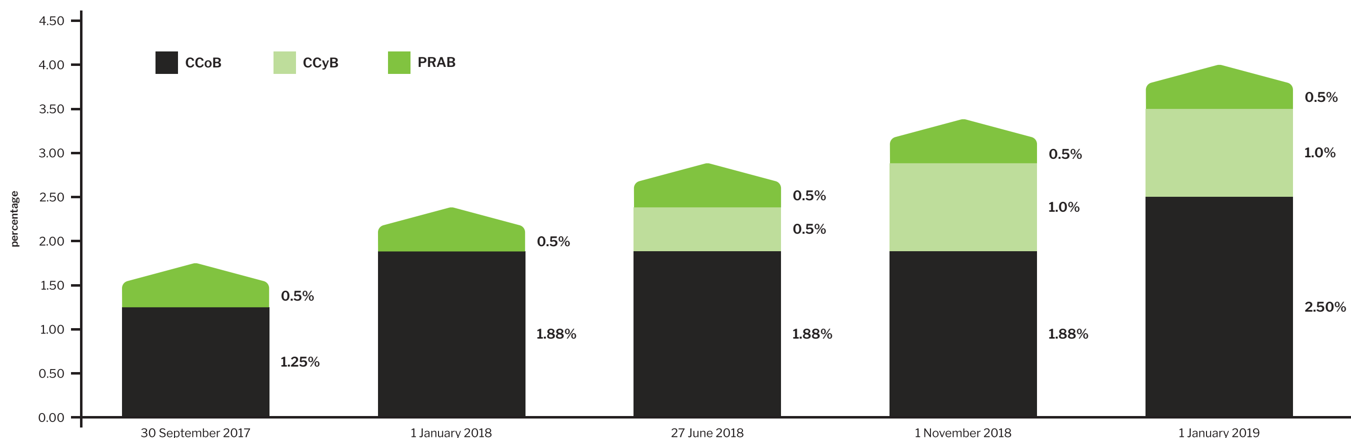
Additional buffers provided for by CRD IV do not apply to the Group.

While an institution's CCyB will be a weighted average of those set by the regulators in the jurisdictions in which it operates, forming an 'Institution Specific CCyB Rate', as all of the Group's risk exposure is within the UK, its rate will be equal to that set for the UK by the FPC. This is currently 0.00% and hence the Group's Institution Specific CCyB Requirement as at 30 September 2017 was £nil (2016: £nil). The Group's approach to reporting CCyB is discussed in Appendix C.

The PRA have indicated that their intention is that their buffer will be used in future to address governance and risk management issues which have not been adequately addressed by firms. In the short-term it is being used to supplement other CRD IV buffers where the overall capital buffer amount is less than the former capital planning buffer requirement.

The buffers presently expected to apply to the Group, assuming a 0.5% PRA buffer for the purposes of illustration, are shown below

Projected CRD IV Buffers



The PRA buffer may be amended by the PRA as part of the SREP process, while the FPC may vary the CCyB from time to time. For forecasting purposes the Group has assumed a CCyB of 0.5% which is assumed to be consistent until November 2018, when it is expected to increases to 1.0%, as the FPC have indicated their withdrawal of the CCyB amount is intended as a short-term measure.

CRD IV also sets minimum requirements for the quality of capital held, i.e. its distribution between Tier 1, Additional Tier 1 and Tier 2 instruments. At 30 September 2017 the Group's regulatory capital was mostly CET1 equity.

The Group has reviewed the requirements set out within the CRR, including the impact of the changes in buffers. The capital position of the Group over the planning horizon demonstrates a significant surplus that can accommodate the requirements of the capital conservation and countercyclical capital buffers.

The Group has concluded that it will maintain a capital surplus over and above the CRR capital requirements, including relevant buffers, through the planning horizon.

5
CREDIT RISK

This section sets out

- An overview of the Group's overall exposure to credit risk
- How the Group's risk exposure for credit risk (its risk weighted assets) is derived
- The most significant metrics used by the Group to assess credit risk in its principal asset classes

The Group's business objectives rely on maintaining the credit quality of its 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 in the collections process.

Primary responsibility for credit risk management across the Group lies with the Credit Committee. The Credit Committee is made up of nine senior employees, headed by the CRO. 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, establishes limits for each counterparty and monitors compliance with those limits.

The carrying values of the assets of the Group which are subject to credit risk are set out below:

	2017	2016
	£m	£m
Loans to customers	**11,124.1**	10,737.5
Derivative financial assets	**906.6**	1,366.4
Accrued interest	**0.2**	0.3
Credit Support Annex ('CSA') assets	**2.0**	3.7
CRDs	**1.6**	0.6
Trade debtors	**4.2**	2.4
Short term investments	**-**	7.1
Cash	**1,496.9**	1,237.6
Maximum exposure to credit risk	**13,535.6**	13,355.6

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 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.

The Group's risk weighted assets, used in determining its Pillar 1 capital requirement can be analysed by category as shown below.

		Exposure	Average risk weighting	Risk weighted exposure	Minimum capital required
		£m	%	£m	£m
30 September 2017					
Government and central banks	(a)	**616.6**	-	-	-
Credit institutions	(f)	**1,788.5**	**24.33**	**435.1**	**34.8**
Total liquidity exposures		**2,405.1**	**18.09**	**435.1**	**34.8**
Local authorities	(b)	**12.3**	**20.33**	**2.5**	**0.2**
Corporate and similar exposures	(g)	**125.8**	**100.00**	**125.8**	**10.1**
Retail and SME lending	(h)	**592.0**	**77.38**	**458.1**	**36.6**
Residential lending	(i)	**10,315.9**	**36.06**	**3,719.5**	**297.6**
Non-performing	(j)	**38.7**	**105.68**	**40.9**	**3.3**
Specialist lending	(k)	**42.3**	**150.12**	**63.5**	**5.1**
Loans and advances to customers		**11,127.0**	**39.64**	**4,410.3**	**352.8**
Fixed and other assets	(q)	**62.3**	**100.00**	**62.3**	**5.0**
Total on balance sheet exposures		**13,594.4**	**36.10**	**4,907.7**	**392.6**
Off balance sheet exposures - pipeline		**417.9**	**16.34**	**68.3**	**5.5**
Total credit risk exposure		**14,012.3**	**35.51**	**4,976.0**	**398.1**
30 September 2016					
Government and central banks	(a)	322.1	-	-	-
Credit institutions	(f)	2,289.0	20.76	475.2	38.0
Total liquidity exposures		2,611.1	18.19	475.2	38.0
Local authorities	(b)	12.8	20.31	2.6	0.2
Corporate and similar exposures	(g)	81.6	100.00	81.6	6.5
Retail and SME lending	(h)	464.5	78.60	365.1	29.2
Residential lending	(i)	10,127.2	36.07	3,669.0	293.5
Non-performing	(j)	56.2	108.01	60.7	4.9
Specialist lending	(k)	-	-	-	-
Loans and advances to customers		10,742.3	38.90	4,179.0	334.3
Fixed and other assets	(q)	68.3	108.64	74.2	6.0
Total on balance sheet exposures		13,421.7	35.23	4,728.4	378.3
Off balance sheet exposures - pipeline		228.7	22.52	51.5	4.1
Total credit risk exposure		13,650.4	35.02	4,779.9	382.4

The additional category included in the year, specialist lending, represents the Group's development finance business.

'Other assets' includes residual values of assets leased under finance leases, included in finance lease assets in the balance sheet. Risk weighted exposures on derivatives include allowances for potential future exposure.

The exposures shown above are assigned to the exposure classes set out in Article 112 of the CRR as shown below:

a) Exposures to central governments or central banks

b) Exposure to regional governments and local authorities

f) Exposure to institutions

g) Exposure to corporates

h) Retail exposures

i) Exposures secured by mortgages on immovable property

j) Exposures in default

k) Exposures associated with particularly high risk

q) Other items

There are no equity exposures.

These calculations use the Standardised Approach for credit risk for all asset classes. A risk weighting of 8% is applied to risk weighted asset values calculated in accordance with Article 92 of the CRR to determine the minimum Pillar I requirement for credit risk.

The risk weightings used in the SA for exposures to central governments, central banks and local authorities within the EU are set in the CRR.

For institutional exposures, where the SA requires the use of external ratings to determine appropriate risk weightings, the Group uses ratings published by Fitch, Standard and Poor's and Moody's, assigning the exposure to the credit quality step indicated by the majority. This is the only use of External Credit Assessment Institutions ('ECAI') in the Group's application of the SA.

Further information on the credit risk relating to the Group's sovereign and institutional exposures is given in Section 7.

A reconciliation of the on-balance sheet exposure shown above to the audited amounts in the Group Accounts is shown below.

	2017	2016
	£m	£m
Total balance sheet assets	**13,682.2**	13,518.4
Less amounts deducted in regulatory capital		
Intangible assets	**(104.4)**	(105.4)
Add back non-specific provisions		
Qualifying as tier 2 capital	**4.4**	4.8
Deferred tax asset netted off creditors in balance sheet	**-**	3.9
Fair value hedging portfolio adjustments	**12.2**	-
Total balance sheet exposure	**13,594.4**	13,421.7

The Group has a very low operational risk appetite, highlighted by its lack of historic operational risk losses. In order to assess whether a Pillar 2a add-on is required for operational risk, the Group has reviewed historic operational losses, as well as performing scenario analysis on the Group's major operational risks.

Individual balance sheet classes of credit risk bearing instruments are discussed further below.

Loans to customers

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.

All of the Group's loan assets are situated in the UK and therefore each portfolio is considered to comprise a single geographical exposure.

The Group's retail lending portfolios, including buy-to-let lending, each comprise a single counterparty type. Hence no analysis of these portfolios, or elements within them, is provided.

Specific credit risk adjustments represent loan by loan impairment provisions determined in accordance with IAS 39. The Group identifies loan accounts potentially requiring impairment provisions through the number of missed payments and whether the account is in possession or a similar enforcement status (the 'impairment population' shown in the tables later in this section).

The amount of provision is determined based on the current balance reduced by the value of any security. Allowances are also made for current collection performance.

General credit risk adjustments represent emergence provisions derived in accordance with IAS 39, based on historic experience of the asset type and current economic conditions.

The Group's loan assets at 30 September 2017 are analysed as follows:

	Gross loan assets £m	Impairment provisions £m	Net loan assets £m	%
30 September 2017				
Buy-to-let mortgages	**9,917.0**	**(80.5)**	**9,836.5**	**88.4%**
Owner-occupied mortgages	**27.5**	**(8.5)**	**19.0**	**0.2%**
Total first residential mortgages	**9,944.5**	**(89.0)**	**9,855.5**	**88.6%**
Second charge mortgage loans	**493.2**	**(2.5)**	**490.7**	**4.4%**
Loans secured on residential property	**10,437.7**	**(91.5)**	**10,346.2**	**93.0%**
Development finance	**42.3**	**-**	**42.3**	**0.4%**
Commercial mortgages	**3.2**	**(0.5)**	**2.7**	**-**
Loans secured on property	**10,483.2**	**(92.0)**	**10,391.2**	**93.4%**
Motor finance loans	**164.4**	**(1.4)**	**163.0**	**1.5%**
Other consumer loans	**234.9**	**(15.8)**	**219.1**	**2.0%**
Asset finance loans	**327.6**	**(2.6)**	**325.0**	**2.9%**
Factoring and discounting balances	**24.2**	**(0.4)**	**23.8**	**0.2%**
Other loans	**2.0**	**-**	**2.0**	**-**
Total loans to customers	**11,236.3**	**(112.2)**	**11,124.1**	**100.0%**

	Gross loan assets £m	Impairment provisions £m	Net loan assets £m	%
30 September 2016				
Buy-to-let mortgages	9,700.0	(78.8)	9,621.2	89.6%
Owner-occupied mortgages	28.5	(9.1)	19.4	0.2%
Total first residential mortgages	9,728.5	(87.9)	9,640.6	89.8%
Second charge mortgage loans	530.3	(3.5)	526.8	4.9%
Loans secured on residential property	10,258.8	(91.4)	10,167.4	94.7%
Development finance	9.1	-	9.1	0.1%
Commercial mortgages	3.4	(0.5)	2.9	-
Loans secured on property	10,271.3	(91.9)	10,179.4	94.8%
Motor finance loans	96.0	(0.7)	95.3	0.9%
Other consumer loans	213.1	(18.0)	195.1	1.8%
Asset finance loans	252.6	(2.2)	250.4	2.3%
Factoring and discounting balances	17.4	(0.5)	16.9	0.2%
Other loans	0.4	-	0.4	-
Total loans to customers	10,850.8	(113.3)	10,737.5	100.0%

Impairment provisions at 30 September 2017 shown above include collectively assessed provisions of £4.4m (2016: £4.8m). Of these provisions £2.4m (2016: £2.9m) related to buy-to-let mortgages, £0.2m (2016: £0.3m) to second charge mortgage loans, £0.3m (2016: £0.2m) to car loans and £1.5m (2016: £1.4m) to asset finance loans.

An analysis of the movements in impairments provisions is given in note 35 to the Group Accounts. An analysis of this movement between specific and collectively assessed provisions has not been given due to the immateriality of the collectively assessed element.

First mortgages and second charge mortgage loans are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities. Development finance facilities are secured by a charge over the property and a number of other charges related to the build. Motor finance and asset finance loans are effectively secured by the financed asset.

The Group does not utilise any form of credit risk mitigation in respect of loan assets beyond the security provided by its customers under their loan agreements.

Other consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount.

All of the loans shown allow the customer to repay the balance early and this facility is often used, especially for mortgage loans. It is therefore considered that an analysis of these balances by contractual maturity would not provide useful information. An analysis of the contractual due dates for motor finance and asset finance loans is given in note 34 to the Group Accounts.

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 provide evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement.

In its underwriting of buy-to-let mortgage loans the Group's processes address the potential customers' business models to assess their sustainability, based on the Group's understanding of rental markets.

Despite the existence of the security described above, 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 2017 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2017	**2017**	2016	2016
	First mortgages	**Secured loans**	First mortgages	Secured loans
	%	**%**	%	%
Loan to value ratio				
Less than 70%	**62.1**	**56.7**	60.7	50.9
70% to 80%	**25.0**	**17.5**	23.4	17.8
80% to 90%	**9.5**	**11.5**	11.3	13.0
90% to 100%	**1.3**	**7.1**	2.2	8.9
Over 100%	**2.1**	**7.2**	2.4	9.4
	100.0	**100.0**	100.0	100.0
Average loan to value ratio	**66.3**	**70.0**	67.1	72.7
of which				
Buy-to-let	**66.4**		67.2	
Owner-occupied	**30.9**		27.5	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 2.0% in the year ended 30 September 2017 (2016: 5.3%). The increase in average prices, however, is part of a more volatile picture, which has been particularly marked at the local and regional level. The Group maintains a specialist team of in-house surveyors to maximise its understanding of particular markets, both from a valuation and lettings standpoint.

The Group conducts valuations of properties given as security at the inception of loans and updates the valuations from time to time as part of its arrears management process, typically conducting drive-by or full valuations as accounts move through arrears states. LTV amounts shown above are based on the most recent valuation of each property on the Group's records.

In determining appropriate allowances for impairment, the most recent valuation of the security will be used, with a discount reflecting the potential impact of a forced sale.

An analysis of those loan accounts secured on property, classified by property location, by value at 30 September 2017 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2017	2016
	£m	£m
Region		
Greater London	**1,812.6**	1,734.1
South East	**3,156.2**	2,991.5
South West	**977.8**	991.2
East Anglia	**324.9**	342.5
East Midlands	**547.0**	545.2
West Midlands	**499.2**	498.1
North	**381.4**	390.6
North West	**1,075.6**	1,065.0
Yorkshire and Humberside	**1,020.0**	1,054.4
Total England	**9,794.7**	9,612.6
Northern Ireland	**20.1**	22.9
Scotland	**181.0**	181.7
Wales	**369.1**	375.6
Total United Kingdom	**10,364.9**	10,192.8

The amount analysed above represents the current balance of live loans before provision and includes £9,870.0m (2016: £9,657.5m) of first mortgage assets and £494.9m (2016: £535.3m) of second charge mortgage loans. The reconciliation of these amounts to the carrying values is shown in the aged analysis later in this section.

The majority of the Group's lending, excluding asset finance, is to consumers.

The broad industrial sectors to which the Group's asset finance business, acquired in 2016, has credit exposure are set out below. All of the activities take place in the UK.

	2017	2016
	£m	£m
Broadcast and audio	**27.8**	27.9
Veterinary services	**8.8**	7.4
Construction and plant hire	**138.5**	79.6
Print	**24.4**	23.6
Engineering	**9.1**	5.4
Distribution	**17.1**	11.2
Property	**1.9**	1.1
Forestry and agriculture	**8.8**	5.6
Waste	**4.3**	17.9
Packaging	**2.9**	0.4
Local authority	**17.3**	14.7
Travel	**2.3**	-
Other transport	**19.3**	20.1
Other manufacturing	**13.3**	14.8
Other services	**62.3**	40.9
Total	**358.1**	270.6

The nature of the assets providing security for asset finance loans is analysed below:

	2017	2016
	£m	£m
Asset finance		
Broadcast and audio	**26.6**	27.2
Veterinary services	**8.8**	7.4
Computer hardware and software	**3.2**	5.2
Gym equipment	**1.4**	1.9
Printing equipment	**29.1**	27.8
Other equipment and receivables	**11.3**	7.7
Contractors plant	**32.2**	30.4
Plant and equipment	**94.5**	51.3
Commercial vehicles and cars	**84.2**	61.1
Refuse collection vehicles	**29.9**	21.1
Machine tools	**9.9**	9.4
Forestry and agricultural equipment	**8.8**	5.1
Total asset finance	**339.9**	255.6
Commercial mortgages	**3.3**	2.9
Invoice discounting	**14.9**	12.1
Total	**358.1**	270.6

Collectively assessed impairment provisions for asset finance loans are determined on a portfolio-wide basis. No analysis of the specific provision by industrial sector has been presented as the total amount is immaterial.

The Group conducts detailed analysis of customer servicing risk indicators across its portfolios, analysing some 385 million pieces of customer data each month to identify potential future arrears cases. The Group's customer servicing teams then work with the identified customers to prevent the accounts falling into arrears where possible.

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 2017, compared to the industry averages at that date published by UKF and the Finance and Leasing Association ('FLA'), was:

	2017	2016
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.08**	0.11
Buy-to-let accounts excluding receiver of rent cases	**0.02**	0.02
Owner-occupied accounts	**3.55**	3.23
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.45**	0.52
Buy-to-let accounts excluding receiver of rent cases	**0.41**	0.47
Owner-occupied accounts	**0.95**	1.03
All mortgages	**0.86**	0.94
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	**17.55**	17.15
Post-2010 originations	**0.06**	0.00
Legacy cases	**16.75**	16.33
Purchased assets	**19.69**	17.86
FLA data for secured loans	**10.70**	12.40
Car loans		
Accounts more than 2 months in arrears	**0.67**	0.30
FLA data for point of sale hire purchase	**1.70**	1.50
Asset finance loans		
Accounts more than 2 months in arrears	**0.97**	0.82
FLA data for business lease / hire purchase loans	**0.60**	0.60
Other loans		
Accounts more than 2 months in arrears	**96.03**	96.35

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 UKF, the comparative industry figures above have been amended.

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

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 UKF 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 figures shown above for second charge mortgage 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. However, this will lead to higher than average reported arrears.

The worsening in the arrears position for car loans shown above is due to the increase in portfolio size and the time taken for the bigger portfolio to season.

The payment status of the carrying balances of the Group's loan assets, before provision for impairment, at 30 September 2017 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 include 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

	2017	2016
	£m	£m
Not past due	**9,724.2**	9,528.1
Arrears less than 3 months	**112.6**	82.1
Performing accounts	**9,836.8**	9,610.2
Arrears 3 to 6 months	**1.1**	2.4
Arrears 6 to 12 months	**1.9**	2.8
Arrears over 12 months	**7.7**	11.0
Possessions and similar cases	**22.5**	31.1
Impairment population	**33.2**	47.3
Total gross balances	**9,870.0**	9,657.5
Impairment provision on live cases	**(12.7)**	(16.4)
Timing adjustments	**(1.8)**	(0.5)
Carrying balance	**9,855.5**	9,640.6

Consumer and Asset Finance

	Second charge mortgage loans	**Motor finance loans**	**Asset finance loans**	**Total**
	£m	**£m**	**£m**	**£m**
30 September 2017				
Not past due	**400.8**	**158.0**	**315.3**	**874.1**
Arrears less than 2 months	**20.5**	**5.0**	**10.0**	**35.5**
Performing accounts	**421.3**	**163.0**	**325.3**	**909.6**
Arrears 2 to 6 months	**14.9**	**0.7**	**0.5**	**16.1**
Arrears 6 to 9 months	**7.1**	**0.2**	**0.7**	**8.0**
Arrears 9 to 12 months	**5.4**	**0.1**	**-**	**5.5**
Arrears over 12 months	**46.2**	**0.3**	**0.1**	**46.6**
Specifically impaired asset finance cases	**-**	**-**	**2.7**	**2.7**
Impairment population	**73.6**	**1.3**	**4.0**	**78.9**
Total gross balances	**494.9**	**164.3**	**329.3**	**988.5**
Impairment provision on live cases	**(2.1)**	**(1.2)**	**(3.1)**	**(6.4)**
Timing adjustments	**(2.1)**	**(0.1)**	**(1.2)**	**(3.4)**
Carrying balance	**490.7**	**163.0**	**325.0**	**978.7**
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

Other consumer loans

	2017	2016
	£m	£m
Not past due	**6.7**	4.1
Arrears less than 3 months	**0.3**	0.3
Performing accounts	**7.0**	4.4
Arrears 1 to 3 months	**0.5**	0.4
Arrears 3 to 6 months	**0.9**	0.7
Arrears 6 to 12 months	**2.9**	2.3
Arrears over 12 months	**223.6**	203.5
Impairment population	**227.9**	206.9
Total gross balances	**234.9**	211.3
Impairment provision on live cases	**(15.8)**	(16.4)
Timing adjustments	**-**	-
Carrying balance	**219.1**	194.9

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.

Under the CRD, mortgages are past due if repayments are 90 days or more in arrears at the accounting date. The Group closely monitors arrears of loan repayments and impairment provisions are made where appropriate. The Group's accounting policy for impairments of loan assets is set out in note 4 to the Group Accounts and full details of movements in impairment provisions are set out in note 35 to the Group Accounts.

For capital adequacy purposes, collectively assessed credit impairment allowances are considered to be Tier 2 capital. This amount is capped at 1.25% of risk weighted assets.

Acquired assets

In the debt purchase industry, Estimated Remaining Collections ('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 are set out below. These are derived using the same models and assumptions used in the IAS 39 Effective Interest Rate ('EIR') calculations, but the differing bases of calculation lead to different outcomes. Amounts shown include loans disclosed as first mortgages and other loans, within loans to customers.

	Carrying value	**84 month ERC**	**120 month ERC**
	£m	**£m**	**£m**
30 September 2017	**503.5**	**608.9**	**688.8**
30 September 2016	**533.9**	**651.3**	**740.7**

Development Finance

Development finance loans do not require customers to make payments during the life of the loan, therefore arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. At 30 September 2017, this monitoring showed no accounts in default. The average loan to gross development value ratio for the portfolio at year end, a measure of security cover, was 60.6%.

Trade Debtors

The Group's trade debtors balance represents principally amounts outstanding on unpaid operating lease obligations in the asset finance business, where similar acceptance criteria as are used for finance lease cases apply.

6
ASSET ENCUMBRANCE

This section sets out

- An overview of the Group's overall exposure to asset encumbrance
- An analysis of encumbered assets as disclosed in the Group Accounts
- The asset encumbrance template disclosures required under CRD IV

Asset encumbrance is the process by which assets are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn. The Group maintains a level of encumbrance commensurate with the scale and scope of its business operation, within the context of a robust and diversified funding capability. The majority of encumbrance arises from its securitisation transactions and from activity in connection with Bank of England facilities intended to support lending. Assets are encumbered in accordance with the contractual requirements of these transactions.

Unencumbered assets include cash-on-hand, un-securitised loan assets, derivative assets, property, plant and other fixed assets, intangible assets including goodwill, and deferred tax assets.

Certain of the Group' buy-to-let mortgage assets have been utilised as whole mortgage pools for the purpose of the Funding for Lending Scheme ('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 £109.0m (2016: £108.8m).

During the year the Bank has also drawn down funding under the Term Funding Scheme ('TFS'), again utilising whole mortgage pools, to support new lending. This funding scheme is based on the value of the pledged assets, subject to a haircut. At 30 September 2017 £700.0m had been drawn under the TFS (2016: £nil).

During the year the Bank also participated in the Bank of England Indexed Long-Term Repo scheme ('ILTR') again encumbering assets. Further mortgage assets of the Bank have been pre-positioned with the Bank of England for use in the FLS, TFS and other funding schemes.

Responsibility for monitoring the Group's use of asset encumbrance in financial transactions lies with ALCO.

An analysis of the Group's loan assets between assets held within securitisation structures, those within warehouse structures awaiting securitisation, those utilised for the FLS and TFS or prepositioned with the Bank of England and other loan assets is shown below.

	First Mortgages	Consumer Finance	Other	Total
	£m	£m	£m	£m
30 September 2017				
In respect of:				
Asset backed loan notes	**5,328.8**	**270.5**	**-**	**5,599.3**
Warehouse facilities	**1,449.3**	**-**	**-**	**1,449.3**
Central bank facilities	**1,224.9**	**-**	**-**	**1,224.9**
Total pledged as collateral	**8,003.0**	**270.5**	**-**	**8,273.5**
Prepositioned with Bank of England	**122.1**	**-**	**-**	**122.1**
Other assets not pledged as collateral	**1,730.4**	**439.3**	**558.8**	**2,728.5**
	9,855.5	**709.8**	**558.8**	**11,124.1**
30 September 2016				
In respect of:				
Asset backed loan notes	6,845.8	413.8	0.1	7,259.7
Warehouse facilities	1,762.1	-	-	1,762.1
Central bank facilities	192.2	-	-	192.2
Total pledged as collateral	8,800.1	413.8	0.1	9,214.0
Prepositioned with Bank of England	428.1	-	-	428.1
Other assets not pledged as collateral	412.4	308.1	374.9	1,095.4
	9,640.6	721.9	375.0	10,737.5

At 30 September 2017 63.3% (2016: 84.0%) of the carrying value of the Group's loans to customers was funded by securitisations and structures affecting the credit risk exposure of the Group in a similar way (see Section 10).

The Group manages its level of encumbrance in accordance with the approved limits within its liquidity and funding risk strategies, and endeavours to ensure that a ratio covering depositor liabilities with unencumbered assets is maintained during normal business conditions. It continues to work closely with the regulators to ensure that its encumbrance profile remains transparent, proportionate and relevant to the business model.

In accordance with the threshold criteria under PRA supervisory statement SS11/14 (CRD IV: Compliance with the EBA's Guidelines on the disclosure of encumbered and unencumbered assets), the Group is not required to report on the fair value of encumbered and unencumbered collateral received. Furthermore, the statement requires that the data is presented as a median calculation rather than point in time.

The disclosures below are drawn up in accordance with templates A and C set out in the EBA guidelines (EBA/GL/2014/03). This means they will differ to the asset encumbrance disclosures presented in the Group Accounts, due to scope and definition differences.

Assets (Template A)

This sets out the assets of the Group, analysed between those pledged as security or otherwise encumbered and unencumbered assets, both at their carrying amounts and fair values (where reported), split by category of asset, and in some cases, further analysed. It should be noted that the template may not provide sub-categories for all balances within an individual category.

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	£m	£m	£m	£m
At 30 September 2017				
Assets of the reporting institution	**9,689.0**	**N/A**	**4,189.9**	**N/A**
Loans on demand	**553.9**	**N/A**	**943.0**	**N/A**
Debt securities	**-**	**-**	**-**	**-**
Of which: issued by general government	**-**	**-**	**-**	**-**
Loans and advances other than loans on demand	**8,169.3**	**N/A**	**3,027.6**	**N/A**
Of which: mortgage loans	**7,978.0**	**N/A**	**1,878.6**	**N/A**
Other assets	**965.8**	**N/A**	**219.3**	**N/A**
At 30 September 2016				
Assets of the reporting institution	13,096.1	N/A	434.1	N/A
Loans on demand	842.5	N/A	391.7	N/A
Debt securities	-	-	7.1	7.1
Of which: issued by general government	-	-	7.1	7.1
Loans and advances other than loans on demand	10,710.5	N/A	27.6	N/A
Of which: mortgage loans	10,059.3	N/A	6.5	N/A
Other assets	1,543.1	N/A	7.7	N/A

Encumbered Assets / Collateral Received and associated liabilities (Template C)

This table sets out those of the Group's liabilities and contingent liabilities in respect of which it has given security, or otherwise encumbered assets, set out in the left-hand column. In the right-hand column is set out the value of the Group's assets or collateral to which it is entitled, which are encumbered in respect of those liabilities.

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	£m	£m
At 30 September 2017		
Carrying amount of selected financial liabilities	**7,806.7**	**10,410.4**
Debt Securities issued	**7,806.7**	**10,410.4**
Of which: cover bonds issued	-	-
Of which: asset-backed securities issued	**7,806.7**	**10,410.4**
Other sources of encumbrance	**1,306.7**	-
Other	**1,306.7**	-
Total sources of encumbrance	**9,113.4**	**10,410.4**

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	£m	£m
At 30 September 2016		
Carrying amount of selected financial liabilities	8,593.0	14,280.3
Debt Securities issued	8,593.0	14,280.3
Of which: cover bonds issued	-	-
Of which: asset-backed securities issued	8,593.0	14,280.3
Other sources of encumbrance	3,449.2	-
Other	3,449.2	-
Total sources of encumbrance	12,042.2	14,280.3

7
COUNTERPARTY CREDIT RISK

This section sets out

- An overview of the Group's policy on counter-party credit exposure
- The Group's institutional exposures and the ratings used for these balances

The Group's Treasury Policy statements include policies covering liquidity risk, interest risk, foreign exchange risk and counterparty risk, which are used to manage the credit risk that arises from exposures to treasury counterparties. The Counterparty Policy limits the Group's exposure to individual counterparties and compliance with the policy is reviewed monthly by ALCO. The Group requires all counterparties with which it contracts to meet specific credit rating criteria.

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. Exposure is monitored daily by senior management within the Group's Treasury function and is reported monthly to ALCO. 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. This is the only credit mitigation technique used by the Group. The amounts of these cash collateral deposits, which do not form part of the Group's cash position, are shown below.

While the Group's counterparty credit risk policies cover all of its institutional exposures, the CRR defines counterparty credit risk for the Group as the credit risk relating to its derivative asset exposures only.

Derivative financial assets

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, and the Credit Quality Step ('CQS') to which these are mapped by the regulator, is set out below.

		Carrying value		Exposure value	
		2017	2016	**2017**	2016
		£m	£m	**£m**	£m
Counterparties rated					
AA-	(CQS 1)	**213.3**	218.7	**52.8**	43.7
A+	(CQS 2)	**41.8**	58.1	**29.5**	29.0
A	(CQS 2)	**615.4**	969.2	**365.3**	484.6
BBB+	(CQS 3)	**36.1**	120.4	**22.2**	60.2
Gross exposure		**906.6**	1,366.4	**469.8**	617.5
Collateral amounts posted		**(723.6)**	(1,184.2)	**(211.0)**	(326.8)
Net exposure		**183.0**	182.2	**258.8**	290.7

The values shown above are calculated as the fair value of the assets at the balance sheet date in accordance with the provisions of IFRS 13 – 'Fair Value Measurement'. The exposure values are calculated according to the Standardised Approach for risk weighting and include allowances for potential future exposure ('PFE') on all derivatives whether they are currently assets or liabilities.

The reduction in exposure value shown against the collateral amounts posted represents the impact on risk weighted assets of the use of the collateral for the purpose of credit risk mitigation.

Cash collateral deposits placed by derivative counterparties are held with UK banks or other entities which satisfy a minimum rating of at least F1 and a long term default rating of A by Fitch, and similar ratings by other agencies. These deposits will therefore always qualify for CQS1.

The only financial instruments to which the Group is a party which require the posting of collateral are certain interest rate swaps in Paragon Bank documented under the International Swaps and Derivatives Association ('ISDA') Master Agreement. For certain counterparties to such swaps a Credit Support Annex ('CSA') has been executed, and the amount of collateral posted under such CSA agreements at 30 September 2017 was £2.0m (30 September 2016: £3.7m). This amount remains on the Group balance sheet.

Short term investments

The Group's short term investments were held within the Bank and formed 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 was judged to be minimal. Due to the Group's use of the FLS and central bank deposit facilities, it ceased to invest in such items in the year.

Cash and cash equivalents

Thr Group's cash balances are held in sterling at the Bank of England and 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.

The list of institutions where the Group's cash balances may be placed is agreed annually by ALCO, but kept under permanent review by the Treasury function. Counterparties for corporate deposits must be rated at least P-2 by Moody's and / or A-2 by Standard and Poors and / or F2 by Fitch Ratings. Counterparties for deposits in SPV ('Special Purpose Vehicle') companies must be rated at least P-1 by Moody's and / or A-1 by Standard and Poors and / or F1 by Fitch Ratings.

The SPV deposits, which comprise the greatest proportion of the Group's cash position, will therefore always qualify for CQS1, with other deposits qualifying for at least CQS2. Credit risk on these balances and the interest accrued thereon is considered to be minimal.

Summary of exposures

The Group's counterparty credit risk exposures can be summarised as shown below.

	Carrying value		**Exposure value**	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Institutional exposures				
Derivative financial assets	**906.6**	1,366.4	**258.8**	290.7
Bank deposits	**881.9**	922.6	**176.3**	184.5
Total institutional exposures	**1,788.5**	2,289.0	**435.1**	475.2
Sovereign exposures				
Short-term investments	**-**	7.1	**-**	-
Central bank deposits	**615.0**	315.0	**-**	-
CRDs	**1.6**	-	**-**	-
Total sovereign exposures	**616.6**	322.1	**-**	-
Total counterparty credit exposures	**2,405.1**	2,611.1	**435.1**	475.2

8
INTEREST RATE RISK

This section sets out

- An overview of the Group's exposure to interest rate risk
- The sources of that risk
- The Group's approach to controlling the risk
- An illustration of the Group's sensitivity to movements in interest rates

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. The Group does not seek to generate income from taking interest rate risk and aims to minimise exposures that occur as a natural consequence of carrying out its normal business activities.

The Group has no trading book, so all of its interest rate risk is classified as interest rate risk in the banking book ('IRRBB') in the terms used by CRD IV.

IRRBB is the risk of loss of income from movements in interest rates. Such losses can occur because of the differing characteristics of the various elements within the balance sheet and mismatches between balances with the same characteristics on opposite sides of the balance sheet.

It has been established in the ICAAP that the interest rate risks to which the Group is most exposed if mitigating action is not taken, are re-pricing and basis risk.

IRRBB EXPOSURES

Risk exposure in the Group's operations might occur through:

- Gap or re-pricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times moving by different amounts
- Basis risk. The risk arising where assets and liabilities re-price with reference to different reference interest rates, for example Bank of England base rate and LIBOR ('London Interbank Offered Rate'). Relative changes in the difference between rates over time may impact earnings
- Option or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

Due to the maturity transformation inherent in the Group's business model it is also exposed to the risk that the relationship of the market rates affecting the shorter-term funding balance to those affecting the longer-term lending balance will have altered when the funding has to be refinanced.

MANAGING IRRBB

The Group has a dedicated Treasury function which is responsible for the day-to-day management of interest rate risk within Board approved limits. Control and oversight is provided by ALCO who report to the Risk and Compliance Committee.

The Group's risk management framework for IRRBB has been enhanced over the last year to reflect the BCBS Principles and methods expected to be used by banks for measuring, managing, monitoring and controlling such risks. The Group will continue to develop these processes as interpretation of these standards becomes clearer as they become more widely implemented.

IRRBB is managed through Board approved risk appetite limits and policies. The Group seeks to match the structure of assets and liabilities naturally where possible or by using appropriate financial instruments, such as interest rate swaps.

The Group measures IRRBB risks through a combination of economic value and earnings-based measures considering prepayment risk:

- Economic Value of Equity ('EVE'). A range of parallel and non-parallel interest rate stresses are applied to assess the change in market value from assets, liabilities and off-balance sheet items re-pricing at different times.

- Net Interest Income ('NII'). Impact on earnings from a range of interest rate stresses.

The Group has performed stress testing in order to assess whether a Pillar 2a add-on is required for interest rate risk and capital has been provided in accordance with the results.

INTEREST RATE SENSITIVITY

The sensitivity of the Group's earnings to movements in UK interest rates is illustrated below. This table shows the effect of a 1.0% movement in interest rates on the annual interest payable or receivable on those of the Group's assets and liabilities which bear interest at variable rates, based on the balances outstanding on such assets and liabilities at 30 September 2017 and 30 September 2016. For the purpose of this disclosure, movements in bank base rates and market interest rates are assumed to be broadly parallel and movements in market rates are assumed to be passed on immediately to borrowers and depositors where rates are in the Group's control.

	2017	2016
	£m	£m
Variable rate mortgage loans	**69.4**	72.5
Variable rate consumer loans	**5.8**	6.9
Portfolio hedging on fixed rate loans	**22.5**	18.4
Interest bearing cash balances	**13.6**	11.6
Sterling equivalent principal of FRN and warehouse borrowings	**(68.9)**	(98.6)
TFS funding at bank base rate	**(7.0)**	-
Variable rate retail deposits	**(9.4)**	(5.4)
Portfolio hedging on fixed rate retail deposits	**(13.7)**	(3.5)
	12.3	1.9

It should be noted that such a change in rates might have other impacts on the Group's performance and that the extent to which increases in rates can be passed on to certain customers may be limited by commercial and regulatory factors.

The sensitivity set out above is illustrative only, and much simplified from those used to manage IRRBB in practice.

9
LIQUIDITY RISK

This section sets out

- An overview of the Group's exposure to liquidity risk and liquidity position
- The Group's approach to managing this risk
- Key metrics relating to liquidity risk
- Sources of further available liquidity

Liquidity risk exposure represents the amount of potential stressed outflows in any future period less expected inflows. Liquidity is considered from both an internal and a regulatory perspective. The Group's most material source of liquidity risk arises from the Bank's obligations to retail depositors and that exposure, which is subject to PRA regulation is considered here.

The Board has set a liquidity risk appetite which aims to ensure a sufficient level of liquidity is held to cover any unexpected outflows, such that the Group is always able to meet its short-term commitments, as required. The risk appetite set takes in to consideration appropriate liquidity risk stresses to ensure liquidity remains appropriate throughout a target survival period.

The Group retail funding strategy is focused on building a stable mix of deposit products. A high proportion of balances, 98.8%, are protected by the Financial Services Compensation Scheme ('FSCS') which mitigates against the possibility of a retail run.

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

	2017	2016
	£m	£m
Payable in less than one year or on demand	**2,259.1**	1,036.8
Payable in one to two years	**795.5**	596.0
Payable in two to five years	**687.4**	312.9
	3,742.0	1,945.7

In order to reduce the liquidity risk inherent in the Group's retail deposit balances, the PRA requires that the Bank, like other regulated banks, maintains a buffer of liquid assets to ensure it has sufficient available funds at all times to protect against unforeseen circumstances. The amount of this buffer is calculated using Individual Liquidity Guidance ('ILG') set by the PRA based on the ILAAP submitted by the Bank. The ILAAP determines the liquid resources that must be maintained in the Bank to meet its Overall Liquidity Adequacy Requirement ('OLAR') and to ensure that it can meet its liabilities as they fall due. It is based on an analysis of its forecast cash requirements and their predicted behaviour in stressed conditions.

At 30 September 2017 the liquidity buffer of High Quality Liquid Assets ('HQLA') comprised the following on and off balance sheet assets, all held within the Bank.

	2017	2016
	£m	£m
Balances with central banks	**615.0**	315.0
Short term investments	**-**	7.1
Total on balance sheet liquidity	**615.0**	322.1
FLS drawings	**109.0**	108.8
Total HQLA	**724.0**	430.9

RISK MONITORING

To protect the Group and its customers against the effects of liquidity risk, the Group performs regular assessments of its liquidity position through meetings of the Liquidity Outlook Group ('LOG'), ALCO and the Internal Liquidity Adequacy Assessment Process ('ILAAP').

LOG meetings occur weekly and comprise senior operational, treasury, finance and savings managers who meet to ensure a sufficient liquidity position is being held as well as to forecast any upcoming liquidity surplus or deficits to ensure appropriate action can be taken. The outcomes and key findings from LOG meetings are then escalated to ALCO meetings to ensure a clear and consistent communication line is maintained.

Through the LOG process, the Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its HQLA relative to its short term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement is set through regulation for all regulated financial institutions. The Bank also monitors its Net Stable Funding Ratio ('NSFR') which measures the stability of the funding profile in relation to the composition of its assets and off-balance sheet activities.

Through the ILAAP the Group assesses the level of liquidity required to prudently cover a wide variety of systemic and idiosyncratic risks. This process identifies a liquidity buffer for the Group to hold in order to cover such circumstances.

KEY LIQUIDITY INDICATORS

Key liquidity indicators for regulatory purposes are monitored at the level of the firm, rather than the consolidated group. The only entity within the Group subject to such regulation is the Bank, and its liquidity measures are set out below.

Indicator	**2017**	**2016**	**Regulatory minimum**	
			Current	**Future**
LCR	246%	451%	90%	100% †
NSFR	110%	149%	-	100% ‡

† From 1 January 2018
‡ From 1 January 2019

The LCR is designed to ensure financial institutions have the necessary HQLA on hand to cover net cash outflows during a 30-day period in a liquidity stress scenario. Various inflow and outflow rates are prescribed for assets and liabilities to reflect their assumed behaviour in stressed conditions.

The NSFR measures the amount of longer-term, stable sources of funding used by financial institutions in relation to the composition of their assets and off-balance sheet activities. Various weightings are prescribed for the components of stable funding and the assets being financed.

The above ratios are likely to normalise as the scale of the Bank's activities grow.

POTENTIAL LIQUIDITY

At 30 September 2017 the Group had £2,850.6m of unencumbered loan assets at carrying value, which might be used to generate liquidity either as security for debt, or through sales (30 September 2016: £1,523.5m). Of these £122.1m had been pre-positioned with the Bank of England, giving rapid access to central bank funding (2016: £428.1m).

This provides the Group with the ability to raise funds at short notice, if required, and therefore aids the liquidity position.

Available cash at the year end, excluding balances included in HQLA and already charged balances, was £305.5m (2016: £383.1m).

FURTHER INFORMATION

More details on the Group's wider, longer term liquidity exposure is given in note 10 to the Annual Report.

10
SECURITISATION

This section sets out

- The Group's involvement in securitisation
- The location of the information required to be disclosed under Part 8

One of the Group's principal sources of funding is asset securitisation. The largest part of this funding relates to securitisations issued under the 'Paragon Mortgages' programme but other issues have been made from time to time to support other parts of the business. In each of these transactions a group company acts as issuer of the securitised debt and group companies act as administrator of the assets after the completion of the deal.

The strategy underlying the Group's securitisation activities is to gain access to attractive funding rates for its lending activities and to mitigate liquidity risk by match funding the underlying loan assets. The structures are not intended to achieve significant transfer of credit risk away from the Group. The risk relating to the underlying assets therefore remains with the Group and is included in the credit risk analyses in this document.

All of the Group's loan assets funded through securitisation are included in 'loans to customers' in the Group Accounts and risk weighted accordingly. The amount of the Group's loan assets funded through securitisation is shown in Section 6 – 'Asset Encumbrance'.

There are no specific capital requirements for the Group's securitisation vehicle companies.

The Group has no exposures to purchased securitisation positions.

FURTHER INFORMATION

A more detailed description of the Group's securitisation activities and how they affect the Group's risk profile and contribute to its risk management objectives is given in note 10 to the Group Accounts.

Further information on the Group's securitisations, including average funding rates, outstanding balances and redemption dates, on a transaction by transaction basis is provided in note 45 to the Group Accounts and detailed information on each of the Group's public securitisation transactions is published in the 'Bond Investor' section of the Group's corporate website at www.paragonbankinggroup.co.uk.

11
REMUNERATION POLICIES AND PRACTICES

This section sets out

- The basis on which the Group is required to disclose information on remuneration under CRD IV
- The location of relevant disclosures on remuneration

Paragon Bank is required to prepare Remuneration Code Pillar III disclosures in addition to the regulatory capital disclosures. These disclosures are the subject of a separate, stand-alone document and are published on the Paragon Bank website, www.paragonbank.co.uk, on an annual basis.

PRA Supervisory Statement LSS8/13 'Remuneration Standards: the application of proportionality' (updated June 2015) categorises Paragon Bank within proportionality level 3, as a bank with total assets less than £15 billion, reducing the level of disclosures required by Part 8. This supervisory statement also sets out the PRA view that the requirement for remuneration disclosures applies only to CRR firms directly.

It should be noted that following the Group's reorganisation, from 20 September 2017, the directors of the Company have also constituted the Board of Directors of the Bank.

FURTHER INFORMATION

Information on the remuneration of the directors and senior personnel of the Group is contained in the Directors' Remuneration Report presented as Section B5 of the Group Accounts. This report includes:

- Details of the operations of the Remuneration Committee, including its membership and the number of meetings held
- The design of variable remuneration, including share based awards, and the vesting and deferral criteria applied
- Details of the Group's external advisers on remuneration
- The Group's remuneration policy statement, which includes policies on levels and forms of remuneration, initial arrangements and severance provisions

12
GLOSSARY

This section sets out

- A listing of defined terms used in the document.

ALCO	Asset and Liability Committee
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
CCoB	Capital Conservation Buffer
CCyB	Counter Cyclical Buffer
CET1	Common Equity Tier 1
CFO	Chief Financial Officer
CQS	Credit Quality Step
CRD	Capital Requirements Directive
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSA	Credit Support Annex
C-SREP	Capital Supervisory Review and Evaluation Process
EBA	European Banking Authority
ECAI	External Credit Assessment Institutions
EIR	Effective Interest Rate
ERC	Estimated Remaining Collections
ESOP	Employee Share Ownership Plan
EU	European Union
EVE	Economic Value of Equity
FCA	Financial Conduct Authority
FLA	Finance and Leasing Association
FLS	Funding for Lending Scheme
FPC	Financial Policy Committee (of the Bankof England)
FRC	Financial Reporting Council
FRN	Floating Rate Note
FSCS	Financial Services Compensation Scheme
Group Accounts	Annual Report and Accounts of Paragon Banking Group PLC for the year ended 30 September 2017
HQLA	High Quality Liquid Assets
ICAAP	Internal Capital Adequacy Assessment Process
ICR	Individual Capital Requirement
ILAAP	Internal Liquidity Adequacy Assessment Process
ILG	Individual Liquidity Guidance
ILTR	Bank of England Indexed Long-Term Repo scheme
IMLA	Intermediary Mortgage Lenders Association
IRB	Internal Ratings Basis
IRRBB	Interest Rate Risk in the Banking Book
ISDA	International Swaps and Derivatives Association

LCR	Liquidity Coverage Ratio
LIBOR	London Interbank Offered Rate
LOG	Liquidity Outlook Group
L-SREP	Liquidity Supervisory Review and Evaluation Process
LTV	Loan to value
MCR	Minimum Capital Requirement
MRC	Model Risk Committee
NII	Net Interest Income
NSFR	Net Stable Funding Ratio
OLAR	Overall Liquidity Adequacy Requirement
ORCC	Operational Risk and Compliance Committee
PAF	Paragon Asset Finance
Plan	The defined benefit pension plan operated by the Group
PRA	Prudential Regulation Authority
RCC	Risk and Compliance Committee
Regulatory minimum / maximum	Where applicable, the minimum or maximum levels set by the PRA, FCA or other regulatory bodies
Risk appetite	The maximum level of risk the Group is prepared to take to meet its strategic objectives
Risk appetite limit	The level of risk which, if breached, would require immediate corrective action and escalation to the RCC or Board
Riskappetite target	The level at or range within which the Group would, in normal circumstances, wish to operate
Risk appetite trigger	The level at which escalation will occur to the next RCC because the risk profile is sufficiently close to the risk appetite limit to warrant corrective actions being considered
Risk capacity	The maximum level of risk at which the Group can operate whilst remaining within the constraints implied by capital and funding needs and the obligations to its stakeholders
Risk profile	The Group's entire risk landscape reflecting the nature and scale of its risk exposures aggregated within and across each relevant risk category
RWA	Risk Weighted Assets
SA	Standardised Approach
SME	Small and / or Medium Sized Enterprise
SPV	Special Purpose Vehicle
SREP	Supervisory Review and Evaluation Process
TFS	Term Funding Scheme
The Bank	Paragon Bank PLC
The Company	Paragon Banking Group PLC
The Group	Paragon Banking Group PLC and all its subsidiary entities
TRE	Total Risk Exposure
UK	United Kingdom

Appendix A
OWN FUNDS DISCLOSURES

CAPITAL INSTRUMENTS' MAIN FEATURES

Presented in accordance with Annex II of Commission Implementing Regulation (EU) No 1423/2013. This disclosure includes the 2005 corporate bond which was redeemed during the year.

		1	2	3
		EQUITY	**2016 CORPORATE BOND**	**2005 CORPORATE BOND**
1	Issuer	Paragon Banking Group PLC	Paragon Banking Group PLC	Paragon Banking Group PLC
2	Unique identifier (eg. CUSIP, ISIN or Bloomberg identifier for price placement)	ISIN GB00B2NGPM57	ISIN XS1482136154	ISIN XS0216276070
3	Governing law(s) of the instrument	England and Wales	England and Wales	England and Wales
REGULATORY TREATMENT				
4	Transitional CRR rules	N/A	N/A	N/A
5	Post-transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2
6	Eligible at solo/(sub-) consolidated	Solo and (sub) consolidated	Solo and (sub) consolidated	Solo and (sub) consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Corporate Bond	Corporate Bond
8	Amount recognised in regulatory capital (currency in million, as most recent reporting date)	£360.5m	£150.0m	-
9	Nominal amount of instrument	£295.5m	£150.0m	£110.0m
9a	Issue price	Nominal value £1 †	Par	99.347%
9b	Redemption price	N/A	Par	Par
10	Accounting classification	Shareholders' Equity	Liability-amortised cost	Liability-amortised cost
11	Original date of issuance	Original listing date 15 May 1989 *	9 September 2016	20 April 2005
12	Perpetual or dated	Perpetual	Dated	Dated
13	Original maturity date	No maturity	9 September 2026	20 April 2017
14	Issuer call subject to prior supervisory approval	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	N/A	Callable by issuer on 9 September 2021 Tax and Regulatory calls also	Tax call only No specified dates
16	Subsequent call dates, if applicable	N/A	N/A	N/A

		1	2	3
		EQUITY	**2016 CORPORATE BOND**	**2005 CORPORATE BOND**
COUPONS / DIVIDENDS				
17	Fixed or floating dividend/ coupon	Floating	Fixed‡	Fixed
18	Coupon rate and related index	N/A	7.25%	3.729%
19	Existence of a dividend stopper	N/A	No	No
20a	Full discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory	Mandatory
20b	Fully discretional, partially discretionary or mandatory (in terms of amount)	Fully discretional	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No	No
22	Noncumulative or cumulative	Non-cumulative	Cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	N/A	N/A	N/A
25	If convertible, fully or partially	N/A	N/A	N/A
26	If convertible, conversion rate	N/A	N/A	N/A
27	If convertible, mandatory or optional conversion	N/A	N/A	N/A
28	If convertible, specify instrument type convertible into	N/A	N/A	N/A
29	If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A
30	Write-down features	N/A	No	No
31	If write-down, write-down trigger(s)	N/A	N/A	N/A
32	If write-down, full or partial	N/A	N/A	N/A
33	If write-down, description of write-down mechanism	N/A	N/A	N/A
34	If temporary write-down, description of write-up mechanism	N/A	N/A	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	2/3	N/A	N/A
36	Non-compliant transitioned features	No	No	No
37	If yes, specify non compliant features	N/A	N/A	N/A

† Shares have been issued at various different premiums from time to time.

* This is the date of the first listing of the Company's ordinary shares. There have been restructurings since that date and further shares have been issued from time to time.

‡ Subject to market based repricing five years after issue.

OWN FUNDS DISCLOSURE

Presented in accordance with Annex IV from the Commission Implementing Regulation (EU) No 1423/2013.

		2017 £M	2016 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
COMMON EQUITY TIER 1 (CET1) CAPITAL: INSTRUMENTS AND RESERVES				
1	Capital instruments and the related share premium accounts	347.0	360.5	26 (1), 27, 28, 29
	Of which: ordinary shares	347.0	360.5	EBA list 26 (3)
2	Retained earnings	784.5	725.9	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	(122.1)	(116.9)	26 (1)
3a	Funds for general banking risk	-	-	26 (1) (f)
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET 1	-	-	486 (2)
5	Minority interests (amount allowed in consolidated CET1)	-	-	84
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	(28.9)	(25.5)	26 (2)
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**980.5**	**944.0**	**Sum of rows 1 to 5a**
COMMON EQUITY TIER 1 (CET1) CAPITAL: REGULATORY ADJUSTMENTS				
7	Additional value adjustments (negative amount)	-	-	34, 105
8	Intangible assets (net of related tax liability) (negative amount)	(104.4)	(105.4)	36 (1) (b), 37
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	-	-	36 (1) (c), 38
11	Fair value reserves related to gains or losses on cash flow hedges	-	-	33 (1) (a)
12	Negative amounts resulting from the calculation of expected loss amounts	-	-	36 (1) (d), 40, 159
13	Any increase in equity that results from securitised assets (negative amount)	-	-	32 (1)
14	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	-	-	33 (1) (b)
15	Defined-benefit pension fund assets (negative amount)	-	-	33 (1) (e), 41
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	-	-	36 (1) (f), 42
17	Direct, indirect and synthetic holding of the CET 1 instruments of financial sector entities, where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	36 (1) (g), 44
18	Direct, indirect and synthetic holding of the CET 1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	36 (1) (h), 43, 45, 46, 49 (2) (3), 79
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	36 (1) (i), 43, 45, 47, 48 (1) (b), 49 (1) to (3), 79

		2017 £M	2016 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
COMMON EQUITY TIER 1 (CET1) CAPITAL: REGULATORY ADJUSTMENTS				
20a	Exposure amount of the following items which qualify for a RW of 1250% where the institution opts for the deduction alternative	-	-	36 (1) (k)
20b	Of which: qualifying holdings outside the financial sector (negative amount)	-	-	36 (1) (k) (i), 89 to 91
20c	Of which: securitisation positions (negative amount)	-	-	36 (1) (k) (ii) 243 (1) (b), 244 (1) (b), 258
20d	Of which: free deliveries (negative amount)	-	-	36 (1) (k) (iii), 379 (3)
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the condition in Article 38 (3) are met (negative amount)	-	-	36 (1) (c), 38, 48 (1) (a)
22	Amount exceeding the 15% threshold (negative amount)	-	-	48 (1)
23	Of which: direct and indirect holding by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-	-	36 (1) (i), 48 (1) (b)
25	Of which: deferred tax assets arising from temporary differences	-	-	36 (1) (c), 38, 48 (1) (a)
25a	Losses for the current financial year (negative amount)	-	-	36 (1) (a)
25b	Foreseeable tax charges relating to CET1 items (negative amount)	-	-	36 (1) (i)
27	Qualifying AT1 deductions that exceed the AT1 Capital of the institution (negative amount)	-	-	36 (1) (j)
28	**Total regulatory adjustments to Common Equity Tier 1 (CET 1)**	**(104.4)**	**(105.4)**	**Sum of rows 7 to 20a, 21, 22 and 25a to 27**
29	**Common Equity Tier 1 (CET1)**	**876.1**	**838.6**	**Row 6 minus row 28**
ADDITIONAL TIER 1 (AT1) CAPITAL INSTRUMENTS				
30	Capital instruments and the related share premium accounts	-	-	51, 52
31	Of which: classified as equity under applicable accounting standards	-	-	
32	Of which: classified as liabilities under applicable accounting standards	-	-	
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	-	486 (3)
34	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	-	-	85, 86
35	Of which: instruments issued by subsidiaries subject to phase out	-	-	486 (3)
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	**-**	**-**	**Sum of rows 30, 33 and 34**

		2017 £M	2016 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
ADDITIONAL TIER 1 (AT1) CAPITAL: REGULATORY ADJUSTMENTS				
37	Direct and indirect holdings by an institution of own AT1 instruments (negative amount)	-	-	52 (1) (b), 56 (a), 57
38	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	56 (b), 58
39	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	56 (c), 59, 60, 79
40	Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	-	56 (d), 59, 79
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	-	-	56 (e)
43	**Total regulatory adjustments to Additional Tier 1 (AT1) Capital**	**-**	**-**	**Sum of rows 37 to 42**
44	**Additional Tier 1 (AT1) capital**	**-**	**-**	**Row 36 minus row 43**
45	**Tier 1 capital (T1 = CET1 + AT1)**	**-**	**-**	**Sum of row 29 and row 44**
TIER 2 (T2) CAPITAL: INSTRUMENTS AND PROVISIONS				
46	Capital instruments and the related share premium accounts	150.0	162.2	62, 63
47	Amount of qualifying items referred to in article 484 (5) and the related share premium accounts subject to phase out from T2	-	-	486 (4)
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	-	-	87, 88
49	Of which: instruments issued by subsidiaries subject to phase out	-	-	486 (4)
50	Credit risk adjustments	4.4	4.8	62 (c) & (d)
51	**Tier 2 (T2) capital before regulatory adjustments**	**154.4**	**167.0**	

		2017 £M	2016 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
TIER 2 (T2) CAPITAL: REGULATORY ADJUSTMENTS				
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	-	-	63 (b) (i), 66 (a), 67
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	66 (b), 68
54	Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in these entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	66 (c), 69, 70, 79
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	-	66 (d), 69, 79
57	**Total regulatory adjustments to Tier 2 (T2) capital**	**-**	**-**	**Sum of rows 52 to 56**
58	**Tier 2 (T2) capital**	**154.4**	**167.0**	**Row 51 minus row 57**
59	**Total capital (TC = T1 + T2)**	**1,030.5**	**1,005.6**	**Sum of row 45 and row 58**
60	**Total risk weighted assets**	**5,508.7**	**5,287.5**	
CAPITAL RATIOS AND BUFFERS				
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	15.9%	15.9%	92 (2) (a)
62	Tier 1 (as a percentage of total risk exposure amount)	15.9%	15.9%	92 (2) (b)
63	Total capital (as a percentage of total risk exposure amount)	18.7%	19.0%	92 (2) (c)
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	9.250%	8.625%	CRD 128, 129, 130, 131, 133
65	Of which: capital conservation buffer requirement	1.250%	0.625%	
66	Of which: countercyclical buffer requirement	-	-	
67	Of which: systemic risk buffer requirement	-	-	
67a	Of which: Global Systematically Important Institution (G-SII) or Other Systematically Important Institution (O-SII) buffer	-	-	
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	7.9%	7.9%	CRD 128
AMOUNTS BELOW THE THRESHOLDS FOR DEDUCTION (BEFORE RISK WEIGHTING)				
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	-	36 (1) (h), 46, 45 56 (c), 59, 60 66 (c), 69, 70
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	-	36 (1) (i), 45, 48
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	-	-	36 (1) (c), 38, 48

		2017 £M	2016 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
APPLICABLE CAPS ON THE INCLUSION OF PROVISIONS IN TIER 2 36 (1) (C), 38, 48				
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	4.4	4.8	62
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	-	-	62
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	-	-	62
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	-	-	62
CAPITAL INSTRUMENTS SUBJECT TO PHASE-OUT ARRANGEMENTS (ONLY APPLICABLE BETWEEN 1 JAN 2014 AND 1 JAN 2022)				
80	Current cap on CET1 instruments subject to phase out arrangements	-	-	484 (3), 486 (2) & (5)
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-	-	484 (3), 486 (2) & (5)
82	Current cap on AT1 instruments subject to phase out arrangements	-	-	484 (4), 486 (3) & (5)
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-	-	484 (4), 486 (3) & (5)
84	Current cap on T2 instruments subject to phase out arrangements	-	-	484 (5), 486 (4) & (5)
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-	-	484 (5), 486 (4) & (5)

Appendix B
LEVERAGE RATIO DISCLOSURES

Presented in accordance with Annex I of the Commission Implementing Regulation (EU) 2016/200.

CRR LEVERAGE RATIO

Reference Date	30 September 2017
Entity name	Paragon Banking Group PLC
Level of application	Consolidated

Table LRSum: Summary reconciliation of assets and leverage ratio exposures.

		APPLICABLE AMOUNT	
		2017 £M	2016 £M
1	Total assets as per published financial statements	13,682.2	13,518.4
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	-	-
3	(Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio total exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013)	-	-
4	Adjustments for derivative financial instruments	191.3	68.6
5	Adjustment for securities financing transactions (SFTs)	-	-
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	209.0	136.9
EU-6a	(Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No 575/2013)	-	-
EU-6b	(Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(14) of Regulation (EU) No 575/2013)	209.0	136.9
7	Other adjustments	(104.4)	(105.4)
8	**Leverage ratio total exposure measure**	**13,978.1**	**13,618.5**

Table LRCom: Leverage ratio common disclosure.

		CRR LEVERAGE RATIO EXPOSURES	
		2017 £M	2016 £M
APPLICABLE CAPS ON THE INCLUSION OF PROVISIONS IN TIER 236 (1) (C), 38, 48			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	12,775.6	12,152.0
2	(Asset amounts deducted in determining Tier 1 capital)	(104.4)	(105.4)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**12,671.2**	**12,046.6**
DERIVATIVE EXPOSURES			
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	906.6	1,366.4
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	191.3	68.6
EU-5a	Exposure determined under Original Exposure Method	-	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-	-
8	(Exempted CCP leg of client-cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	**Total derivatives exposures (sum of lines 4 to 10)**	**1,097.9**	**1,435.0**
SFT EXPOSURES			
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	-	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
14	Counterparty credit risk exposure for SFT assets	-	-
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	-	-
15	Agent transaction exposures	-	-
EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	-	-
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**-**	**-**

		CRR LEVERAGE RATIO EXPOSURES	
		2017 £M	2016 £M
OTHER OFF-BALANCE SHEET EXPOSURES			
17	Off-balance sheet exposures at gross notional amount	417.9	273.8
18	(Adjustments for conversion to credit equivalent amounts)	(208.9)	(136.9)
19	**Other off-balance sheet exposures (sum of lines 17 and 18)**	**209.0**	**136.9**
EXEMPTED EXPOSURES IN ACCORDANCE WITH ARTICLE 429(7) AND (14) OF REGULATION (EU) NO 575/2013 (ON AND OFF BALANCE SHEET)			
EU-19a	(Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
EU-19b	(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
CAPITAL AND TOTAL EXPOSURE MEASURE			
20	Tier 1 capital	876.1	838.6
21	**Leverage ratio total exposure measure (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**13,978.1**	**13,618.5**
LEVERAGE RATIO			
22	**Leverage ratio**	**6.3%**	**6.2%**
CHOICE ON TRANSITIONAL ARRANGEMENTS AND AMOUNT OF DERECOGNISED FIDUCIARY ITEMS			
EU-23	Choice on transitional arrangements for the definition of the capital measure	Fully phased in	Fully phased in
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	-	-

Table LRSpl: Split-up of on balance sheet exposures (excluding derivatives, SFT and exempted exposures)

		CRR LEVERAGE RATIO EXPOSURES	
		2017 £M	2016 £M
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	12,671.2	12,152.0
EU-2	Trading book exposures	-	-
EU-3	Banking book exposures, of which:	12,671.2	12,152.0
EU-4	Covered bonds	-	-
EU-5	Exposures treated as sovereigns	616.6	322.1
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	12.3	12.8
EU-7	Institutions	881.9	922.6
EU-8	Secured by mortgages of immovable properties	10,315.9	10,127.2
EU-9	Retail exposures	592.0	464.5
EU-10	Corporate	125.8	81.6
EU-11	Exposures in default	38.7	56.2
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	88.0	165.0

Table LRQua: Free form text boxes for disclosure on quantitative items

1	Description of the processes used to manage the risk of excessive leverage	Included in section 3
2	Description of the factors that had an impact on the leverage Ratio during the period to which the disclosed leverage Ratio refers	Included in section 4

Appendix C
COUNTERCYCLICAL BUFFER DISCLOSURES

The Group has not presented the template analysing its firm specific countercyclical buffer, as required by Annex I of the Commission Delegated Regulation (EU) 2015/1555, as all of its credit exposures are within the UK and therefore only the CCyB set by the FPC applies to it.

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