Paragon Banking Group PLC

Pillar III Disclosures - 30 September 2018

CONTENTS

1. Introduction Page 3
2. Governance Page 7
3. Risk management objectives and policies Page 11
4. Capital resources Page 28
5. Credit risk Page 34
6. Asset encumbrance Page 45
7. Counterparty credit risk Page 48
8. Interest rate risk Page 50
9. Liquidity risk Page 52
10. Securitisation Page 54
11. Remuneration policies and practices Page 55
12. Glossary Page 58

APPENDICES

A. Own funds disclosures Page 60
B. Leverage ratio disclosures Page 66
C. Counter-cyclical Buffer Disclosures Page 69
D. Liquidity coverage ratio disclosure template Page 70

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 specialist bank, 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 5.

THE GROUP

The Company controls a group of companies ('the Group') including a regulated bank, Paragon Bank PLC ('the Bank'). The Group 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 development finance, structured lending and 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. These include disclosures in respect of wrong way risk and detailed disclosures in respect of the collectively assessed impairment allowance.

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, Treasury 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 2019 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 2018 ('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 67 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.

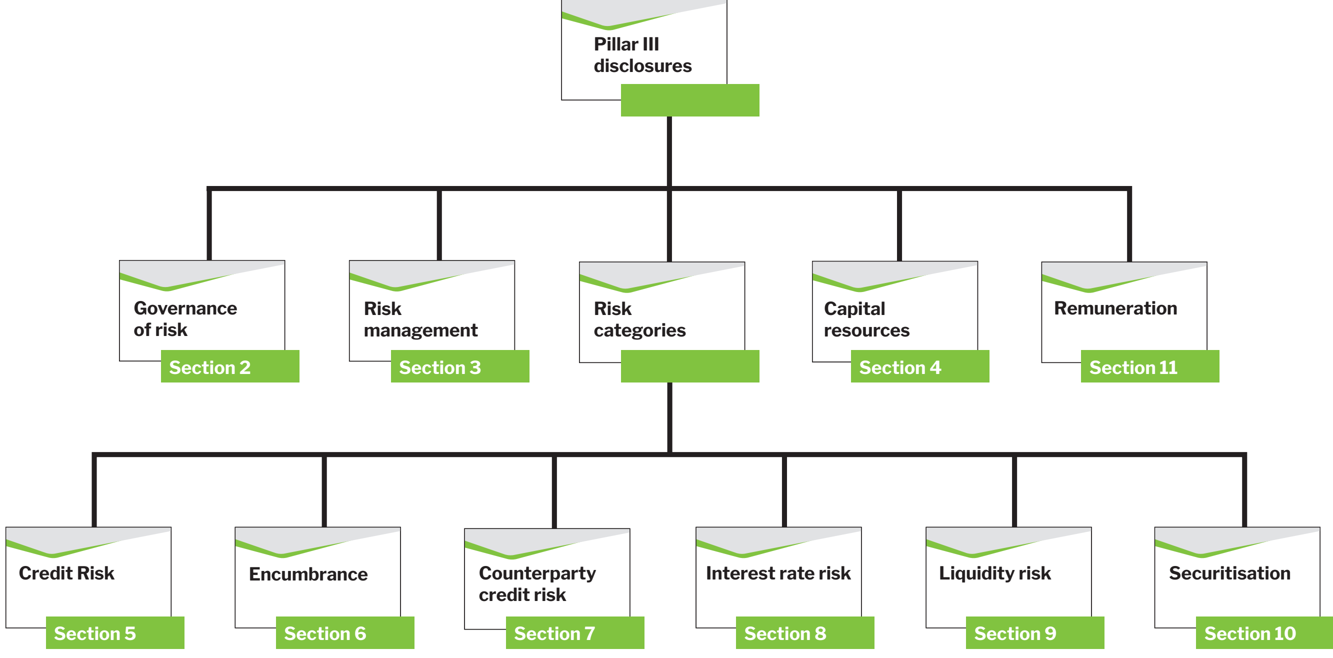
The Bank is required to prepare Remuneration Code Pillar III disclosures. These disclosures are included within this document as the relevant members of staff work for both the Group and the Bank.

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.

Pillar III document overview



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 2017, except that information on remuneration within the Bank has been included in the document, instead of in a stand-alone publication, for reasons set out in section 11, and an extract of the EU mandated LCR common disclosure template has been provided as appendix D.

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 is 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. For regulatory capital purposes the CRR allows the impact of the transition to be phased in over a five year period, so that the initial impact on capital ratios will be negligible.

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 went through the annual ICAAP process during the year. The ICAAP 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 September 2018. 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 2019.

2. GOVERNANCE

This section sets out

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

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

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in April 2016 ('the Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2018 the Company complied with the principles and provisions of the Code (except for a short period as noted below when this was necessary due to the need to comply with regulatory processes). The Board has considered the new edition of the Code, published in July 2018, which is applicable to the Company from 1 October 2019 and will make any necessary and appropriate amendments to its practices and procedures.

As part of its governance arrangements, the Group has a defined risk management framework. This is designed tosupport 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.

At 30 September 2018 the Board consisted of the Chairman, three executive directors, six independent non-executive directors and one non-independent non-executive director. At the start of the year the Board included seven independent non-executive directors, however, Alan Fletcher ceased to be considered independent in February 2018 on the ninth anniversary of his appointment and consequently ceased to be a member of any board committees. All the directors bring a broad and valuable range of experience to the Company and further details of this together with other biographical details are set out in Section B2 of the Group Accounts. Throughout the year the independent non-executive directors have formed the majority of the Board and consequently, the balance between independent and non-independent directors has been appropriate. Alan Fletcher, the non-independent non-executive director, and Patrick Newberry, a non-executive director, stepped down from the Board in December 2018.

The division of responsibilities between the Chairman and Chief Executive Officer ('CEO') is clearly established, set out in writing, regularly revised and agreed by the Board.

There is a strong non-executive representation on the Board, including the Senior Independent Director (Fiona Clutterbuck until June 2018 and subsequently Peter Hartill). This provides effective balance and challenge.

The Chairman's other business commitments are set out in the biographical details in Section B2 of the Group Accounts.

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

CODE COMPLIANCE

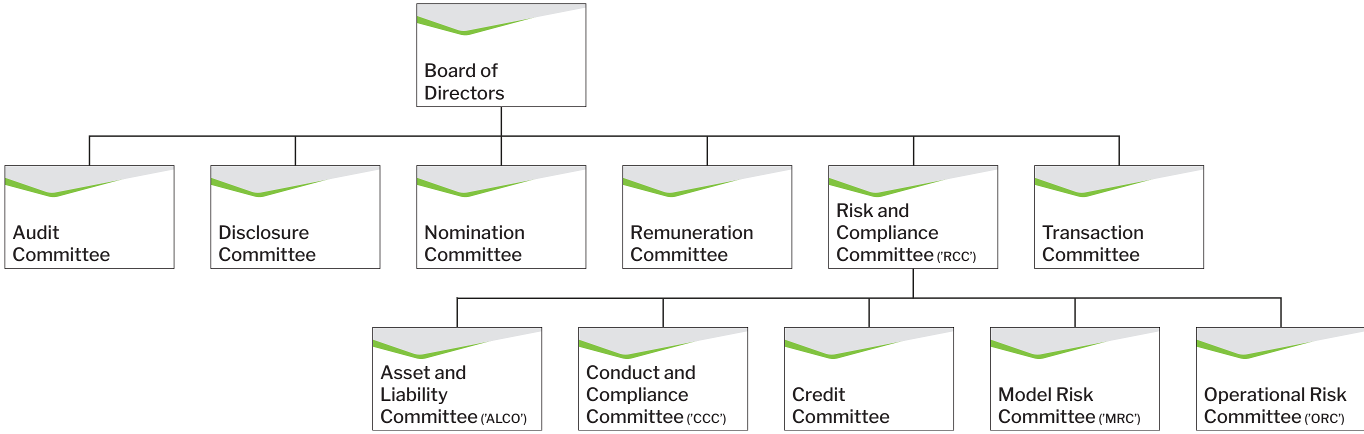
During the year under review there was a short period when the Company was not fully in compliance with the provisions of the Code. This occurred while regulatory approvals for various appointments were awaited. The provisions which the Company did not comply with, and the periods of non-compliance were:

- From 10 May 2018 until 5 June 2018 there was no Senior Independent Director (Code provision A.4.1)
- From 10 May 2018 until 19 June 2018 the Chairman of the Board was also Chairman of the Remuneration Committee (Code provision D.2.1)
- From 10 May 2018 until 5 June 2018 there were only two independent non-executive directors excluding the Chairman on the Remuneration Committee (Code provision D.2.1)

During the period when the Company was not in compliance with the Code provisions relating to remuneration committees, no meetings of the Remuneration Committee were scheduled or held.

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

Board committee structure



The Transaction Committee is an executive committee and is described in further detail below

BOARD COMMITTEES

Summarised information on each of the board committees is set out below.

Committee		Audit	Remuneration	Risk and Compliance	Nomination
Chair	From 1 October 2017	P J N Hartill	F J Clutterbuck	F F Williamson	R G Dench
	To / from		19/06/18		10/05/18
	To 30 September 2018	P J N Hartill	H R Tudor	F F Williamson	F J Clutterbuck
Minimum number of meetings		3	3	4	2

Members	Independent non-executive	Audit	Remuneration	Risk and Compliance	Nomination
F J Clutterbuck	Until 10 May 2018	Until 10 May 2018	Yes	Yes	Yes
R G Dench	No	No	Until 10 May 2018	Until 10 May 2018	Until 10 May 2018
N S Terrington	No	No	No	No	Until 20 September 2018
A K Fletcher	Until 24 February 2018	Until 24 February 2018	Until 24 February 2018	Until 24 February 2018	Until 24 February 2018
P J N Hartill	Yes	Yes	Yes	Yes	Yes
H R Tudor	Yes	Yes	Yes	Yes	Yes
P J Newberry	Yes	Yes	Until 5 June 2018	Yes	Yes
B A Ridpath	Yes	Yes	No	Yes	No
F F Williamson	Yes	Yes	No	Yes	No
G H Yorston	Yes	Yes	No	Yes	No

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.

The Disclosure Committee assists in the design, implementation and evaluation of disclosure controls and procedures; monitors compliance with the Company's disclosure controls; considers the requirements for announcement; and overall determines the disclosure treatment of material market information. The Committee's members are the Chairman, CEO and Chief Financial Officer ('CFO'), of which any two can form a quorum.

EXECUTIVE COMMITTEES

Five main executive committees, the Asset and Liability Committee ('ALCO'), the Credit Committee ('CC'), the Model Risk Committee ('MRC'), the Operational Risk Committee ('ORC') and the Conduct and Compliance Committee ('CCC'), consisting of executive directors and appropriate senior employees, report to the Risk and Compliance Committee ('RCC'). The Operational Risk and Compliance Committee was split during the year to ensure that a greater focus could be put into both areas.

- The ALCO comprises the heads of relevant functions and is 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 CCC comprises heads of relevant functions and is chaired by the Deputy Chief Risk Officer. The CCC is responsible for overseeing the Group's conduct risk and compliance arrangements. The Committee considers conduct risk information such as details of conduct breaches; systems and procedures for delivering fair outcomes to customers; the product governance framework; monitoring reports; and employee incentive schemes. It also considers product reviews from a customer perspective. With respect to compliance, the CCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct related regulatory obligations. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Compliance function, including the annual Compliance Plan
- The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the Chief Risk Officer ('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 portfolios, 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 Committee also operates the Group's most senior lending mandate
- The MRC comprises senior managers from the risk, finance and main business areas and is 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 ORC comprises heads of relevant functions and is chaired by the CRO. The ORC is responsible for overseeing the Group's operational risk and business risk management arrangements. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures and operational resiliance measures. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the RCC.

In addition, the Transaction Committee has been established for a number of years, but meetings are called on an as required basis and have occured more frequently this year due to the establishment of the Group's Structured Lending business. The Committee consists of the CEO and the CFO, the Director of Treasury and Structured Finance and the CRO, of which any two can form a quorum but that quorum shoud include either the CEO or CFO. The Committee meets to consider potential acquisitions or disposals of loan assets by the Idem Capital business, where these are not large enough to require consideration at the Board, and also to approve, within delegated limits, wholesale term and / or revolving credit facilities proposed by the Group's Structured Lending operation.

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
F J Clutterbuck	Chairman	1
N S Terrington	Chief Executive	-
R J Woodman	Chief Financial Officer	-
J A Heron	Managing Director, Mortgages	-
A K Fletcher	Non-executive director	3
P J N Hartill	Non-executive director	3
H R Tudor	Non-executive director	2
P J Newberry	Non-executive director	2
B A Ridpath	Non-executive director	-
F F Williamson	Non-executive director	-
G 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, including the process of selection of the Chairman
- Succession planning in respect of the Board and senior management
- 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.

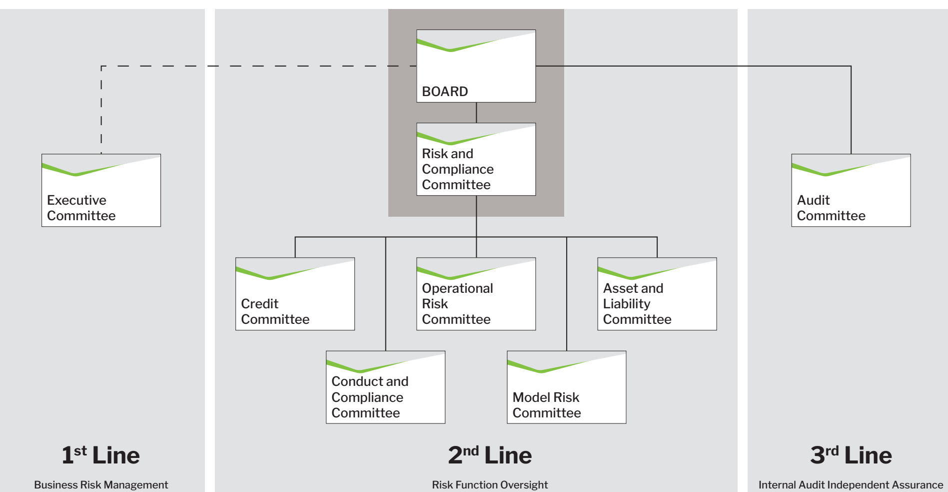
The Group's risk management framework operates within a 'Three Lines of Defence' model:

- 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*, is provided by the Risk and Compliance division, headed by the CRO, which is responsible for providing risk oversight and guidance to the first line. The function is overseen by the RCC and its supporting executive committees The Risk and Compliance division has been further expanded during the year and includes dedicated functions responsible for the oversight of Credit Risk, Property Risk, Compliance and Conduct Risk, Operational Risk, IT and Cyber Security, Data Protection, Financial Crime, and Liquidity and Market Risk
- The *third line of defence*, is provided by the Internal Audit function which is responsible for reviewing the effectiveness of the first and second lines of defence. This function is overseen by the Audit Committee

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 Board is illustrated below:

Risk Management Model



The Group's risk management framework promotes a structured and disciplined approach to the identification and management of risk across all categories of risk. The key objectives of the framework are to:

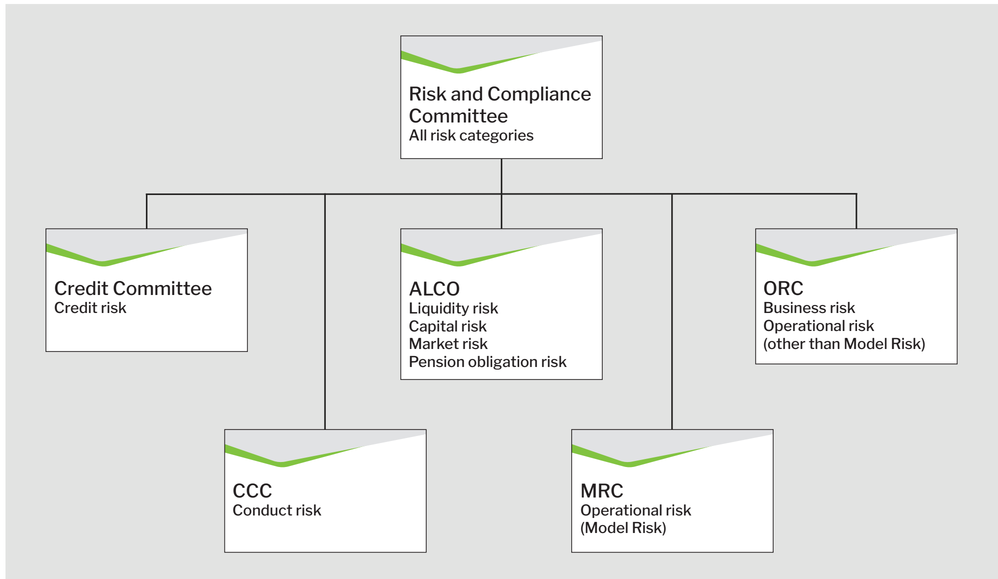
- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction 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 internal governance committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information provided
- Promote an appropriate risk culture across the Group, consistent with its aim of operating as a prudent, risk focussed, specialist lender, that delivers fair outcomes for its customers and complies with the letter and spirit of applicable regulations

The Group Accounts includes a Risk Management Report in Section B6. This report sets out:

- The activities of the Risk and Compliance 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 specific committee primarily responsible for them, from a second line governance perspective, are set out in the diagram below:

Risk Governance Responsibilities



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	Personal assessment
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. The likelihood of this occurring has become more difficult to forecast given the continuing material uncertainties as to the terms on which the UK will leave the EU in March 2019. A material downturn in economic performance 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 material change in the operation 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, such as Titlestone, 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, its ability to meet its regulatory obligations 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	Given the highly regulated sectors in which the Group operates, compliance failures or failures to respond effectively to new and emerging regulatory and legal 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 could 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 2018 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:

Risk Increasing	Risk Decreasing	Risk Stable

BUSINESS RISK

Economic Risk

Description	Mitigation
The potential for a deterioration in the UK's economic conditions is harder to forecast given the continuing material uncertainties as to the terms on which the UK will leave the European Union ('EU') 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 uses stress testing 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 again been broadly stable in the last financial year, the near-term outlook has continued to remain uncertain given a lack of clarity as to the basis of the UK's withdrawal from, and future relationship with, the EU. This continuing uncertainty has led to the overall risk assessment being considered to have increased further 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 several economic cycles together with regular independently conducted research commissioned over many years. The Group 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, 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 effectively to the various regulatory changes introduced in recent years in relation 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. This is consistent with its strategic objective of operating as a prudent, risk focussed specialist lender that delivers fair outcomes for its customers and complies with the letter and spirit of applicable regulations. The Group's strategy towards diversification was illustrated in the last financial year by the acquisition of the Iceberg and Titlestone businesses and the continued expansion of its other Commercial Lending businesses.

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 positively to recent regulatory changes. The implementation of these changes has seen a refocussing of the market towards larger portfolio landlords with more complex needs. The Group continues to be well placed to service this area of the market effectively given its expertise and extensive experience. In the longer term, the changes to the UK taxation regime for private landlords and greater regulatory intervention in the sector may 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.	

Transition risk

Description	Mitigation
The Group acquisition of the Titlestone development finance business during the year ended 30 September 2018, significantly expanded its exposure in this market segment. The Group also acquired the Iceberg legal profession finance business in the last financial year. Any failure to manage effectively the transition and implementation risks resulting from material corporate acquisitions of this type could impact adversely on the Group's financial performance and its reputation.	The Board's M&A strategy is that 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		
	Whilst the acquisition of new businesses inevitably creates the potential for greater transition risk, the integration of the Iceberg and Titlestone businesses has progressed entirely satisfactorily. The Group remains confident that any residual risks in this area can be managed effectively. As such, despite the new acquisitions, the risk profile is considered to have remained stable in the last twelve months.	

CREDIT RISK

Customer Risk

Description	Mitigation
As a lender, a failure to screen potential borrowers, underwrite individual credit decisions robustly and manage repayments 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, house price inflation, property rental inflation and asset depreciation which are in turn used to guide policy and underwriting. The Credit Risk function provides regular reports to the Credit Committee and RCC 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. 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. The operation of these processes benefits from the availability of experienced, specialist staff. As indicated previously, the Group uses stress testing 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 EU, 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. As such, the risk profile is considered to have remained stable in the last twelve months. 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	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 have remained stable.	← →

CONDUCT RISK

Customer Fair Outcomes

Description	Mitigation
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.	The Group has a formal Conduct Risk Management framework which includes a number of detailed policies and standards 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 • Distribution • Financial Difficulties • Vulnerable Customers • Product Governance 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. This may also 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. During the last financial year, the Group has further strengthened its governance in relation to conduct risk by the introduction of a dedicated Conduct and Compliance Committee ('CCC'). The CCC has a remit which extends to overseeing the fair treatment of customers. The Committee receives management information each month covering various conduct related metrics, which include; complaints handling, quality assurance, outsourced service level agreement adherence, arrears levels, repayment arrangement performance, vulnerable customer identification, customer insight research, staff performance and attrition reports, and other cultural indicators. The CCC also receives items for review and/or approval, such as; product governance submissions (new product approvals, change requests, annual product reviews, etc.), conduct risk related policies and standards, business area incentive schemes, compliance monitoring outputs and regulatory communications. 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 on at least an annual basis by the RCC.

CONDUCT RISK continued...

Customer Fair Outcomes

Description	Mitigation
	Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at the CCC, ORC and 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. As noted previously, all schemes are required to be approved by the CCC before implementation and then reviewed, at least annually, by that committee.

Change		
	The Group operates in areas which are highly regulated and where continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure. In response to this, the Group has continued to develop and embed its conduct risk management framework during the year. As a result, the overall risk profile in this area is considered to have remained stable in the last twelve months.	

OPERATIONAL RISK

People Risk

Description	Mitigation
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 very difficult to replicate in the short term.	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 with Executive and Board covering all key roles • Monitoring external remuneration and reward structures to ensure the Group 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 • Offering key employees long term incentivisation plans with a minimum vesting period of three years to promote retention • 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 • Monitoring and reporting statistics relating to vacancy levels and leavers to senior management, the CCC and RCC to ensure root causes are fully understand and corrective actions can be taken accordingly 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		
	A strong employment market and particularly buoyant demand for skilled financial services staff has again been a feature of the last financial year. This has led to continued strong 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 85% engagement level amongst its staff. This is well above the average for the financial services sector. The maintenance 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.	The Group has continued to strengthen its capabilities in relation to operational resilience and in particular 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 increased investment in security solutions to counteract cyber security threats and the recruitment of specialist resource. A formal Cyber Incident Response Plan is in place 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'). The Group has continued to be accredited to ISO 22301 (Business Continuity) during the financial year. The Group also has 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	The Group has continued to invest significantly in order to further enhance its operational resilience. This has included ensuring that it maintains a robust and secure IT infrastructure that supports its operational needs. However, the level and sophistication of cyber-crime continues to increase, heightening the risk that this may impact on the Group's operations and strategic objectives. As such, notwithstanding the proactive actions which the Group has undertaken, the heightened external threat environment has led to an increasing risk profile in this area during the year.	

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 maintains a formal second line monitoring plan which is approved by the RCC. Progress against the plan and the issues identified within individual reviews are reported to the CCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded, and any lessons learnt are applied across all relevant areas of the Group. Similarly, the Financial Crime function provides second line oversight of business areas' adherence to anti-money laundering and financial crime requirements. The implementation of the Data Protection Act 2018, which covered the requirements of the EU General Data Protection Regulation, was a major regulatory and legislative development during the last financial year. In order to ensure it responded to this effectively, the Group initiated a formal programme under the sponsorship of the CRO. This included the delivery of comprehensive training and communications to all staff and the establishment of a Data Protection Office within the second line with appropriate supporting resource and a detailed programme of oversight reviews.

Change		
	The increasingly regulated nature of the Group's operations heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging regulations. The Group therefore continues to ensure it has robust arrangements in place to enable it to respond effectively to new and emerging regulatory developments. Overall, the risk profile in this area is considered to have remained stable in the last twelve months.	

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.	The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. It remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. The Group, through the 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 deposits (97.9%) 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. During the financial year, the Bank made further prudent use of the Bank of England's TFS to support its ongoing lending activities. The drawings made under the Scheme were well phased to minimise the risks to the Group as they fall due over the coming years. 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. In April 2018, the Company's credit rating from Fitch was increased from BBB- to BBB. This investment grade credit rating helps to support maintenance of the Company's access to funding markets.

Change		
Change	Following last year's corporate reorganisation, the Group is better placed to access funding from a wide range of sources to meet its future funding requirements. However, despite this, there has been continued strong competition for retail deposits amongst an increasing number of 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.	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 Internal Ratings Basis ('IRB') 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 commence its application process with the relevant regulatory authorities during the first half of the new financial year. 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. This new application process is now embedded in the Group's IRB project plan.

Change		
Change	In December 2017, the BCBS published its 'Basel III: Finalising Post-Crisis Reforms' document. This has clarified the proposed increase to the capital risk weights for buy-to-let lending under the revised standardised approach and the introduction of a capital output floor based on the revised standardised approach. The proposed changes had been anticipated within the Group's IRB project. 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') continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks for 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		
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	

<table>
<tr><th colspan="4">PENSION OBLIGATION RISK</th></tr>
<tr><th colspan="4">Pension Obligation Risk</th></tr>
<tr><th colspan="2">Description</th><th colspan="2">Mitigation</th></tr>
<tr><td colspan="2">The Group operates both a defined benefit and defined contribution pension schemes 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.</td><td colspan="2">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 process, as at 31 March 2016 included the agreement of a recovery plan which aims to clear the deficit in the Plan by January 2023.</td></tr>
<tr><td>Change</td><td colspan="2">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.

Further details of the Group’s exposure to the Plan are given in note 56 to the Group Accounts.</td><td> </td></tr>
</table>

RISK APPETITE STATEMENTS

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.

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 a 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, CCC, CC and ORC each month against performance measures with any immediate adverse indicators escalated to the RCC and 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 in information security
- The Board has no appetite for material breaches of 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 / Leverage ratio / Total Capital ratio** 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	Losses as % of operational risk capital	Complaint levels
	Buy-to-let affordability	Significant operational losses			NSFR	Issue management	Complaint resolution
	Buy-to-let collateral quality				Encumbrance	IT resilience	Quality assurance testing
	Buy-to-let large exposures				Parent company liquidity	Cyber security	Borrower credit/ affordability profiles
	Idem portfolio performance				OLAR	Resource capacity	Collateral quality
	Commercial Lending arrears / losses						
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				Information Security	
	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 of the principal risks facing the Group
- Consideration and challenge of the ratings applied to the various risk categories to which the Group is exposed
- Consideration of performance against the Board risk appetite measures, with particular focus on any measures outside agreed target ranges
- Consideration of the continuing appropriateness of the Board risk appetite measures
- Consideration of key regulatory developments

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

In addition, the directors specifically considered the impact on risk and viability through review and approval of key risk assessments for the Group, including the ICAAP, ILAAP and its Recovery and Resolution Plan ('RRP').

At the year end the directors reviewed their on-going risk management activities and the most recent risk information available 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 or liquidity. These principal risks are those set out above.

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, which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This is defined by the international Basel III rules, set by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR').

The Group's regulatory capital is monitored by the Board of Directors, its Risk and Compliance Committee and the Asset and Liability Committee, who ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

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; and
- 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

The tables below demonstrate that at 30 September 2018 the Group's regulatory capital of £1,045.7m (2017: £1,030.5m) was comfortably in excess of the amounts required by the regulator, including £727.7m in respect of Pillar 1 and Pillar 2a capital, which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer of 1.875% of risk weighted assets (at 30 September 2018) and a Counter-Cyclical Buffer, currently 0.5% of risk weighted assets. Firm specific buffers may also be required. 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 2018 is set out below.

		2018	2017
		£m	£m
Total equity		**1,095.9**	1,009.4
Deductions			
Proposed final dividend		**(35.8)**	(28.9)
Intangible assets		**(169.3)**	(104.4)
Common Equity Tier 1 ('CET1') capital		**890.8**	876.1
Other Tier 1 capital		**-**	-
Total Tier 1 capital		**890.8**	876.1
Corporate bond		**150.0**	150.0
Less: amortisation adjustment	†	**-**	-
		150.0	150.0
Collectively assessed credit impairment allowances	††	**4.9**	4.4
Total Tier 2 capital		**154.9**	154.4
Total regulatory capital		**1,045.7**	1,030.5

† When Tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. No adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026.

†† Collective impairment provisions are calculated for each key portfolio based on recent historical performance, with adjustments for expected changes in losses based on management's judgement. These balances will cease to be Tier 2 capital following the transition to IFRS 9.

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. They were issued in 2016 and mature in 2026. Further details of these bonds are given in note 50 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:

	2018			2017		
	CET 1	**Tier 2**	**Total**	CET 1	Tier 2	Total
	£m	**£m**	**£m**	£m	£m	£m
Capital at 1 October 2017	**876.1**	**154.4**	**1,030.5**	838.6	167.0	1,005.6
Trading transactions						
Profit after tax	**145.8**	**-**	**145.8**	117.2	-	117.2
Other comprehensive income	**8.0**	**-**	**8.0**	23.9	-	23.9
Charge for share based payment	**6.1**	**-**	**6.1**	4.2	-	4.2
Tax on share based payment	**1.1**	**-**	**1.1**	0.8	-	0.8
Movement in collectively assessed impairment allowances	**-**	**0.5**	**0.5**	-	(0.4)	(0.4)
Intangible assets arising on acquisition	**(65.5)**	**-**	**(65.5)**	0.3	-	0.3
Purchase of intangible assets	**(1.5)**	**-**	**(1.5)**	(0.9)	-	(0.9)
Amortisation of intangible assets	**2.1**	**-**	**2.1**	1.6	-	1.6
Capital transactions						
Proposed dividend at year end	**(35.8)**	**-**	**(35.8)**	(28.9)	-	(28.9)
Interim dividend paid in year	**(14.2)**	**-**	**(14.2)**	(12.5)	-	(12.5)
Share buy-backs	**(25.2)**	**-**	**(25.2)**	(65.5)	-	(65.5)
Shares issued	**0.4**	**-**	**0.4**	1.5	-	1.5
Shares purchased by ESOP	**(6.2)**	**-**	**(6.2)**	(4.2)	-	(4.2)
Share awards exercised	**(0.4)**	**-**	**(0.4)**	-	-	-
Amortisation of Tier 2 instruments	**-**	**-**	**-**	-	(12.2)	(12.2)
Capital at 30 September 2018	**890.8**	**154.9**	**1,045.7**	876.1	154.4	1,030.5

The amount shown above for other comprehensive income principally represents actuarial gains 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. The minimum capital requirement in respect of each class, based on 8% of risk exposure, is also set out below.

	Risk exposure		Capital requirement	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Credit risk				
Balance sheet assets	**5,767.3**	4,907.7	**461.4**	392.6
Off balance sheet	**87.8**	68.3	**7.0**	5.5
Total credit risk	**5,855.1**	4,976.0	**468.4**	398.1
Operational risk	**485.1**	464.9	**38.8**	37.2
Market risk	**-**	-	**-**	-
Other	**105.1**	67.8	**8.4**	5.4
Total risk exposure	**6,445.3**	5,508.7	**515.6**	440.7
Solvency ratios				
CET1	**13.8**	15.9		
Total regulatory capital	**16.2**	18.7		

Source: Group Accounts

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').

	2017 RWA	**Portfolio Quality**	**Portfolio Size**	**2018 RWA**
	£m	**£m**	**£m**	**£m**
First mortgages	3,537.8	(10.8)	186.2	**3,713.2**
Second charge mortgages	265.8	(14.1)	(27.8)	**223.9**
Development finance	63.5	-	465.7	**529.2**
Exposures secured on real estate	3,867.1	(24.9)	624.1	**4,466.3**
Retail exposures	344.7	(18.7)	110.2	**436.2**
Asset finance exposures	267.0	-	91.9	**358.9**
Exposure on loans to customers	4,478.8	(43.6)	826.2	**5,261.4**
Institutions	435.1	-	83.6	**518.7**
Other assets	62.1	-	12.9	**75.0**
	4,976.0	(43.6)	922.7	**5,855.1**

Credit RWAs have increased by approximately 17.7% since 30 September 2017. The principal cause of this increase has been asset growth from increased levels of advances across the Group's business lines, and from corporate and portfolio acquisitions in the year. However, the impact on RWA from asset growth was mitigated by an improvement in book quality due to increased house prices, impacting exposure on mortgage assets, and better performance.

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

Risk of excessive leverage is the risk that arises through maintaining an inappropriate leverage ratio or mismatches between assets and obligations. This risk is not considered significant for the reasons considered below.

The current structure of the balance sheet returns a high leverage ratio. The Group's leverage ratio has remained well in excess of the minimum 3% set out in the CRR since the Bank's authorisation. This positive position will be maintained during the period covered by the business planning process, which will take account of stress testing impacts on the ratio.

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 2018.

	UK Basis		**EBA Basis**	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Total balance sheet assets	**14,515.1**	13,682.2	**14,515.1**	13,682.2
Add: Credit fair value adjustments on loans to customers	**24.1**	8.7	**24.1**	8.7
Add: Debit fair value adjustments on retail deposits	**4.2**	3.5	**4.2**	3.5
Adjusted balance sheet assets	**14,543.4**	13,694.4	**14,543.4**	13,694.4
Less: Derivative assets	**(855.7)**	(906.6)	**(855.7)**	(906.6)
Less: Central bank deposits	**(895.9)**	(615.0)	**-**	-
Less: CRDs	**(6.2)**	(1.6)	**-**	-
Less: Accrued interest on sovereign exposures	**(0.4)**	-	**-**	-
On-balance sheet items	**12,785.2**	12,171.2	**13,687.7**	12,787.8
Less: Intangible assets	**(169.3)**	(104.4)	**(169.3)**	(104.4)
Total on balance sheet exposures	**12,615.9**	12,066.8	**13,518.4**	12,683.4
Derivative assets	**855.7**	906.6	**855.7**	906.6
Potential future exposure on derivatives	**172.1**	191.3	**172.1**	191.3
Total derivative exposures	**1,027.8**	1,097.9	**1,027.8**	1,097.9
Post offer pipeline at gross notional amount	**817.7**	417.9	**817.7**	417.9
Adjustment to convert to credit equivalent amounts	**(569.2)**	(208.9)	**(569.2)**	(208.9)
Off balance sheet items	**248.5**	209.0	**248.5**	209.0
Tier 1 capital	**890.8**	876.1	**890.8**	876.1
Total leverage exposure	**13,892.2**	13,373.7	**14,794.7**	13,990.3
Leverage ratio	**6.4%**	6.6%	**6.0%**	6.3%

Source: Group Accounts (excluding EBA basis)

The decrease in leverage ratio is in line with the Group's expectation following the reorganisation and improved capital efficiency.

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'). The buffers which apply to the Group at 30 September 2018 and which are expected to apply in the near term are:

- A Capital Conservation Buffer ('CCoB') which is 1.875% of total risk exposure at 30 September 2018 rising to 2.50% at 1 January 2019.
- A Counter Cyclical Buffer ('CCyB'), controlled by the Financial Policy Committee ('FPC'). The CCyB is currently 0.50% of TRE, but in November 2017 it was decided this would increase to 1.00% of TRE from 28 November 2018. The FPC will reconsider the level of the UK CCyB at each quarterly meeting.
- 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.

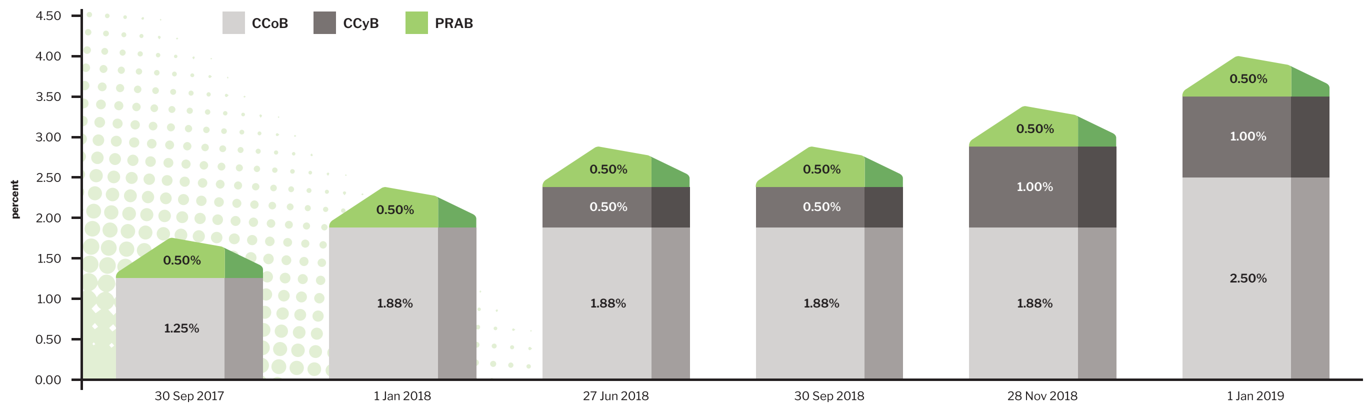
Additional buffers provided for by CRD IV do not apply to the Group.

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 was 0.50% at 30 September 2018 and hence the Group's Institution Specific CCyB Requirement as at 30 September 2018 was £32.2m (2017: £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 increase to 1.0%.

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 2018 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 a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

Primary responsibility for credit risk management across the Group lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired 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.

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

	2018	2017
	£m	£m
Loans to customers	**12,127.8**	11,124.1
Trade receivables	**2.2**	4.2
Derivative financial assets	**855.7**	906.6
Credit Support Annex ('CSA') assets	**3.8**	2.0
CRDs	**6.2**	1.6
Cash	**1,310.6**	1,496.9
Accrued interest	**0.6**	0.2
Maximum exposure to credit risk	**14,306.9**	13,535.6

Source: Group Accounts

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 2018					
Government and central banks	(a)	**902.5**	-	-	-
Credit institutions	(f)	**1,270.4**	**40.8**	**518.7**	**41.5**
Total liquidity exposures		**2,172.9**	**23.9**	**518.7**	**41.5**
Local authorities	(b)	**13.5**	**20.0**	**2.7**	**0.2**
Corporate and similar exposures	(g)	**188.3**	**100.0**	**188.3**	**15.1**
Retail and SME lending	(h)	**797.9**	**71.9**	**573.7**	**45.9**
Residential lending	(i)	**10,743.4**	**35.8**	**3,843.2**	**307.5**
Non-performing	(j)	**36.8**	**103.5**	**38.1**	**3.0**
Specialist lending	(k)	**352.8**	**150.0**	**529.2**	**42.3**
Loans and advances to customers		**12,132.7**	**42.7**	**5,175.2**	**414.0**
Fixed and other assets	(q)	**73.4**	**100.0**	**73.4**	**5.9**
Total on balance sheet exposures		**14,379.0**	**40.1**	**5,767.3**	**461.4**
Off balance sheet exposures - pipeline		**817.7**	**10.7**	**87.8**	**7.0**
Total credit risk exposure		**15,196.7**	**38.5**	**5,855.1**	**468.4**
30 September 2017					
Government and central banks	(a)	616.6	-	-	-
Credit institutions	(f)	1,788.5	24.3	435.1	34.8
Total liquidity exposures		2,405.1	18.1	435.1	34.8
Local authorities	(b)	12.3	20.3	2.5	0.2
Corporate and similar exposures	(g)	125.8	100.0	125.8	10.1
Retail and SME lending	(h)	592.0	77.4	458.1	36.6
Residential lending	(i)	10,315.9	36.1	3,719.5	297.5
Non-performing	(j)	38.7	105.7	40.9	3.3
Specialist lending	(k)	42.3	150.1	63.5	5.1
Loans and advances to customers		11,127.0	39.6	4,410.3	352.8
Fixed and other assets	(q)	62.3	100.0	62.3	5.0
Total on balance sheet exposures		13,594.4	36.1	4,907.7	392.6
Off balance sheet exposures - pipeline		417.9	16.3	68.3	5.5
Total credit risk exposure		14,012.3	35.5	4,976.0	398.1

'Specialist lending' includes assets of 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.

	2018	2017
	£m	£m
Total balance sheet assets	**14,515.1**	13,682.2
Less amounts deducted in regulatory capital		
Intangible assets	**(169.3)**	(104.4)
Add back		
Non-specific provisions qualifying as tier 2 capital	**4.9**	4.4
Fair value hedging portfolio adjustments	**28.3**	12.2
Total balance sheet exposure	**14,379.0**	13,594.4

Source: Group Accounts

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 2018 are analysed as follows:

	Gross loan assets	Impairment provisions	Net loan assets	
	£m	£m	£m	%
30 September 2018				
Buy-to-let mortgages	**10,344.1**	**(82.5)**	**10,261.6**	**84.6**
Owner-occupied mortgages	**79.1**	**(8.5)**	**70.6**	**0.6**
Total first residential mortgages	**10,423.2**	**(91.0)**	**10,332.2**	**85.2**
Second charge mortgage loans	**417.4**	**(1.5)**	**415.9**	**3.5**
Loans secured on residential property	**10,840.6**	**(92.5)**	**10,748.1**	**88.7**
Development finance	**359.0**	**(6.2)**	**352.8**	**2.9**
Loans secured on property	**11,199.6**	**(98.7)**	**11,100.9**	**91.6**
Motor finance loans	**332.1**	**(2.7)**	**329.4**	**2.7**
Other consumer loans	**182.3**	**(8.6)**	**173.7**	**1.4**
Asset finance loans	**405.4**	**(2.0)**	**403.4**	**3.3**
Factoring and discounting balances	**35.2**	**(0.3)**	**34.9**	**0.3**
Professions finance	**42.7**	**(0.1)**	**42.6**	**0.4**
Structured lending	**38.7**	**-**	**38.7**	**0.3**
Other commercial loans	**4.2**	**-**	**4.2**	**-**
Total loans to customers	**12,240.2**	**(112.4)**	**12,127.8**	**100.0**

	Gross loan assets	Impairment provisions	Net loan assets	
	£m	£m	£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
Loans secured on property	10,480.0	(91.5)	10,388.5	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	326.2	(2.6)	323.6	2.9
Factoring and discounting balances	24.2	(0.4)	23.8	0.2
Professions finance	1.4	-	1.4	-
Other commercial loans	5.2	(0.5)	4.7	-
Total loans to customers	**11,236.3**	**(112.2)**	**11,124.1**	**100.0**

Source: Group Accounts

Other consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount. professions finance includes loans originated by the acquired Iceberg business (note 14 to the Group Accounts). These are generally short term unsecured loans made to lawyers and accountants for working capital purposes.

Impairment provisions at 30 September 2018 shown above include collectively assessed provisions of £4.9m (2017: £4.4m). Of these provisions £2.7m (2017: £2.4m) related to buy-to-let mortgages, £nil (2017: £0.2m) to second charge mortgage loans, £0.4m (2017: £0.3m) to car loans and £1.8m (2017: £1.5m) to asset finance loans.

An analysis of the movements in impairments provisions is given in note 38 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.

Average exposure against the Group's loan assets is presented below

For the quarter ended	30 September 2018	30 June 2018	31 March 2018	31 December 2017
	£m	£m	£m	£m
Buy-to-let mortgages	10,179.0	10,022.2	9,936.8	9,873.2
Owner-occupied mortgages	68.3	53.8	36.5	23.1
Total first residential mortgages	10,247.3	10,076.0	9,973.3	9,896.3
Second charge mortgage loans	453.7	471.2	472.4	482.1
Loans secured on residential property	10,701.0	10,547.2	10,445.7	10,378.4
Development finance	343.6	68.6	51.3	43.7
Loans secured on property	11,044.6	10,615.8	10,497.0	10,422.1
Motor finance loans	246.2	213.2	186.4	171.5
Other consumer loans	174.5	182.5	197.0	210.3
Asset finance loans including factoring and discounting balances	545.9	455.5	444.5	433.3
Structured lending	26.7	15.0	-	-
Average exposure	**12,037.9**	**11,482.0**	**11,324.9**	**11,237.2**

For the quarter ended	30 September 2017	30 June 2017	31 March 2017	31 December 2016
	£m	£m	£m	£m
Buy-to-let mortgages	9,836.4	9,797.4	9,646.8	9,602.4
Owner-occupied mortgages	17.8	16.7	17.7	19.3
Total first residential mortgages	9,854.2	9,814.1	9,664.5	9,621.7
Second charge mortgage loans	494.0	503.1	511.8	518.8
Loans secured on residential property	10,348.2	10,317.2	10,176.3	10,140.5
Development finance	43.5	36.7	28.2	15.1
Loans secured on property	10,391.7	10,353.9	10,204.5	10,155.6
Motor finance loans	156.8	137.1	116.1	102.8
Other consumer loans	223.0	263.2	248.8	260.4
Asset finance loans including factoring and discounting balances	427.7	420.4	413.4	396.4
Structured lending	-	-	-	-
Average exposure	**11,199.2**	**11,174.6**	**10,982.8**	**10,915.2**

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 37 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 assessing credit risk, even where the Group would have security on a proposed loan, 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, 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.

First mortgages and secured loans are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities. Motor finance loans and asset finance loans are effectively secured by the financed asset. Development finance loans are secured by the development property and various charges over the build.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

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.

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on property by value at 30 September 2018 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, while for acquired accounts the effect of any discount on purchase is allowed for.

	2018	**2018**	2017	2017
	First Mortgages	**Secured Loans**	First Mortgages	Secured Loans
	%	**%**	%	%
Loan to value ratio				
Less than 70%	**60.6**	**66.1**	62.1	56.7
70% to 80%	**29.7**	**17.4**	25.0	17.5
80% to 90%	**7.1**	**9.3**	9.5	11.5
90% to 100%	**0.8**	**3.5**	1.3	7.1
Over 100%	**1.8**	**3.7**	2.1	7.2
	100.0	**100.0**	100.0	100.0
Average loan to value ratio	**66.0**	**65.9**	66.3	70.0
Of which:				
Buy-to-let	**66.1**		66.4	
Owner-occupied	**51.3**		30.9	

Source: Group Accounts

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 2018 (2017: 2.0%). 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 2018 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2018	2017
	£m	£m
Region		
Greater London	**1,952.5**	1,812.6
South East	**3,385.5**	3,156.2
South West	**987.5**	977.8
East Anglia	**329.5**	324.9
East Midlands	**569.6**	547.0
West Midlands	**535.3**	499.2
North	**378.0**	381.4
North West	**1,090.0**	1,075.6
Yorkshire and Humberside	**997.3**	1,020.0
Total England	**10,225.2**	9,794.7
Northern Ireland	**17.3**	20.1
Scotland	**164.9**	181.0
Wales	**356.8**	369.1
Total United Kingdom	**10,764.2**	10,364.9

The amount analysed above represents the current balance of live loans before provision and includes £10,345.8m (2017: £9,870.0m) of first mortgage assets and £418.4m (2017: £494.9m) 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, development finance and structured lending, 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. All amounts disclosed are pre risk weighting. These balances are shown above as asset finance loans, factoring and discounting balances, profession finance and other commercial loans.

	2018	2017
	£m	£m
Broadcast and audio	**23.4**	27.8
Veterinary services	**10.3**	8.8
Construction and plant hire	**168.3**	138.5
Print	**20.3**	24.4
Engineering	**10.0**	9.1
Distribution	**18.5**	17.1
Property	**1.1**	1.9
Forestry and agriculture	**9.9**	8.8
Waste	**11.5**	4.3
Packaging	**1.2**	2.9
Local authority	**12.4**	17.3
Travel	**22.8**	2.3
Business services	**82.2**	31.7
Other transport	**36.1**	19.3
Other manufacturing	**25.3**	13.3
Other services	**31.8**	30.6
Total	**485.1**	358.1

Business services has been analysed separately this year as a result of the Iceberg acquisition.

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

	2018	2017
	£m	£m
Asset finance		
Broadcast and audio	**28.1**	26.6
Veterinary services	**10.3**	8.8
Computer hardware and software	**4.2**	3.2
Gym equipment	**1.9**	1.4
Printing equipment	**26.5**	29.1
Plant and equipment	**170.3**	126.7
Commercial vehicles and cars	**113.2**	84.2
Refuse collection vehicles	**24.6**	29.9
Machine tools	**13.0**	9.9
Forestry and agricultural equipment	**10.5**	8.8
Other equipment	**18.6**	11.3
Total asset finance	**421.2**	339.9
Commercial mortgages	**1.2**	3.3
Invoice finance	**21.8**	14.9
Professions finance	**40.9**	-
	485.1	358.1

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 465 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 2018, compared to the industry averages at that date published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	2018	2017
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.11**	0.08
Buy-to-let accounts excluding receiver of rent cases	**0.03**	0.02
Owner-occupied accounts	**3.15**	3.55
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.42**	0.45
Buy-to-let accounts excluding receiver of rent cases	**0.38**	0.41
Owner-occupied accounts	**0.86**	0.95
All mortgages	**0.78**	0.86
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	**13.64**	17.55
Post-2010 originations	**0.21**	0.06
Legacy cases (Pre-2010 originations)	**17.91**	16.75
Purchased assets	**14.81**	19.69
FLA data for secured loans	**9.40**	11.20
Car loans		
Accounts more than 2 months in arrears	**3.91**	0.67
FLA data for point of sale hire purchase	**2.50**	2.20
Asset finance loans		
Accounts more than 2 months in arrears	**0.78**	0.97
FLA data for business lease / hire purchase loans	**0.70**	0.60

Source: Group Accounts

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2017 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending 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 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 naturally be higher for legacy books such as the Group's legacy owner occupied mortgage book 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 increase in the arrears measure for car loans shown above is due to the increase in portfolio size and the time taken for the bigger portfolio to season, as well as the portfolio acquired in the period.

The payment status of the carrying balances of the Group's loan assets, before provision for impairment, at 30 September 2018 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, structured lending or invoice discounting businesses, due to their particular contractual arrangements.

First Mortgages

	2018	2017
	£m	£m
Not past due	**10,211.1**	9,724.2
Arrears less than 3 months	**101.7**	112.6
Performing accounts	**10,312.8**	9,836.8
Arrears 3 to 6 months	**3.0**	1.1
Arrears 6 to 12 months	**2.2**	1.9
Arrears over 12 months	**5.7**	7.7
Possessions and similar cases	**22.1**	22.5
Impairment population	**33.0**	33.2
Total gross balances	**10,345.8**	9,870.0
Impairment provision on live cases	**(12.7)**	(12.7)
Timing adjustments	**(0.9)**	(1.8)
Carrying balance	**10,332.2**	9,855.5

Source: Group Accounts

Consumer and Asset Finance

	Second charge mortgage loans	Motor finance loans	Asset finance loans	Total
	£m	**£m**	**£m**	**£m**
30 September 2018				
Not past due	**350.7**	**310.8**	**388.6**	**1,050.1**
Arrears less than 2 months	**19.4**	**13.2**	**13.8**	**46.4**
Performing accounts	**370.1**	**324.0**	**402.4**	**1,096.5**
Arrears 2 to 6 months	**11.0**	**3.2**	**1.3**	**15.5**
Arrears 6 to 9 months	**4.1**	**0.9**	**0.7**	**5.7**
Arrears 9 to 12 months	**3.3**	**0.6**	**-**	**3.9**
Arrears over 12 months	**29.9**	**2.1**	**0.6**	**32.6**
Specifically impaired asset finance cases	**-**	**-**	**0.5**	**0.5**
Impairment population	**48.3**	**6.8**	**3.1**	**58.2**
Total gross balances	**418.4**	**330.8**	**405.5**	**1,154.7**
Impairment provision on live cases	**(1.5)**	**(1.7)**	**(1.7)**	**(4.9)**
Timing adjustments	**(1.0)**	**0.3**	**(0.4)**	**(1.1)**
Carrying balance	**415.9**	**329.4**	**403.4**	**1,148.7**
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

Source: Group Accounts

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 38 to the Group Accounts.

For capital adequacy purposes, collectively assessed credit impairment allowances under IAS 39 are considered to be Tier 2 capital. This amount is capped at 1.25% of risk weighted assets. No such amounts will be included as capital under IFRS 9.

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 consumer loan assets, are set out below. These are derived using the same models and assumptions used in the Effective Interest Rate ('EIR') calculations, but the differing bases of calculation lead to different outcomes.

	Carrying value	84 month ERC	120 month ERC
	£m	£m	£m
30 September 2018	**364.2**	**434.9**	**489.6**
30 September 2017	503.5	608.9	688.8

Source: Group Accounts

Development Finance

Development finance cases include both originated accounts and accounts recognised on the Titlestone acquisition.

Development finance loans do not require customers to make payments during the life of the loan, therefore arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at year end, a measure of security cover, is analysed below.

	2018		2017	
	By value	**By number**	By value	By number
	%	**%**	%	%
By value				
50% or less	**3.4**	**4.4**	4.2	7.3
50% to 60%	**18.9**	**22.8**	36.6	39.0
60% to 65%	**63.3**	**59.6**	42.6	41.5
65% to 70%	**7.1**	**9.6**	16.6	12.2
70% to 75%	**0.7**	**0.7**	-	-
Over 75%	**6.6**	**2.9**	-	-
	100.0	**100.0**	100.0	100.0

The average LTGDV cover at the year end was 63.2% (2017: 60.6%). At 30 September 2018 the development finance portfolio comprised 136 accounts (2017: 41). Of these accounts only four were considered at risk of loss (2017: none). These accounts have been aquired in the Titlestone purchase, where a provision for losses was made in the IFRS3 fair value calculation.

Structured Lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are set out below:

	2018	2017
Number of transactions	**3**	-
Total facilities (£m)	**52.5**	-
Carrying value (£m)	**38.7**	-

The maximum advance under these facilities was 70% to 75% of the underlying assets and the Group's Credit Risk function monitors compliance with agreed covenants relating to both the customer and the asset pool. At 30 September 2018 there were no significant concerns regarding the credit performance of these facilities and no provisions for impairment had been made.

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's 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 £108.7m (2017: £109.0m).

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 2018, £944.4m had been drawn under the TFS (2017: £700.0m).

Following the closure of the TFS to new drawings in February 2018, the Bank participated in the Bank of England Indexed Long-Term Repo scheme ('ILTR') again encumbering assets. Drawings under the ILTR at 30 September 2018 were £80.0m. 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 2018				
In respect of:				
Asset backed loan notes	**5,052.2**	**40.8**	**-**	**5,093.0**
Warehouse facilities	**1,030.2**	**-**	**-**	**1,030.2**
Central bank facilities	**1,670.1**	**-**	**-**	**1,670.1**
Total pledged as collateral	**7,752.5**	**40.8**	**-**	**7,793.3**
Prepositioned with Bank of England	**1,171.1**	**-**	**-**	**1,171.1**
Other assets not pledged as collateral	**1,408.6**	**548.8**	**1,206.0**	**3,163.4**
	10,332.2	**589.6**	**1,206.0**	**12,127.8**

	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

Source: Group Accounts

At 30 September 2018 53.7% (2017: 63.3%) 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. A row reference has been provided to align the table below with Template A.

Row Ref		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 2018				
010	**Assets of the reporting institution**	**8,668.5**	**N/A**	**6,140.9**	**N/A**
020	Loans on demand	**326.5**	**N/A**	**983.0**	**N/A**
040	Debt securities	**-**	**-**	**-**	**-**
070	Of which: issued by general government	**-**	**-**	**-**	**-**
100	Loans and advances other than loans on demand	**7,480.1**	**N/A**	**4,944.7**	**N/A**
110	Of which: mortgage loans	**7,309.8**	**N/A**	**3,438.3**	**N/A**
120	Other assets	**861.9**	**N/A**	**213.2**	**N/A**
	At 30 September 2017				
010	**Assets of the reporting institution**	9,689.0	N/A	4,189.9	N/A
020	Loans on demand	553.9	N/A	943.0	N/A
040	Debt securities	-	-	-	-
070	Of which: issued by general government	-	-	-	-
100	Loans and advances other than loans on demand	8,169.3	N/A	3,027.6	N/A
110	Of which: mortgage loans	7,978.0	N/A	1,878.6	N/A
120	Other assets	965.8	N/A	219.3	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.

Row Ref		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
	At 30 September 2018		
010	Carrying amount of selected financial liabilities	**4,729.5**	**8,668.5**
090	Debt Securities issued	**4,729.5**	**8,668.5**
100	Of which: covered bonds issued	**-**	**-**
110	Of which: asset-backed securities issued	**4,729.5**	**8,668.5**
120	Other sources of encumbrance	**935.6**	**-**
160	Other	**935.6**	**-**
170	**Total sources of encumbrance**	**5,665.1**	**8,668.5**
		£m	£m
	At 30 September 2017		
010	Carrying amount of selected financial liabilities	7,806.7	10,410.4
090	Debt Securities issued	7,806.7	10,410.4
100	Of which: covered bonds issued	-	-
110	Of which: asset-backed securities issued	7,806.7	10,410.4
120	Other sources of encumbrance	1,306.7	-
160	Other	1,306.7	-
170	**Total sources of encumbrance**	9,113.4	10,410.4

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	
		2018	2017	**2018**	2017
		£m	£m	**£m**	£m
Counterparties rated					
AA	(CQS 1)	**7.9**	-	**2.0**	-
AA-	(CQS 1)	**169.7**	213.3	**41.0**	52.8
A+	(CQS 2)	**5.4**	41.8	**3.1**	29.5
A	(CQS 2)	**630.2**	615.4	**373.2**	365.3
BBB+	(CQS 3)	**42.5**	36.1	**29.9**	22.2
Gross exposure		**855.7**	906.6	**449.2**	469.8
Collateral amounts posted		**(77.8)**	(723.6)	**(13.4)**	(211.0)
Net exposure		**777.9**	183.0	**435.8**	258.8

Source: Group Accounts (excluding exposure values)

The carrying 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 by the Group under such CSA agreements at 30 September 2018 was £3.8m (30 September 2017: £2.0m). This amount remains on the Group balance sheet.

The reduction in collateral cover is the result of a major counterparty to the Group's cross-currency basis swaps no longer being required to post collateral due to the improved credit position of the institution, as determined by the independent trustees of the related note issues.

Short term investments

The Group's short term investments are held within the Bank and form part of the liquidity buffer it is required to hold by the PRA. These investments may only be placed in treasury bills and gilts issued by the UK government, or such similar instruments as are permitted by the regulator, and as such the credit risk was judged to be minimal.

Cash and cash equivalents

The 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 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**	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Institutional exposures				
Derivative financial assets	**855.7**	906.6	**435.8**	258.8
Bank deposits	**414.7**	881.9	**82.9**	176.3
Total institutional exposures	**1,270.4**	1,788.5	**518.7**	435.1
Sovereign exposures				
Central bank deposits	**895.9**	615.0	**-**	-
CRDs	**6.2**	1.6	**-**	-
Accrued interest on CRDs	**0.4**	-	**-**	-
Total sovereign exposures	**902.5**	616.6	**-**	-
Total counterparty credit exposures	**2,172.9**	2,405.1	**518.7**	435.1

Source: Group Accounts (excluding exposure values)

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

Interest rate risk is the current or prospective risk to capital or earnings arising from adverse movements in interest rates. The Group's exposure to this risk is a natural consequence of its lending, deposit taking and other borrowing activities, as some of its financial assets and liabilities bear interest at rates which float with various market rates while others are fixed, either for a term or for their whole lives. Such risk is referred to as Interest Rate Risk in the Banking Book ('IRRBB'). The 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.

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.

In July 2017 the FCA announced that it was its intention that by the end of 2021 the LIBOR reference rate would have been superseded and therefore, it would no longer be necessary for it to compel banks to make submissions to the LIBOR process settings after that point. A clear consensus has yet to emerge on how the transition from LIBOR and other Interbank Offered Rates to alternative benchmarks will be managed across the banking industry. LIBOR is used in setting interest rates on significant amounts of the Group's loan assests and borrowings and the Group has established an internal working group to identify the impact on the business and ensure a consistent approach is taken to its transition from LIBOR to other reference rates.

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. Measurement of IRRBB is reported to ALCO on a monthly basis who provide control and oversight and 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 2018 and 30 September 2017. 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. Any repricing is assumed to take place on the year end date.

	2018	2017
	£m	£m
Variable rate mortgage loans	**61.8**	69.4
Variable rate consumer loans	**3.9**	5.8
Portfolio hedging on fixed rate loans	**34.4**	22.5
Interest bearing cash balances	**12.6**	13.6
Sterling equivalent principal of FRN and warehouse borrowings	**(56.7)**	(68.9)
TFS funding at bank base rate	**(9.4)**	(7.0)
Variable rate retail deposits	**(16.5)**	(9.4)
Portfolio hedging on fixed rate retail deposits	**(19.6)**	(13.7)
	10.5	12.3

Source: Group Accounts

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's retail funding strategy is focused on building a stable mix of deposit products. A high proportion of balances, 97.9%, 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:

	2018	2017
	£m	£m
Payable on demand	**1,294.3**	606.6
Payable in less than one year	**2,380.5**	1,652.5
Payable in less than one year or on demand	**3,674.8**	2,259.1
Payable in one to two years	**1,068.8**	795.5
Payable in two to five years	**720.8**	687.4
	5,464.4	3,742.0

Source: Group Accounts

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 2018 the liquidity buffer comprised the following on and off balance sheet assets, all held within the Bank.

	2018	2017
	£m	£m
Balances with central banks	**724.9**	615.0
Short term investments	**-**	-
Total on balance sheet liquidity	**724.9**	615.0
FLS drawings	**108.7**	109.0
Total	**833.6**	724.0

Source: Group Accounts

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 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 High Quality Liquid Assets ('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	**2018**	2017	Regulatory minimum
LCR	**144%**	246%	100%
NSFR	**113%**	110%	100%†

† 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.

Appendix D sets out certain of the disclosures on liquidity mandated by the EBA Guidelines on LCR disclosure (EBA/GL/2017/01), appropriate to the Group's size.

POTENTIAL LIQUIDITY

At 30 September 2018 the Group had £4,334.5m of unencumbered loan assets at carrying value, which might be used to generate liquidity either as security for debt, or through sales (2017: £2,850.6m). Of these £1,171.1m had been pre-positioned with the Bank of England, giving rapid access to central bank funding (2017: £122.1m).

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 the liquidity buffer and already charged balances, was £238.0m (2017: £305.5m).

FURTHER INFORMATION

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

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 47 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
- Information on remuneration governance and practices
- Disclosures required on the remuneration of certain employees
- The location of further relevant disclosures on remuneration

The Bank is required to prepare Remuneration Code Pillar III disclosures in addition to the regulatory capital disclosures. As all of the information which must be included in the disclosures is also relevant to the Group as a whole, these disclosures have been included in this document instead of being presented separately, as in previous years.

PRA Supervisory Statement LSS8/13 'Remuneration Standards: the application of proportionality' (updated June 2015) categorises the 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.

Following the Group's reorganisation on 20 September 2017, the directors of the Company have also constituted the Board of Directors of the Bank and the members of its Remuneration Committee have comprised the Remuneration Committee of the Bank.

GOVERNANCE

The Board of Directors of the Bank has delegated the responsibility for oversight of its remuneration policy and the remuneration decision making process to its Remuneration Committee.

The Committee comprised the Chairman of the Board and three independent non-executive directors at the year-end and was chaired by one of the independent non-executive directors. The terms of reference for the RemCo have been approved by the Bank's Board of Directors. The Remuneration Committee's mandate is to:

1. Determine remuneration policy in relation to fixed and variable pay for employees;
2. Ensure that executive directors and senior employees of the Bank are fairly rewarded for their individual contributions to overall performance, having regard to the importance of retention, motivation, risk appetite and ensuring good customer outcomes are achieved;
3. Determine which employees are Remuneration Code Staff ('Code Staff') for the purposes of the Remuneration Code. The Bank considers the following to be Code Staff:
    i. Paragon Bank executive directors;
    ii. Paragon Bank independent non-executive directors; and
    iii. Employees performing selected roles which have significant influence on the firm's risk profile including selected control functions, as detailed under the Senior Manager Regime and approved as holding a Senior Management Function role
4. Determine levels of fixed and variable pay for individual Code Staff and, as appropriate, for certain schemes, apply claw back;
5. Ensure that its decisions are consistent with an assessment of the Bank's financial condition and future prospects and in the interests of its shareholders and other stakeholders; and
6. Monitor that the Bank is fully compliant with the requirements of the PRA / FCA's Remuneration Code.

ADVISORS

During the year, the Remuneration Committee considered advice from:

- Deloitte LLP ('Deloitte') who were appointed as the Committee's independent advisor in February 2016 following a review process. Deloitte is a founder member of the Remuneration Consultants Group and as such voluntarily operates under its Code of Conduct in relation to executive remuneration in the UK. This supports the Committee's view that all advice received during the year was objective and independent. The total fees paid to Deloitte for advice to the Committee during the year amounted to £61,000 (including VAT). Deloitte provided other professional services to the Group during the year including share scheme advice, corporate tax advice, pension structuring advice, regulatory advice, co-sourced internal audit services and advice relating to the Group's structured finance business.

- The Chief Executive and the People Director in determining directors' remuneration for the year.

LINK BETWEEN PAY AND PERFORMANCE

Fixed pay (salary and benefits) is primarily set taking into account market rates and benchmarks as appropriate. Variable pay is determined via a combination of long-term performance measures and individual performance ratings;

Long term business performance measures

The long-term business performance measures are documented in long term incentive schemes which are operated and provided by the Group, details of which are set out in the Group Accounts.

Individual performance ratings

Individual performance ratings are part of the annual review process and reflect individual contribution against personal objectives. Appropriate risk conduct is reflected in the annual performance objectives, and subsequent rating of the employee.

AGGREGATE QUANTITIVE INFORMATION ON REMUNERATION

Year ended 30 September 2018		
14 Code Staff	**Total Remuneration = £8,409,474**	
	Senior Management*	**Totals**
Fixed remuneration	**£2,635,710**	**£2,635,710**
Variable remuneration – cash	**£2,491,850**	**£2,491,850**
Number of staff	**14**	**14**
Cash paid in year	**£5,127,560**	**£5,127,560**
Variable remuneration - deferred in shares †	**£3,281,915**	**£3,281,915**
Total deferred in current year	**£3,281,915**	**£3,281,915**

Year ended 30 September 2017		
20 Code Staff ‡	Total Remuneration = £1,753,042	
	Senior Management*	Totals
Fixed remuneration	£942,785	£942,785
Variable remuneration – cash	£401,563	£401,563
Number of staff	20	20
Cash paid in year	£1,344,348	£1,344,348
Variable remuneration - deferred in shares †	£408,694	£408,694
Total deferred in current year	£408,694	£408,694

Due to the change in legal and regulatory structure for the Bank and PBG on 20 September 2017, the remuneration of Code staff to 30 September 2018 reflects their full time equivalent earnings, rather than being pro-rated to include only the number of working days a number of individuals held a regulatory authorised role in the bank subsidiary in the previous year.

Notes to the remuneration table

The number of Code Staff represents the number of persons who held a regulatory authorised role at any point in the year. Code staff include four independent non-executive directors, the independent Chairman and senior business risk, compliance and control personnel. Code staff work across all business areas and therefore it is not appropriate to present a split of this information by business area.

No staff, other than senior managers, had a material impact on the risk profile of the firm in the year.

* Senior management are those staff who hold an approved SMF role under the Senior Managers Regime.

‡ During 2017, there were 11 Code Staff prior to the restructure and 13 following the restructure; 4 individuals remained as Code Staff throughout the reporting period, although their SMF function and Prescribed Responsibilities changed.

† Share based remuneration is valued on the basis of the market value of shares granted at the date of grant.

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
BCP	Business Continuity Plan
BIA	Basic Indicator Approach
CC	Credit Committee
CCC	Conduct and Compliance Committee
CCoB	Capital Conservation Buffer
CCyB	Counter Cyclical Buffer
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CFO	Chief Financial Officer
Code Staff	Remuneration Code Staff
CQS	Credit Quality Step
CRD	Capital Requirements Directive
CRD IV	Capital Requirements Directive IV
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
CSA	Credit Support Annex
C-SREP	Capital Supervisory Review and Evaluation Process
Deloitte	Deloitte LLP
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 Bank of 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 2018
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
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
LTGDV	Loan to Gross Development Value
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
ORC	Operational Risk Committee
Part 8	Part 8 of the CRR
PFE	Potential Future Exposure
Plan	The defined benefit pension plan operated by the Group.
Portfolio Quality	Average risk weightings applied to portfolios
Portfolio Size	Unweighted value of portfolios
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
RemCo	Remuneration Committee
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
Risk appetite 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
RRP	Recovery and Resolution Plan
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 Code	The UK Corporate Governance Code
The Company	Paragon Banking Group PLC
The Group	Paragon Banking Group PLC and all its subsidiary entities
TRE	Total Risk Exposure
UK	United Kingdom
UKF	UK Finance
Wrong Way Risk	Risk arising either due to a material positive correlation between collateral and counterparty or arising due to counterparty credit risk

Appendix A
Own funds disclosures

CAPITAL INSTRUMENTS' MAIN FEATURES

Presented in accordance with Annex II of Commission Implementing Regulation (EU) No 1423/2013.

		1	2
		EQUITY	**2016 CORPORATE BOND**
1	Issuer	Paragon Banking Group PLC	Paragon Banking Group PLC
2	Unique identifier (eg. CUSIP, ISIN or Bloomberg identifier for private placement)	ISIN GB00B2NGPM57	ISIN XS1482136154
3	Governing law(s) of the instrument	England and Wales	England and Wales
REGULATORY TREATMENT			
4	Transitional CRR rules	N/A	N/A
5	Post-transitional CRR rules	Common Equity Tier 1	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
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
9a	Issue price	Nominal value £1 †	Par
9b	Redemption price	N/A	Par
10	Accounting classification	Shareholders' Equity	Liability-amortised cost
11	Original date of issuance	Original listing date 15 May 1989 *	9 September 2016
12	Perpetual or dated	Perpetual	Dated
13	Original maturity date	No maturity	9 September 2026
14	Issuer call subject to prior supervisory approval	No	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
16	Subsequent call dates, if applicable	N/A	N/A
COUPONS / DIVIDENDS			
17	Fixed or floating dividend/coupon	Floating	Fixed‡
18	Coupon rate and related index	N/A	7.25%
19	Existence of a dividend stopper	N/A	No
20a	Full discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretional	Mandatory

COUPONS / DIVIDENDS			
21	Existence of step up or other incentive to redeem	No	No
22	Noncumulative or cumulative	Non-cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	N/A	N/A
25	If convertible, fully or partially	N/A	N/A
26	If convertible, conversion rate	N/A	N/A
27	If convertible, mandatory or optional conversion	N/A	N/A
28	If convertible, specify instrument type convertible into	N/A	N/A
29	If convertible, specify issuer of instrument it converts into	N/A	N/A
30	Write-down features	N/A	No
31	If write-down, write-down trigger(s)	N/A	N/A
32	If write-down, full or partial	N/A	N/A
33	If write-down, permanent or temporary	N/A	N/A
34	If temporary write-down, description of write-up mechanism	N/A	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	2	N/A
36	Non-compliant transitioned features	No	No
37	If yes, specify non-compliant features	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.

Full terms of business for the Group's Common Equity Tier 1 and Tier 2 instruments are provided on the Investor Relations section of its website https://www.paragonbankinggroup.co.uk/investors

OWN FUNDS DISCLOSURE

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

		2018 £M	2017 £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	347.4	347.0	26 (1), 27, 28, 29
	Of which: ordinary shares	347.4	347.0	EBA list 26 (3)
2	Retained earnings	890.7	784.5	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	(142.2)	(122.1)	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	(35.8)	(28.9)	26 (2)
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**1,060.1**	**980.5**	**Sum of rows 1 to 5a**

		2018 £M	2017 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
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)	(169.3)	(104.4)	36 (1) (b), 37
9	Empty set in the EU			
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 holdings 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 holdings by the institution 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
20	Empty set in the EU			
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)

		2018 £M	2017 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
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)
24	Empty set in the EU			
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)**	**(169.3)**	**(104.4)**	**Sum of rows 7 to 20a, 21, 22 and 25a to 27**
29	**Common Equity Tier 1 (CET1)**	**890.8**	**876.1**	**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**
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
41	Empty set in the EU			
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	-	-	56 (e)

		2018 £M	2017 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
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)**	890.8	876.1	**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	150.0	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	4.9	4.4	62 (c) & (d)
51	**Tier 2 (T2) capital before regulatory adjustments**	**154.9**	**154.4**	
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**	**154.9**	**154.4**	**Row 51 minus row 57**
59	**Total capital (TC = T1 + T2)**	**1,045.7**	**1,030.5**	**Sum of row 45 and row 58**
60	**Total risk weighted assets**	**6,445.3**	**5,508.7**	
CAPITAL RATIOS AND BUFFERS				
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	13.8%	15.9%	92 (2) (a)
62	Tier 1 (as a percentage of total risk exposure amount)	13.8%	15.9%	92 (2) (b)
63	Total capital (as a percentage of total risk exposure amount)	16.2%	18.7%	92 (2) (c)

		2018 £M	2017 £M	REGULATION (EU) NO 575/2013 ARTICLE REFERENCE
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)	11.00%	9.25%	CRD 128, 129, 130, 131, 133
65	Of which: capital conservation buffer requirement	2.50%	1.25%	
66	Of which: countercyclical buffer requirement	0.50%	-	
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)	5.8%	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
74	Empty set in the EU			
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
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)	4.9	4.4	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 2018
Entity name	Paragon Banking Group PLC
Level of application	Consolidated

Table LRSum: Summary reconciliation of assets and leverage ratio exposures

		APPLICABLE AMOUNT	
		2018 £M	2017 £M
1	Total assets as per published financial statements	14,515.1	13,682.2
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	172.1	191.3
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)	248.5	209.0
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)	248.5	209.0
7	Other adjustments	(141.0)	(92.2)
8	**Leverage ratio total exposure measure**	**14,794.7**	**13,990.3**

Table LRCom: Leverage ratio common disclosure

		CRR LEVERAGE RATIO EXPOSURES	
		2018 £M	2017 £M
ON-BALANCE SHEET EXPOSURES (EXCLUDING DERIVATIVES AND SFTS)			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	13,687.7	12,787.8
2	(Asset amounts deducted in determining Tier 1 capital)	(169.3)	(104.4)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**13,518.4**	**12,683.4**
DERIVATIVE EXPOSURES			
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	855.7	906.6
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	172.1	191.3
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)**	**1,027.8**	**1,097.9**
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)**	**-**	**-**
OTHER OFF-BALANCE SHEET EXPOSURES			
17	Off-balance sheet exposures at gross notional amount	817.7	417.9
18	(Adjustments for conversion to credit equivalent amounts)	(569.2)	(208.9)
19	**Other off-balance sheet exposures (sum of lines 17 and 18)**	**248.5**	**209.0**
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))	-	-

		CRR LEVERAGE RATIO EXPOSURES	
		2018 £M	2017 £M
CAPITAL AND TOTAL EXPOSURE MEASURE			
20	Tier 1 capital	890.8	876.1
21	**Leverage ratio total exposure measure (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**14,794.7**	**13,990.3**
LEVERAGE RATIO			
22	**Leverage ratio**	**6.0%**	**6.3%**
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	
		2018 £M	2017 £M
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	13,518.4	12,683.4
EU-2	Trading book exposures	-	-
EU-3	Banking book exposures, of which:	13,518.4	12,683.4
EU-4	Covered bonds	-	-
EU-5	Exposures treated as sovereigns	902.5	616.6
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	13.5	12.3
EU-7	Institutions	414.7	881.9
EU-8	Secured by mortgages of immovable properties	10,743.4	10,315.9
EU-9	Retail exposures	797.9	592.0
EU-10	Corporate	188.3	125.8
EU-11	Exposures in default	36.8	38.7
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	421.3	100.2

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

1	Description of the processes used to manage the risk of excessive leverage	Risk of excessive leverage is the risk that arises through maintaining an inappropriate leverage ratio or mismatches between assets and obligations. This risk is not considered significant for the reasons considered below. The current structure of the balance sheet returns a high leverage ratio. The Group's leverage ratio has remained well in excess of the minimum 3% set out in the CRR since the Bank's authorisation. This positive position will be maintained during the period covered by the business planning process, which will take account of stress testing impacts on the ratio.
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.

Appendix D
LCR COMMON DISCLOSURE TEMPLATE

Presented in accordance with Annex II of the EBA Guidelines on LCR Disclosure (EBA/GL/2017/01) published on 8 March 2017.

TEMPLATE EU LIQ1

		APPLICABLE AMOUNT	
		2018 £M	2017 £M
21	Liquidity buffer	963.8	724.0
22	Total net cash outflows	669.3	294.0
23	Liquidity Coverage Ratio	144%	246%

PARAGON BANKING GROUP PLC
51 Homer Road, Solihull, West Midlands B91 3QJ
Telephone: 0121 712 2323
www.paragonbankinggroup.co.uk
Registered No. 2336032

400-3 (01/2019)