A. Strategic Report

The business and its performance in the year

The response to the pandemic has demonstrated the strength of the Group's proposition...

Fiona Clutterbuck
Chair of the Board

A1. Chair of the Board's introduction

Dear Shareholder

I find myself introducing my third report and accounts as Chair at the end of one of the most extraordinary years in the history of the Group, and indeed in the history of the UK corporate sector as a whole, and a year which demonstrated the fundamental resilience of the Group. I am very proud of the way in which the business responded to the Covid-19 pandemic, prioritising supporting our customers, protecting our people, preserving our capital and ensuring the ongoing future value of the business.

We have provided additional information in this report to help you understand the impact of Covid-19 on the Group's operations and financial results. I hope you find this report useful in understanding our business and the story of our year.

The business and its purpose

The business is managed through three lending divisions, Mortgage Lending, including buy-to-let, Commercial Lending and Idem Capital, with each division offering a range of specialist lending propositions. These are principally funded through our retail deposit base, supplemented with wholesale and central bank borrowings.

During the year the divisions have continued to pursue the strategic aims we have shared previously, and while the pandemic has adversely affected advances in the short-term, the growth of our development finance business has continued strongly, while our core buy-to-let specialist landlord customer base has remained robust.

The response to the pandemic has demonstrated the strength of the Group's proposition and, notwithstanding the continuing economic uncertainties, we see significant opportunities for further development and investment in the year to come.

I was particularly pleased with the ability of the business to move over 90% of its people to homeworking within a week of the lockdown on 23 March 2020. We supported our customers through the provision of payment reliefs, maintaining service levels across all business areas, preserving the availability of new lending, providing access to CBILS and BBLS and continuing to offer attractively priced deposits. This was a great demonstration of how we aim to fulfil our purpose – to support the ambitions of the people and the businesses of the UK by delivering specialist financial services.

We pride ourselves on our culture and I believe that the way in which our colleagues responded to the crisis has further highlighted how embedded that ethos is within the business and its people. During the year PwC carried out a review of the Group's culture and noted:

"There is strong collaboration across the leadership team, and a real sense of being part of a 'family'. This alignment means that the leadership work well together … and role model the desired behaviours consistently."

It is these behaviours which allowed the Group to respond so effectively to the pandemic for the benefit of all our stakeholders.

The Group's business model and purpose are described more fully in Section A2

Results

The Group's new lending in the year was £2.0 billion, reduced from £2.5 billion in 2019 as a result of constrained volumes in the second half. The savings deposit base grew to £7.9 billion from £6.4 billion a year earlier at an improved funding cost and the Bank of England TFSME programme was accessed.

Margins were impacted during the second half as a result of the base rate cuts in March and the increase in expected loss provisions by £40.0 million saw underlying profit before tax reduce to £120.0 million from £164.4 million in 2019. Profit before tax on the statutory basis fell by 25.5% to £118.4 million, reflecting one off gains made in 2019.

Underlying earnings per share ('EPS') decreased to 36.5 pence (2019: 51.1 pence) and statutory EPS fell to 36.0 pence (2019: 49.4 pence). Underlying return on tangible equity was 9.8% (2019: 14.6%), 9.7% on the statutory basis (2019: 14.1%).

The Group's capital base has remained strong, with high levels of liquidity maintained through the year and regulatory Core Equity Tier 1 ('CET1') ratio increasing to 14.3% (2019: 13.7%).

The financial results and operational performance are reviewed in Section A3

Stakeholders

We take our responsibility to all our stakeholder groups very seriously and our response to Covid-19 during the year was designed to protect the interests of customers, employees and suppliers as well as preserving shareholder value. We acknowledge our duties as a corporate citizen. We did not access any government support schemes, no employees were placed on furlough and no redundancies were made as a result of the Covid-19 outbreak.

Climate change is one of the biggest challenges faced by the world today and we are therefore cognisant of the growing pressure from investors for more and better reporting on companies' responses to climate change and other environmental issues and I hope you will find the additional information we have provided helpful. This evidences the Group's response to climate change, which will continue to develop over time.

I have been deeply impressed by the energy and commitment shown by senior management, and, indeed, all of our colleagues, in response to the pandemic which resulted in considerable personal upheaval for many. A significant number needed to balance childcare and home-schooling commitments whilst working at home during the pandemic. I am pleased that the Group was able to support employees, in some cases changing working patterns or offering additional paid leave. I am very grateful to all of the Group's people for their hard work and dedication throughout the period.

Social responsibility issues are discussed in Section A6

Governance

This was the first year where the Company was operating under the 2018 edition of the UK Corporate Governance Code. We had put systems in place before the beginning of the year and were able to report our compliance with the new provisions.

As part of the new arrangements enhanced employee voice provisions were instituted and I was pleased to attend our People Forum during the year to hear directly from our colleagues. I was also able to meet with shareholders and investor groups over the year on governance matters and I continue to value their input; their perspective helps us determine our priorities for the future.

We also present, for the first time in these accounts, a detailed analysis of how the Board takes into account the impact of its decisions on all stakeholders. I hope you will find this useful.

During the year, John Heron and Peter Hartill stepped down from the Board and Finlay Williamson announced his intention to step down in December 2020. All of them have made significant contributions to the Group over the years and they leave with the grateful thanks of their colleagues, my fellow directors and myself. We will miss their wise counsel.

I am delighted to welcome Alison Morris, who joined the Board in the year and now chairs the Audit Committee and Peter Hill who joined the Board after the year end. Following these changes, I am pleased to say that female directors will comprise 37.5% of the Board.

The Covid-19 crisis has impacted the Group in many ways and required an increased time commitment from my board colleagues. I would like to pay tribute to them for the level of care, thought and commitment they brought to this task.

Corporate governance is discussed in Section B3

Risk

The Group continues to invest in developing and supporting its risk management systems. A thorough review of principal risk categories was adopted by the Board and climate change risk, reputational risk and model risk were separately identified as principal risks for the first time, reflecting their importance in the Group's future strategy.

A particular focus of risk management in the year was the operational changes introduced in response to Covid-19. It was a priority to ensure that there was no weakening of the risk management arrangements as a consequence of employees working from home and the resultant increase in cyber risk.

The Risk Management report is set out in Section B8

Shareholder returns

The actions taken to protect shareholder value and the strong capital position of the Group underpin the payment of a final dividend for the financial year. We decided not to pay an interim dividend, due to the difficulty in determining the long-term economic impact of the pandemic at that point in time, despite the strength of our capital ratios. Following significant capital stress testing the Board has concluded that a dividend for the year of 14.4 pence per share can be declared, subject to shareholder approval, giving a dividend cover of 2.5 times, broadly in line with policy. We thank our shareholders for their support in the year.

Conclusion

The Group has performed well through the Covid-19 crisis, demonstrating its operational robustness and its ability to respond rapidly to new developments, with new processes, systems and ways of working. All of this enabled us to support customers and business partners through this difficult time, strengthening relationships for the future.

The underlying fundamentals of the Group's business remain sound and despite the short-term economic uncertainties which remain as a result of Covid-19, I believe that the Group is well placed for the future.

Fiona Clutterbuck

Chair of the Board

3 December 2020

A2. Business model and strategy

Paragon at a glance

Paragon is a specialist banking group. We offer a range of savings products and provide finance for landlords, small businesses and property developers in the UK.

Listed on the London Stock Exchange, we are a FTSE 250 company, headquartered in Solihull, employing just under 1,400 people.

Since gaining our banking licence in 2014, our new lending is funded principally through an online personal savings operation. We have expanded our operations in buy-to-let and extended into a wide range of commercial lending markets, including asset and development finance. We also service a range of consumer loan portfolios through our subsidiary, Idem Capital.

Our history

Paragon began life as a specialist residential mortgage lender in 1985. A pioneer in buy-to-let lending, in 1995 we launched our first mortgage products for UK landlords in the growing Private Rented Sector ('PRS') achieving a 10% share in the buy-to-let market by 2006. After successfully navigating through the financial crisis in 2008, we returned to new lending in 2010, and in 2014 we embarked on an ambitious transformation to diversify our funding sources and enter new lending markets.

Paragon Bank was established in 2014 and over the next few years we began supporting UK businesses in a wide range of sectors, including asset finance and property development. Today we help more than 400,000 customers to achieve their ambitions.

Our values

We have a strong and unique culture underpinned by eight essential values, which we strive to exceed every day. These values underpin how we operate, what we stand for and how we work together to achieve our goals. We believe that living our values helps us succeed in fulfilling our purpose (see page 14).

Fairness
To work together to ensure fair outcomes for all our customers

Professionalism
To maintain the highest standards and deliver our products and services with care and accuracy

Integrity
To be honest and open in everything we do

Humour
To ensure we have fun while achieving success!

Commitment
To drive the business forward with determination and to do so with effort and enthusiasm

Creativity
To identify and create new business opportunities and apply creative and effective solutions to problems

Teamwork
To work in harmony and collectively towards the delivery of our overall objective

Respect
To treat people as individuals and listen to their views

Our operations

Paragon's operations are organised into three divisions and new lending is funded largely by retail deposits. These divisions are supported by the Group through the provision of capital and central services, including loan servicing, marketing, information technology and legal support. This operating model comprises local specialism with strong centralised resources enabling economies of scale to be achieved and centres of excellence to be developed.

Mortgage Lending

We provide mortgage finance for UK landlords to support growth in the Private Rented Sector ('PRS'), giving people choice and flexibility in housing tenure.

See pages 20 and 21

Commercial Lending

We support UK small businesses operating across a range of sectors with finance to help them grow. This includes finance for property developers, motor finance and structured lending products for non-bank lenders.

See pages 22 to 25

Idem Capital

We acquire and service UK loan portfolios from other financial institutions.

Funding

Our principal source of funding for new lending is our range of savings products offered to UK savers. Other funding for lending is derived from the efficient use of Bank of England funding schemes, while securitisation continues to fund much of the legacy book and is used tactically. Central funding is provided through corporate and retail bonds.

See pages 18 and 19

Our business model

What is a specialist bank?

As a specialist bank, we focus on lending to customers in markets typically underserved by larger high street banks who require funding in specific areas. This approach requires us to be experts in these areas, and we seek to know more than our competitors about our customers and the markets in which we operate, the products and services we offer, and the risks we incur.

We see specialisation as what makes us different, as our competitive advantage, and it runs through our business model and strategy.

What we do

A broad funding base

We fund our assets using a variety of sources, including retail deposits, securitisation and bond issuance. We take care to secure competitive funding over an appropriate term to underpin our assets, meet working capital requirements and maintain a strong financial position.

Lending on diversified loan assets

We focus on building our asset base by originating new loans, developing new products, diversifying into new markets and acquiring loan portfolios.

Generating growing income

Paragon generates income from interest and fees earned on our mortgage, consumer and SME loan assets. We also earn fees from third parties for administering similar loans on their behalf.

A customer focussed culture, based on eight core values, and an engaged, skilled and diverse workforce

How we add value

Our core strengths

Customer expertise
We have a deep understanding of our customers and their markets, designing products to meet their needs and continually striving to exceed their expectations.

600 million items of customer data analysed each month

Risk management
We lend conservatively, based on detailed credit assessments of the customer and underlying loan collateral, to minimise the risk of non-payment and portfolio losses.

Cost of risk 0.39%

Cost control
Distributing loan products principally via third party brokers, collecting savings deposits online and operating mainly from a centralised location means we run a cost efficient business.

Underlying cost:income ratio 43.0%

Our people
We are committed to helping all our employees reach their potential and recognise the importance of diversity, thereby maintaining a skilled and engaged workforce.

Gold Investors in People accreditation

Technology
We are utilising technology to improve productivity and access new markets, and are well placed to take advantage of digital changes to enter new markets.

New online portal for landlord customers launched in 2020

Management expertise
We have an experienced management team with a through-the-cycle track record.

Average length of service for the executive management team is 15 years

Culture
Eight core values underpin the way we do business and how we interact with our customers and other stakeholders, with a focus on treating customers fairly.

91% of employees feel Paragon has clear values[1]

Strong financial foundations
We efficiently utilise capital and debt positions to maintain balance sheet strength.

CET1 14.3%

[1]Investors in People report, 2019

Value created

This approach enables us to create value for all our stakeholders.

Shareholders
Creating long-term shareholder value through growing profits and dividends.

14.4p dividend per share

See page 40

Customers
Providing tailored lending products, expertise and working with intermediaries to help our customers achieve their ambitions.

+61 Net promoter score for savings account opening

See pages 19 and 21

Employees
Helping all our people develop their career and reach their potential.

Average training per employee in 2020: 4.2 days

(CIPD average 2.8-3.3 days)

See page 59

Society
Helping the UK economy grow and supporting the communities in which we operate.

£100,000 charity donation to tackle Covid-19 impact

See page 65

Environment
Continually reducing our environmental impact and designing products that support positive environmental change.

100% of electricity used by sites for which we are responsible was from renewable energy sources in 2020

See page 63

Our strategy

Helping our customers to achieve their ambitions is central to our success and this is what drives our purpose and our vision. We have a clear strategy to help us achieve our goals and we have eight important values that underpin our culture and the way we do business.

Our strategic framework

Our purpose

To support the ambitions of the people and businesses of the UK by delivering specialist financial services

Our vision

To become the UK's leading specialist bank by helping our customers achieve their ambitions and be an organisation of which our employees are proud

Our strategy

To focus on specialist customers, delivering long-term sustainable growth and shareholder returns through a low risk and robust model

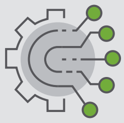
Our strategic priorities

Five strategic priorities help us deliver our strategy (see page 15)

Our values

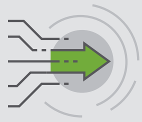
Eight values underpin our culture and the way we do business (see page 10)

Our strategic priorities



Diversification

As a diversified bank, we have a broad funding base and lend on diversified loan assets. We are continually developing our range of savings and lending products, in both existing and new markets, to grow our business and help us succeed in becoming the UK's leading specialist bank.



Specialisation

We operate in selective markets and focus on being experts in these often underserved areas. We lend to customers operating in specific sectors where our specialist knowledge and expertise can help them develop their businesses. We seek to build strong positions in our chosen markets and work closely with our customers to help them succeed.

Growth

To ensure we can deliver long-term sustainable growth for our shareholders and other stakeholders, we are continually seeking new opportunities. Growth both organically and through acquisition helps develop the business to enable long-term success.

Capital management

Strong levels of capital and liquidity provide solid foundations for our business. We aim to recycle capital to reinvest in the business and provide increasing returns for our shareholders.

Sustainability

Sustainability influences every aspect of our business. For Paragon, sustainability means reducing the impact that our operations have on the environment, ensuring we have a positive effect on our stakeholders and communities, and delivering sustainable lending through the products we offer and markets in which we operate.

Risks

We have identified a number of principal risks, arising from both the environment in which we operate and our business model, which could impact our ability to achieve our strategic priorities.

Capital

Insufficient capital to operate effectively and meet minimum requirements.

Liquidity and funding

Insufficient financial resources to enable us to meet our obligations as they fall due.

Market

Changes in the net value of, or net income arising from, our assets and liabilities from adverse movements in market prices.

Credit

Financial loss arising from a borrower or counterparty failing to meet their financial obligations.

Model

Making incorrect decisions based on the output of internal models.

Pension obligation

Our commitments under our defined benefit pension scheme are insufficient to meet our liabilities.

Reputational

Failing to meet the expectations and standards of our stakeholders.

Strategic

Changes to business model or environmental factors may lead to an inappropriate or obsolete strategy or strategic plan.

Climate change

Financial risks arising through climate change impacting the Group and our strategy.

Conduct

Poor behaviours or decision making leading to failure to achieve fair outcomes for customers.

Operational

Resulting from inadequate or failed internal procedures, people, systems or external events.

These risks and their mitigants are discussed in more detail in Section B8.

Our response to Covid-19

Paragon is a strong, resilient and diversified business and we were well placed to deal with the uncertainties that arose from the Covid-19 pandemic. Our operational response was swift and, in March 2020, we were able to quickly shift our focus from growth and diversification, to the implementation of well-developed contingency plans, reflecting our highly agile and flexible infrastructure, technology and people.

Our through-the-cycle experience, robust credit approach, experienced workforce and resilient systems have enabled us to navigate through the crisis and mitigate the impact on our business.

Our priorities during the outbreak of Covid-19 have been to support our customers and suppliers, protect our people, safeguard our capital base and preserve the long-term value of our business.

Supporting our customers and suppliers

The skills and experience of our specialist customer-facing teams helped us to understand the impact of Covid-19 on our customers and to support them with a range of payment relief options and recovery assistance across our portfolios.

- Customers representing 21% of loan balances were given a payment deferral of some sort. Of those, almost 95% had recovered sufficiently by 31 October 2020 and no longer need support
- We introduced a programme of customer engagement surveys and data collection to ensure that optimal approaches to customers' individual situations are identified
- We continued to apply the skills and experience of our in-house surveying team throughout the period
- The flexibility of our workforce meant we could create pools of employees so that high volume areas could be addressed, with resource being moved around the Group

We offered payment holidays to our mortgage customers to help them provide security for their tenants and we provided funding to our SME customers by gaining accreditation to the UK Government's Coronavirus Business Interruption Loans Scheme ('CBILS') and Bounce Back Loans Scheme ('BBLS').

These measures required rapid developments in IT systems and procedures delivered using agile techniques and on an accelerated timescale. Our systems were adapted to record such reliefs and ensure they did not impact on our customers' credit agency records.

Protect our people

Our 1,400 people are central to the success of our business. Keeping them safe has been our main priority and enabled us to maintain operational stability throughout this period.

By 31 March 2020, more than 90% of our people were working from home, supported by IT upgrades and expanded use of technology across the business. We adopted a flexible approach to working patterns and introduced policies focussing on the morale and wellbeing of employees, providing extensive communication and enhanced management.

Around 10% of our employees continued to travel to work to deliver essential services to our customers which could not be carried out from home. To keep them safe, we implemented strict social distancing, together with additional measures to promote good hygiene practices.

We introduced regular employee wellbeing surveys to help us understand how our people were coping and to highlight where extra support is needed. Our intranet site features a host of wellbeing information and our internal wellbeing team provides confidential support and advice to employees across the Group.

0 employees have been placed on furlough schemes and no redundancies have been necessary

60% increase in communication activity on our intranet

94% of employees believe Paragon has been considerate of employee wellbeing when making decisions that affect the workforce and **84%** of employees are satisfied or very satisfied with the support available[1]

Safeguard our capital base

Paragon entered this period with a strong capital base and significant liquidity, and our capital position has since been strengthened with liquidity access remaining good.

The volume of retail deposits in our savings operation has continued to grow, enhanced by the launch of a flexible ISA product, which proved successful in the spring 2020 ISA season.

No interim dividend was declared which helped retain resources to support our customers and continue to deliver growth, protecting our long-term financial position.

We completed our first fully retained securitisation, containing £760 million of prime buy-to-let fixed rate mortgage assets.

> **We have strong levels of capital and liquidity and are well placed to develop our core businesses as well as make the most of any potential opportunities that may arise in future...**
>
> **Nigel Terrington,**
> Chief Executive

Preserving the long-term value of the business

Building a long-term sustainable business is central to our strategy, and we have continued to take steps to ensure we are in a strong position to continue to grow lending volumes in our chosen markets when customer confidence returns.

- Our historic credit focus and operational resilience have enabled us to continue to lend across our divisions and maintain functionality across all customer-facing and support areas
- We have continued to invest in projects to make improvements in our systems and technology
- We have instigated engagement programmes with our customers and maintained operational performance with minimal impact on customer service
- We have maintained our prudent approach to lending, focus on risk and disciplined underwriting

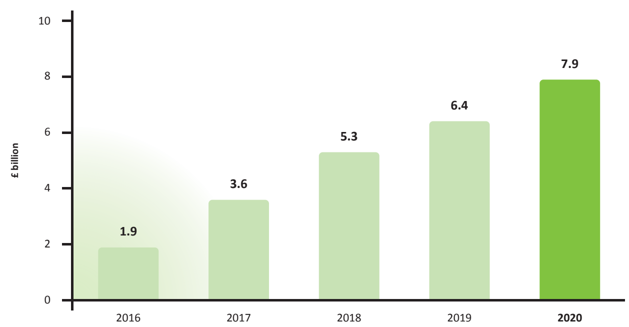
An important part of our response to Covid-19 has been changes to our risk profile. *See Section B8 for more details.*

[1]Employee survey, June 2020

In focus: Savings

> **There is no doubt we've seen a seismic shift in the savings market this year, which has brought both challenges and opportunities. Our savings business has proved nimble, adaptive and resilient to rapid market fluctuations, which has allowed us to secure strong growth...**
>
> **Michael Helsby,** Strategic Development Director

Our principal source of funding for new lending is our range of savings products offered to UK savers. The savings arm entered its sixth year in 2020 and the total volume of retail deposits has continued to grow and now stands at £7.9 billion.



Products

We offer simple and straightforward products at competitive rates. This ranges from fixed term products to easy access, including notice and defined access products and ISAs.

The majority of deposits are sourced through our own website and through aggregator platforms, however during the year we expanded our services to be available through an increased number of digital banks and wealth management platforms, including Monzo, Revolut and Hargreaves Lansdown.

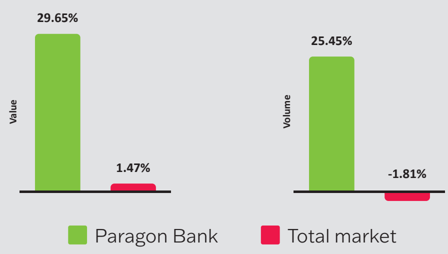
We also launched postal access across all of our fixed rate products.

ISA innovation

In November 2019, Paragon became one of few financial providers to offer a Lifetime ISA product, helping to engage with a new demographic of savers by predominantly appealing to 18-39 year old first time buyers. We also launched Wallet and Flexible ISA features across our portfolio during the year which allow savers to split their yearly ISA allowance across a range of ISAs held with Paragon.

45% **year-on-year increase in ISA applications during March and April**

Growth in ISA applications



Source: CACI, January – September 2020

Market

The UK household savings market is estimated at £1.29 trillion.

The Bank of England base rate declines triggered a reduction in saving rates offered across the market, with rates sinking to an historical low in the first months of the pandemic.

The climate of financial uncertainty brought on by the pandemic also had a profound impact on household deposits and created a divided picture in the UK savings market. Whilst many households were at a financial disadvantage due to Covid-19, others were able to supplement their savings, aided by reduced opportunities for consumer spending.

As a result, deposits soared during the first few months of the pandemic, although this then started to plateau as lockdown measures started to lift.

Between March and June 2020, household savings deposits increased by nearly £43 billion, compared to an increase of £18 billion in the same period in 2019[1]

Customers

In order to monitor customer satisfaction and identify areas for improvement, we regularly ask customers why they choose to save with us. We survey our savers at two stages of the customer journey: when they open a new account and at the maturity of a product.

187,000

direct savings customers, an increase of 14.3% on last year

£29,000

average deposit for direct customers

New customers

+61 **Net promoter score for savings account opening[2]**

75% of new customers reported being very satisfied with the customer service that they received, with **86%** finding the account opening process easy or very easy.

Amongst new customers, **93%** chose Paragon because we offered the highest rate of interest, however the FSCS guarantee, online access and the easy application process were also cited as popular reasons.

Overall, **88%** of new customers would consider taking another savings account with Paragon.

"Very quick and easy process to transfer my ISA from another provider. Everything done online which was important to me and the whole thing was done and in my Paragon account within a week. Excellent service - very pleased

Customer feedback

Existing customers

85% of customers were satisfied with the customer service they had received when their fixed rate product matured. **90%** of fixed rate product customers would take out another savings account with Paragon in the future.

+50 **Net promoter score for customers with maturing products[3]**

We also display customer feedback sourced through the independent service rating Feefo on our website. Our average Feefo customer rating stands at **4.3/5**, which is based on more than **1,100 reviews** during the last 12 months.

feefo

[1]Source: Bank of England [2]Net Promoter Score of +61 for new savings account opening process based on an online survey of 3,311 savings customers between 1 October 2019 and 30 September 2020 (total respondents to this survey were 3,438). [3]Net promoter score +50 for maturity accounts where fixed rate period ended based on an online survey of 2,972 savings customers between 1 October 2019 and 30 September 2020 (total respondents to this survey were 3,044).

In focus: Buy-to-let mortgages

With projected strong population and household formation growth across the UK, demand for good quality privately rented homes will become more pronounced in the coming years. Professional, larger-scale landlords have a greater propensity to invest in new property and it will be these portfolio landlords who will deliver the majority of new stock in the sector. Paragon's focus on this landlord customer group means we are well placed to meet this future demand, helping to provide homes for millions of people...

Richard Rowntree, Managing Director, Mortgages

We offer buy-to-let mortgage finance for landlords operating in the UK's Private Rented Sector ('PRS').

We were one of the first lenders to pioneer buy-to-let lending and, since 1996, we have originated £23.8 billion of buy-to-let accounts. During this time, we have built an unrivalled level of expertise in the market, becoming a leading authority on the sector and a principal source of engagement for regulators and government.

Our customer-focussed approach, combined with our expertise in property valuation and risk assessment, helps us support a wide range of customers, especially landlords with large-scale property portfolios, those investing in complex properties and those operating through corporate structures.

3.1% share of all new buy-to-let mortgages in the UK

77,000+ buy-to-let loan accounts

£10.6 billion buy-to-let loan assets

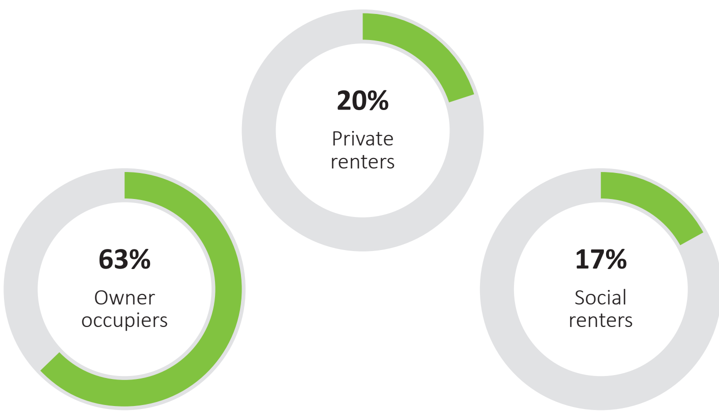
Market

The UK's PRS provides a vital social function, delivering accommodation for people who want the flexibility that renting provides, as well as those who cannot afford to buy and need the security of a stable home. Paragon supports socially responsible investment in the PRS by promoting high standards in accommodation, ensuring minimum energy efficiency levels, supporting professionalism in the landlord community, and working with industry and government to improve the sector.

The UK's PRS has more than doubled in size since 2000. Today, in England, it comprises 4.6 million households, almost 20% of the total[1]. After owner-occupation, renting in the PRS is the second most common housing tenure in the UK. Economic, social and demographic changes, together with the flexibility that renting provides, have combined to make renting in the PRS an increasingly popular choice.

Housing tenure

The PRS makes up 20% of the English housing market[1]



[1]MHCLG English Housing Survey 2018-2019

Market trends

- UK buy-to-let mortgage lending totalled £42 billion in 2019, including 72,000 loans for new house purchase, providing much needed new homes into the Private Rented Sector[1]
- Tenant demand has increased in most UK regions strongly during 2020 – ARLA Propertymark data shows that prospective tenants rose to the highest on record during the month of October 2020
- Landlords have supported tenants throughout the pandemic – nearly half have put rent relief measures in place[2]

Market outlook

- Despite strong historic growth in the PRS, Knight Frank forecasts further sectoral growth of 10% between 2020 and 2024
- The number of households in England is expected to grow from 23.2 million today to 24.8 million by 2028 and 26.3 million by 2038, with much of the increase attributable to single person households, a group which has a greater propensity to rent[3]
- Professional landlords have a greater propensity to invest in new homes – 26% of landlords with 6 or more properties say they will acquire new PRS property compared to 6% of those with one property[2]
- The Build to Rent ('BTR') sector is growing, but not at scale to satisfy forecast levels of tenant demand – 167,853 BTR homes complete, in construction or planning phase at the end of Q2 2020 according to the British Property Federation

Customers

We focus on specialist landlords with large portfolios - 59% of Paragon landlords own four or more properties and 36% list their lettings business as their main occupation. Nearly three quarters (72%) have more than 10 years' experience as a landlord, and many have a long standing, valued relationship with Paragon[4]. In Q3 2020 a typical portfolio:

was worth around **£2.4 million[5]**

x15

consisted of 15.3 properties **valued at an average of £154,000** each[5]

generated an **annual income of £7,499** per property[5]

achieved a gross rental income of **£113,219 per annum[5]**

74% **of Paragon landlords said they were happy /very happy with the service they received[6]**

The service I have received over the years has been exemplary...

Landlord customer, February 2020[6]

Even in this difficult time with businesses locked down you performed really well and made the whole process easy...

Landlord customer, April 2020[6]

Support during Covid-19

To help our landlord customers during Covid-19 we introduced mortgage payment holidays and other forms of relief. This enabled our customers to offer security and support to their tenants. We have kept in regular contact with our landlords throughout the pandemic, conducting three sentiment surveys between April and September. Well over half of landlord customers (58%) rated Paragon's response to the coronavirus crisis as Excellent/Good compared with other lenders' responses. This figure increased to 77% amongst customers who arranged a mortgage payment deferral[4].

68% **of mortgage intermediaries rated Paragon's service during the pandemic as better than other lenders[7]**

[1]UK Finance [2]BVA-BDRC Landlord panel Q2 2020 [3]ONS [4]Landlord sentiment surveys April, May, September 2020 combined base 872 [5]BVA-BDRC Landlord panel Q4 2019 - Q3 2020
[6]Customer satisfaction survey feedback from 924 landlord customers 1 October 2019 – 30 September 2020 [7]Telephone survey of 392 intermediaries April – September 2020

In focus: SME lending

We have been working closely with all of our customers to support them through this period and have remained open for business. As well as joining the UK Government's lending schemes, we are staying in close contact with our customers to discuss how the pandemic is affecting them and what support they need...

John Phillipou, Managing Director, SME lending

Paragon entered the SME finance market in 2015 with the acquisition of Five Arrows Leasing Group and we have continued to expand our offering to small businesses over the last five years with the acquisition of the asset finance broker Premier Asset Finance in 2016 and Iceberg in 2018.

We provide a range of finance solutions for SMEs covering a wide array of sectors, including agriculture, aviation, construction, business equipment, manufacturing, vehicle, technology and electric vehicles. Our expert SME lending teams have deep and specialist knowledge, not only in finance but also in the asset categories within which they operate.

We offer a range of finance types to fund assets including hire purchase, finance leases, operating leases and commercial loans. We also offer refinancing solutions.

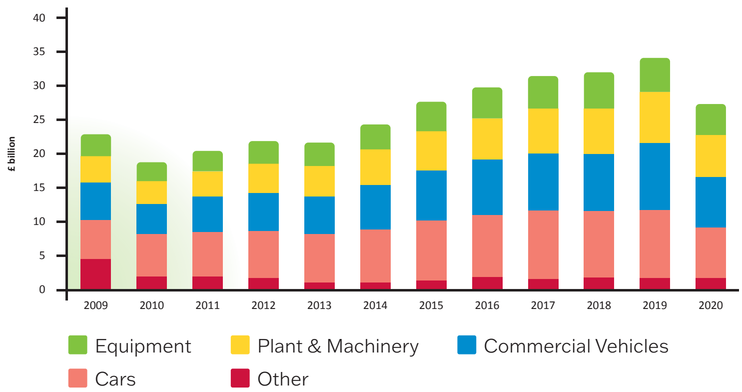
Market

The SME lending market is broad, and Paragon is focussed on specific asset classes.

The general economic conditions within the UK influence activity in these markets and other key drivers include:

- The rate of new work in commercial industries such as construction
- Government regulations and trading restrictions, particularly for sectors such as agriculture
- Advances in technology and SME growth
- Environmental concerns and the drive towards fuel efficiency

UK asset finance originations



Source: FLA

Market trends

- The asset finance market declined by 11% in September 2020 compared with the same month in 2019[1]
- The plant and machinery finance sector saw a fall in new business of 19% in the 12 months to September 2020, compared to the same period in 2019[1]
- The car finance sector reported growth in new business of 3% in September 2020 compared with the same month in 2019. Over the same period, the commercial vehicle finance and business equipment sectors reported falls in new business of 2% and 4% respectively[1]

Market outlook

- In the motor finance market, the number of new car registrations is expected to grow by 28.3% in 2021[1]
- New customs regulations and changes to tariffs following the Brexit transition period are expected to impact supply chains for both the construction and agriculture sectors, in addition to the wider UK economy
- One million new electric vehicles ('EVs') are forecast to be sold in the UK by 2025 and 11 million by 2040 with consumers increasingly likely to purchase EVs over conventional vehicles[2]

Customers

To help our business customers during Covid-19, we gained accreditation to offer government-backed Coronavirus Business Interruption Loans and Bounce Back Loans.

£25.9 million
Total CBILS and BBLS lending

37% **of customers offered additional support**
including flexibility with payment arrangements (typically in the form of an interest-only period) and access to BBLS and CBILS

Broker research drives new digital solution

During 2020, we undertook research with our brokers to gain a clear understanding of their current end-to-end digital experience and their future expectations, in order to subsequently improve the experience for the end customer.

The results highlighted a desire for simplicity, accuracy and speed across the digital journey, in addition to the need for lenders to offer an end-to-end digital solution.

As a result of this research, Paragon is in the process of developing a digital solution that is based on the needs of both brokers and SME business owners. This continued insight enables us to be forward-looking and innovative, developing new ways to best support our customers.

AdCo UK
Switching to manufacturing hand gel as a result of Covid-19

The support has enabled AdCo to help those in need and the funding has also assisted us in sustaining staffing levels without the need for furloughing. It's always a pleasure to work with the Paragon team. They are efficient, friendly and knowledgeable and they provide the right support for their client's needs...

Stuart Climpson, Director at AdCo UK Ltd

Milton Farms
Renewables (AD generator)

Over the years we have built up a friendship with Paragon, who provide us not only with competitive rates but sound professional advice, all under a relaxed atmosphere. Paragon is able to respond at short notice which gives us flexibility in the marketplace...

Edward Morris, Milton Farms

[1]FLA, November 2020 [2]Accenture, 2019

Strategic Report

In focus: Development finance

> **Throughout the difficult period during the height of coronavirus, Paragon's development finance team honoured all of the facilities we approved pre-lockdown as well as continuing to support new and existing projects throughout. As a result, we have seen some excellent opportunities across the last three months...**
>
> **Robert Orr,** Managing Director of Development Finance

Our development finance business provides competitive and flexible financing solutions targeted at experienced SME property developers. We started to offer finance to property developers in 2016 and the acquisition of Titlestone in 2018 accelerated progress in this area.

We support developers with a successful track record who are delivering an attractive product, correctly priced in the right locations. Our highly experienced team is based in London, as well as in locations across the Midlands, the North West and the North, offering tailored funding solutions to our clients.

Products

We focus on residential development loans, accounting for 98% of business written in 2020, and support experienced developers involved in multi-unit residential, new build, conversion or refurbishment projects. We provide loans up to £30 million and we lend up to 65% of the gross development value ('GDV').

£4.8 million average facility

We also provide:

Bridging finance

Access to short-term funding when securing the acquisition is the priority

Pre-planning finance

Working with developers to help fund sites that have not yet gained full planning permission

Student accommodation development finance

Helping experienced developers build quality student accommodation with good letting potential

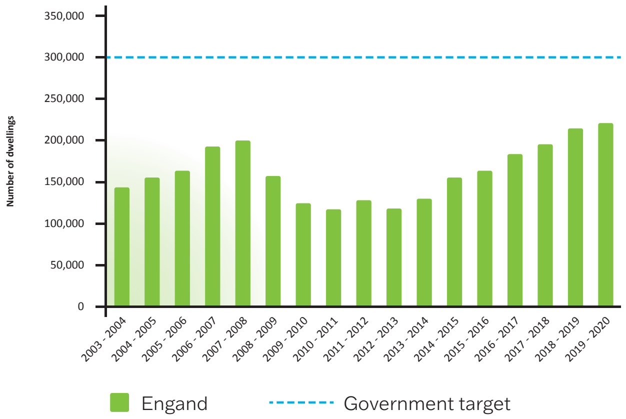
Marketing period loans

Funding for the marketing period once a development reaches completion

Market

The UK property market and rate of housebuilding drive the opportunities for development finance. The general economic conditions within the UK influence activity in the residential development sector, alongside interest rates, lifestyle choices, government targets for new homes and help to buy schemes.

New homes completed



Source: MHCLG - House building: permanent dwellings completed

Market trends

- Demand for new homes in the UK continues to grow due to population expansion and forecast household formation. The UK Government has set a target of 300,000 new homes per year, yet housebuilding activity currently falls below that - 178,300 homes were completed in 2019, with 151,750 started
- To accelerate the number of new homes being constructed, the UK Government has launched proposed planning reforms, including automatic planning permission on land designated for growth. Nearly half of SME housing developers cited planning issues as restricting their ability to build new homes
- Consumer demand is driving the growth of three and four bedroom homes, which accounted for three in every four homes completed in England in the past year. The proportion of completed flats fell to its lowest level for 20 years at 15%
- Covid-19 impacted developers' ability to operate during the second quarter of the calendar year. Between March and June almost 40,000 fewer homes were built in England and Wales as a result of Covid-19
- 37% of SME developers are concerned about the impact of restricted mortgage availability and what this will mean for prospective househunters (Federation of Master Builders Housebuilder survey)

Customers

75% **of sites remained open during lockdown and all sites fully open by mid-June**

Only 15.6%

of the portfolio needed additional support at the peak of the pandemic

(September 2020: 0%)

£15.5m funding for The General, Bristol

The Paragon team listened to our requirements and were able to quickly structure a great deal that matched our operational needs...

Tim Sargeant, owner of City and Country

£3.5m funding for Brick House, Romford

The project was made much easier by Paragon's great Relationship Manager, who thoroughly understood our needs as developers and was able to provide excellent support throughout all stages of the development as it progressed. Paragon is a trusted partner...

Daren Burney, Managing Director of Burney Essex Ltd

Sustainability

Sustainability is central to our long-term success. It influences every aspect of our business, from the markets we enter and the products we offer, to the support we give our customers and the culture that we cultivate at Paragon. We have a responsibility to use our influence and our resources wisely and we work diligently to support the communities in which we operate and the environment upon which we all depend.

Helping customers

We want our customers to be confident that we will always consider their needs and act fairly and responsibly in our dealings with them. We are committed to ensuring good outcomes and fair treatment for all customers across the Group.

7/10 landlords rated Paragon's Covid-19 support as good or excellent. See page 21.

We expanded our Insight team to augment our customer understanding. Not only do we measure customer satisfaction, **we also work to identify what customers value most** so that we can further improve our products and service.

Offering the right **support to vulnerable customers** is essential and we work hard to identify and support those who need extra care, particularly during Covid-19.

Working better

Working better means building a strong and inclusive team with shared values and a commitment to helping our customers achieve their ambitions. We gauge success using a range of metrics and continuously challenge ourselves towards higher achievement.

INVESTORS IN PEOPLE | Champion

The Investors in People framework helps us assess how well we lead and support our people. Gold accreditation and Champion status highlight our success.

Our wide-ranging development programme helps employees grow their capability and achieve their potential.

Employees enjoy comprehensive wellbeing support to boost physical, emotional and financial wellbeing.

We are a signatory to HM Treasury's Women in Finance Charter, part of an external mentoring programme, led by the 30% Club and delivered by Women Ahead, and work with The Women's Association to increase the visibility of women in the workplace.

Our newly formed Equality, Diversity and Inclusivity Network is designed to support all employees and champion ideas to make Paragon an even more inclusive workplace.

Caring for the environment

We support the UK's ambition to reduce greenhouse gas emissions to net zero by 2050. We are taking steps to quantify and manage climate-related financial risks associated with our lending and to develop products which will support our strategic aim for sustainable finance.

> **Working together, we now have an urgent need to measure and protect against the impact of irreversible climate change...**
>
> **Richard Woodman**
> Chief Financial Officer

Lending sustainably

Climate change and risk

This year, the Board adopted climate change as a principal risk, ensuring we consider climate issues, alongside capital and liquidity, when making decisions and planning for the future.

Promoting sustainable finance

SFS, who provide vehicle leasing for local authorities, hosted a Low Carbon Emissions Awareness Day to highlight the crucial considerations and challenges for clients in delivering low emission vehicle projects.

Operational impact

100% renewable energy used at owned sites

Key performance indicators highlight our success in reducing Paragon's operational impact on the environment. Our Green Charter, environment policy, risk management and procurement approach provide a framework for continuous improvement.

Supporting communities

We aim to be an energetic and valuable contributor to the communities in which we operate, and we are actively involved in a wide range of volunteering and charity partnerships.

Employee volunteer scheme

Employees are encouraged to take an annual volunteer day to help at one of a range of community projects focussed on reducing poverty and improving education.

WE ARE MACMILLAN. CANCER SUPPORT

Charity of the year

Employees selected Macmillan Cancer Support as their charity partnership for 2020, raising in excess of £30,000 through events including Move for Macmillan and Paragon's Biggest Coffee Morning.

Covid-19

In May, Paragon made a £100,000 donation to tackle the impact of Covid-19, split between the NHS, Solihull Change into Action, Age UK and Macmillan.

Nigel Terrington
Chief Executive Officer

Paragon's business model has been built upon strong financial and operational resilience, through-the-cycle sustainability and crucially, adaptability...

A3. Chief Executive's review

Introduction

2020 has been an eventful, challenging and unprecedented year. It started with the run-in to the Brexit Withdrawal Agreement and the general election. The strength of the economy in the first few months of the year was brought to an abrupt halt with the emergence of the Covid-19 pandemic and lockdown. The consequences have been far-reaching for the economy, society and the political landscape and it will change forever how we work, how we live, how we buy and sell goods and services, and how we interact.

Paragon's business model has been built upon strong financial and operational resilience, through-the-cycle sustainability and crucially, adaptability. All these elements have been tested this year. Whilst the year had started well at an operating level, with strong new business volumes and good momentum, the rapid onset of the crisis meant that our priorities had to be dramatically changed. The new focus was on protecting our people, supporting our customers, protecting our suppliers, preserving our capital and protecting the longer term franchise of the business.

Whilst our business model has been tested across much of 2020, I am pleased to say it has stood up to these tests. Paragon's focus will remain on reinforcing the fundamentals of our business, whilst looking for the opportunities that this new world order will invariably create.

Response to Covid-19

The business reacted swiftly to the onset of Covid-19. Within four days of the national lockdown, over 90% of our employees were working from home. Our technology has been resilient, and we maintained all our product and service offerings throughout, including during both lockdowns.

Customer support was central to our activities across all business lines. Temporary payment reliefs were provided to mortgage, consumer and SME lending customers impacted by Covid-19, the vast majority of whom have returned to full payment as the year progressed, with 97% of the customers granted payment reliefs fully up to date at 30 September 2020. We also participated in the UK Government's business lending schemes.

Paragon has always maintained a strong focus on prudential strength. Capital ratios have been robust throughout and by the year end, CET1 stood at 14.3%, up from 13.7% a year earlier, after allowing for a full-year dividend at policy levels. Liquidity levels have been strong, benefitting from increasing diversification of our funding sources and a prudent approach to maintaining high cash levels.

Paragon's prudent lending approach has also resulted in exemplary portfolio strength and measures were taken to protect against the economic consequences of the pandemic with a tighter lending risk appetite. The Group's portfolio is credit defensive, with 99% of the book secured and only 4% of the mortgage portfolio having a loan-to-value ratio greater than 80%.

Trading performance

New lending activities were disrupted during lockdown, particularly in mortgage lending where the housing market was effectively closed. Most of the impact was felt in the second half of the year, with new lending down approximately 20% on the first half. However, with improved levels of customer retention the loan book expanded by 3.7% year-on-year, and lending volumes remained robust despite the challenges presented by Covid-19.

In mortgage lending, a strong first half was tempered by the impact of lockdown, when the housing market was effectively closed for a two-month period. Landlord demand rebounded quickly in the summer months once the housing market reopened, with pent-up acquisition opportunities and the introduction of the Stamp Duty holiday contributing to a replenished pipeline.

Development finance benefitted from approximately 80% of sites remaining open through the lockdown and the long-term nature of the product, with phased lending commitments. However, SME lending felt a greater impact as customers sought to defer investment decisions or chose instead to draw under one of the UK Government's funding initiatives.

This disruption to lending has now largely played through the business, notwithstanding the effects of a second wave and a further lockdown. At the same time, we are tracking the emergence of the expected credit losses which we have already provided for. The pipelines across the key business lines have rebuilt to pre-Covid-19 levels and, in some cases, are close to record levels. This momentum bodes well for the coming year.

In March the Bank of England reduced base rates to just 10bp. For the Group this resulted in the repricing of assets ahead of liabilities generating a short-term impact to Net Interest Margin ('NIM') in the second half. This had substantially unwound by the year end and we expect the structural upward trajectory in margins witnessed in recent years to resume going forward.

Financial performance

The Group reported an operating profit of £120.0 million for the full-year, 30% below 2019, largely driven by the IFRS 9 impairment charge which rose by over 500% year-on-year to £48.3 million, and was taken in anticipation of the expected impacts of Covid-19. Given the extensive government support to the UK economy, which has now been extended for a further period, much of this impairment charge is unlikely to crystallise in the form of customer defaults and write offs in the near term. Nevertheless, our approach has been conservative, applying post-model adjustments to modelled expected loss outputs. These were based on our close understanding of the customer base and reflected the Group's economic forecasts, anticipating the potential impact on our loan portfolio of the inevitable real economic consequences of the pandemic. Notwithstanding this impact on profitability, the Group still delivered an underlying return on tangible equity of 9.8% (9.7% on a statutory basis).

The huge uncertainty in the early stages of the pandemic meant that the Board took the decision at the time of the half-year results not to pay a dividend. The Group's resilient performance, strong capital ratios and our assessment of the book under stress gives us sufficient confidence to declare a full-year dividend of 14.4 pence per share in line with the policy of maintaining dividend cover of 2.5 times.

Business model developments

Our operating capability was thoroughly tested this year and has proven its resilience and adaptability. The efficient switch to home working enabled many of our customers to receive high levels of support across the depths of the lockdown period through the provision of forbearance and participation in government-sponsored initiatives. The experiences of 2020 will have a far-reaching impact on banking generally and on how customer engagement is undertaken in the future.

Despite the challenging environment, we delivered a number of customer and introducer-facing systems across the year. Whilst there have been some delays to the roll-out of the change road map this year it is likely we will see an acceleration of the new technology plans as digitalisation and greater workforce location flexibility emerge.

Paragon is a data-focussed business. This background, together with strong credit-focussed governance structures, has supported our application for IRB accreditation. IRB would allow internal credit models, specific to the Group, to be used to determine capital requirements. The greater use of such models within the Group's decision-making and capital analysis will further enhance our risk management over time. The IRB application process can be a lengthy one and for Paragon it has begun with its buy-to-let mortgage portfolio, with a subsequent roll-out to the Group's other lending portfolios scheduled over the next few years.

The Group's savings platform has seen material growth during the year, at much improved pricing with stock rates falling from 1.81% at 30 September 2019 to 1.34% at 30 September 2020. Strong direct inflows have been supplemented by closer ties with third-party platforms providing further diversification to our funding strategy. We expect to build on this strategy by increasing the number of third-party relationships and further extensions of our product range.

Alongside retail savings we have continued to broaden our wholesale funding facilities, having accessed securitisation markets, expanded warehouse capacity and increased central bank funding through access to the Bank of England's TFSME scheme.

Diversification is as important for our liabilities as it is in our assets. Warehouse and securitisation funding now represents 27.4% of total liabilities compared to 95.6% in 2014.

People

The performance of our people has been exceptional during this challenging year. Supported by our technology team, the move to home working was delivered efficiently and quickly, with minimal business interruption.

Each of our operating businesses remained open for new business and to support customers throughout the year. The material increase in customer contact to put appropriate arrangements in place was delivered effectively and swiftly, demonstrating the adaptability of our people and processes.

A key priority of our strategic response to Covid-19 was the protection of our long-term franchise – I firmly believe the incredible performance of our various teams has enhanced this position across 2020.

The flexibility of our employee base also facilitated a rotation of certain roles from front-end underwriting to a more customer service focussed position. There has been greater flexibility applied to working patterns and a material focus on enhanced communications, morale and wellbeing. When surveyed, 94% of our employees believed the Group had been considerate of their wellbeing when making decisions affecting the workforce and 84% of our people were either satisfied or very satisfied with the support available for them.

Paragon has not used the Coronavirus Job Interruption (furlough) scheme, nor has it made any redundancies since the onset of Covid-19.

Sustainability

2020 was a fundamentally important year in the recognition of the significance of some of the non-financial aspects of our business. We have always ensured that a wide range of stakeholders' interests are considered and, where appropriate, factored into strategy and policy. We are now explaining more fully about what we do across a range of stakeholder communications.

Paragon recognises that sustainable development can only be delivered through an increased awareness of such impacts across the business, embedded in its culture and values. The Board is fully engaged with this project and during the year made a clear statement of its commitment by promoting climate change to a principal risk within the governance framework, ensuring that environmental sustainability is placed at the core of our business model.

Outlook

We have delivered on the objectives we set at the start of the pandemic to protect our people, support our customers and business partners, preserve capital and protect the longer term franchise of the business. As a consequence, we are a stronger business today than before the crisis.

Our business model has proven its resilience both financially and operationally. Capital ratios and liquidity are strong, the balance sheet is credit defensive and the franchises have been enhanced during this difficult period.

Covid-19 has cast a long and dark shadow on the people and businesses of the UK, but we are well placed to manage the uncertainty that will run into 2021 and beyond. We remain committed to supporting our customers, helping them navigate through this period and achieve their ambitions, and believe we are in a strong position to capitalise on the opportunities which will inevitably emerge as the UK recovers from this pandemic.

Nigel Terrington

Chief Executive Officer

3 December 2020

A4. Review of the year

A4.1 Lending

The Group's operations are organised into three divisions, based on product type, origination and servicing capabilities. This organisational and management structure has been in place throughout the year.

New business advances and investments in the year, together with the year end loan balances, by division, are summarised below:

	Advances in the year		Net loan balances at the year end	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Mortgage Lending	**1,259.7**	1,568.6	**10,819.5**	10,344.1
Commercial Lending	**790.8**	968.0	**1,514.8**	1,452.1
Idem Capital	**-**	-	**297.1**	389.9
	2,050.5	2,536.6	**12,631.4**	12,186.1

The Group's loan book increased by 3.7% in the year, despite the restrictions in lending activity caused by the Covid-19 crisis which depressed new business volumes across the business in the second half of the financial year.

A4.1.1 Mortgage Lending

The Group's Mortgage Lending division offers buy-to-let first charge and owner-occupied first and second charge mortgages on residential property in the UK. In all its offerings, the Group targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from mass market and other specialist lenders. Its core products are buy-to-let residential property mortgages, targeted at specialist landlords (those who have four or more properties and / or operate through corporate structures).

Housing and mortgage market

During March 2020 the UK housing market began to be impacted by the Covid-19 crisis, with the increased levels of economic uncertainty impacting on house purchase decisions. Government responses on lockdown and social distancing also placed practical limitations on the operation of the housing market. RICS reported in its April 2020 Residential Market Survey that levels of activity in the housing market were the weakest since the inception of the survey in 1999.

To help mitigate the impact of the national lockdown on homeowners and landlords, the UK Government introduced mortgage relief schemes, covering both owner-occupied and buy-to-let mortgages of residential property which lenders in the sector then had to put in place. These enabled customers to take payment holidays without this impacting on their credit history or score. These holidays were initially for three months, but subsequently extended to six months if required.

In November 2020, after the end of the year, the payment holiday regime was extended further to address the new wave of Covid-19 restrictions. Many of the Group's landlord customers will have been able to provide rent relief to their tenants as a result of these arrangements.

Activity in the mortgage market recovered in the final quarter of the financial year, following the end of the UK lockdown, which allowed physical valuations of properties to resume and house moves to take place.

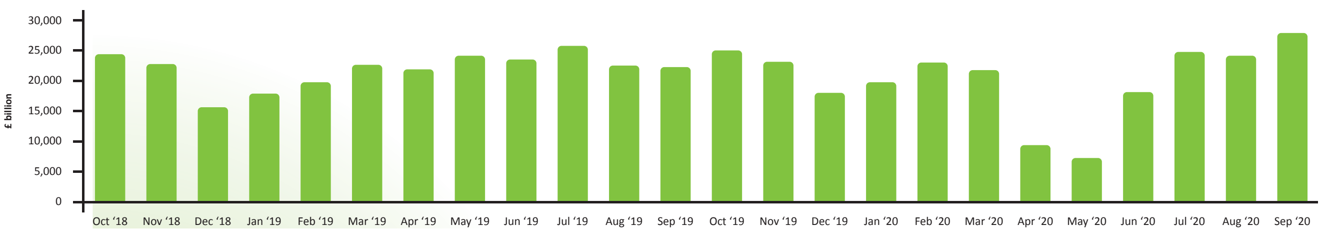
For most of the first half of the financial year the prospects for the UK housing market had appeared relatively positive, with economic uncertainty reduced by the UK general election in December 2019. This led to increasing transaction levels and upward pressure on house prices following a period of stagnation in the market. Market conditions for mortgage customers had remained benign, with low interest rates, arrears and possession levels.

This pattern is clearly shown in the Bank of England's data on mortgage approvals. The total approvals for the year ended 30 September 2020 of £242.3 billion reduced by 7.8% (2019: £262.9 billion), with most of the reduction attributable to the quarter ended June 2020 when mortgage approvals, at £34.8 billion, were half of the £69.5 billion recorded in the corresponding quarter of 2019.

House prices began to increase after the election, with the Nationwide Building Society reporting an average increase of 2.0% in the first six months of the financial year. The expected downward pressure on house prices following the onset of Covid-19 did not emerge. Rather than withdraw from the market, homeowners looked to improve their housing position, resulting in a structural shift in demand buoyed by the stamp duty holiday introduced by the UK Government. As a result, house prices increased by 5.0% over the financial year, benefitting the Group's security values. As the impact of the pandemic continues to emerge, significant uncertainty on the near and medium-term outlook will remain.

Mortgage approvals (Bank of England) (£billion)

1 October 2018 – 30 September 2020



The Private Rented Sector ('PRS') and the buy-to-let mortgage market

Specialist landlords form the largest part of the Group's target market. These are landlords with four or more rental properties who generally run their portfolio as a business and have a high level of personal day-to-day involvement. This approach has meant these specialist landlords have been better placed to address the challenges than other classes of mortgage customer.

The Group is amongst a small number of specialist lenders addressing this sector, which is underserved by many of the larger lenders. Non-bank lenders had a significant position in this market before the Covid-19 outbreak, but their funding issues have led to a restriction of the supply of credit from this source, providing opportunities for the Group.

Buy-to-let lending reflected the performance of the larger mortgage finance sector, with new advances of £38.2 billion in the year ended 30 September 2020 reported by UK Finance ('UKF'), compared to £41.8 billion in the same period in the previous year, a reduction of 8.6%, principally attributable to the performance in the June quarter. Refinancing of existing borrowings continued to represent the bulk of this activity, with 72.8% of new advances by value representing remortgages (2019: 71.3%).

Whilst Covid-19 restrictions meant that on-site property valuations could not be conducted during April and May 2020, restricting new business activity, the Group developed an enhanced desktop valuation process and introduced products with stricter than normal loan-to-value limits. These changes allowed lending to continue through the lockdown period, particularly in the larger remortgage market, ahead of the phased reintroduction of physical valuations in late May.

In common with other lenders in the market, the Group tightened policy on properties which it could accept as security, especially in the student lettings and complex property space. Market limitations on propositions have remained in place, to a greater or lesser extent, post lockdown, with the level of supply into the buy-to-let market such that lenders can be selective.

The lettings market remained stable through the early part of the period, with RICS reporting continuing supply issues and increasing tenant demand towards the end of the year, leading to an expectation of rent increases. The Covid-19 impact saw a short-term downward pressure on supply, demand and rents, but in its September survey RICS expected a generally upward trend for rents and there is some evidence that restricted volumes in the residential mortgage market have kept potential first time buyers in the rented sector.

Lending activity

The Group's new lending activity in the segment during the year is set out below.

	2020	2019
	£m	£m
Originated assets		
Specialist buy-to-let	**1,119.0**	1,315.1
Non-specialist buy-to-let	**86.4**	165.4
Total buy-to-let	**1,205.4**	1,480.5
Owner-occupied	**0.3**	11.9
Second charge	**54.0**	72.0
	1,259.7	1,564.4
Acquired assets	**-**	4.2
	1,259.7	1,568.6

Total mortgage originations in the Group reduced by 19.7% in the year. The major factor driving the reduction was the Covid-19 lockdown, and its impact on market activity over the summer months.

Buy-to-let

Specialist buy-to-let lending activity fell 14.9% when compared to 2019, principally as a result of the restricted market in the summer months, whereas non-specialist, or simple, buy-to-let lending fell by 47.8% as the Group tightened its focus on the specialist market. The new business pipeline, the loans passing through the underwriting process, was £868.1 million at the year end (2019: £911.7 million), showing business returning to more normal levels heading into the new financial year.

The Group sources the majority of its new buy-to-let lending through specialist intermediaries and it continues to invest to ensure the service offered to them is excellent. All the Group's significant intermediaries were able to stay in operation through the Covid-19 crisis. During the year the Group's regular surveys of its intermediaries showed 91% were satisfied with the ease of obtaining a response from the Group (2019: 84%), delivering a net promoter score at offer stage of +56 (2019: +60).

This result was achieved against the background of Covid-19, highlighting the value placed by the intermediary community on the Group's offering and on their relationship with the business. This relationship was enhanced by the Group's response to the Covid-19 crisis, with a survey of intermediaries finding that around 70% believed that its response was better than that of other lenders. Anecdotal evidence suggests that response times for brokers have generally been better than for other lenders in the market due to the proportion of the Group's employees who were able to remain active through the crisis.

The business is aware of the potential for climate change to impact on the mortgage business and seeks to mitigate risk through careful consideration of the properties on which it will lend. Since 2018 all properties accepted as security must have a minimum Energy Performance Certificate rating of E at the time of offer. The Group had EPC records for 85% of its mortgage book at 30 September 2020 with 98.1% of these covered by certificates of grade E and higher (on a scale of A to G). Such action by lenders will also lead to improvements in the housing stock in the PRS.

The Group also monitors the physical risks from climate change on its property exposure. As part of the underwriting process a property's flood risk is considered and less than 2.2% of our properties were situated within a medium or high flood risk zone (2019: 2.5%).

The business is also working with the Green Finance Institute to develop products which would encourage energy and carbon efficiency for the future.

Other lending

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

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

The Group continues to limit its exposure to first charge residential lending to owner-occupiers, given the pressure on market yields and a limited demand for products where its specialist approach adds value. The opportunities for the Group in this area principally relate to lending to the existing professional landlord customer base.

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	30 September 2020	30 September 2019
	£m	£m
Post-2010 assets		
First charge buy-to-let	**6,202.5**	5,427.7
First charge owner-occupied	**51.2**	68.3
Second charge	**182.6**	171.6
	6,436.3	5,667.6
Legacy assets		
First charge buy-to-let	**4,381.3**	4,674.2
First charge owner-occupied	**1.9**	2.3
	10,819.5	10,344.1

At 30 September 2020, the Group's total net mortgage balance was 4.6% higher than at the start of the financial year, despite the impact of Covid-19 on advances and provisions. The balance on the post-2010 buy-to-let portfolio grew by 14.3% and it now represents 57.3% of the total (2019: 52.5%).

The annualised redemption rate on buy-to-let mortgage assets, at 6.6% (2019: 8.6%), has continued to reduce, driven partly by the slowing of the market due to Covid-19, partly as a result of continuing initiatives to encourage existing customers to remain with the Group and partly as a result of the increasing average length of fixed rate periods over recent years.

Arrears on the buy-to-let book decreased in the year to 0.15% (2019: 0.18%), although some arrears will inevitably have been suppressed by payment holidays. Arrears on post-2010 lending were at 0.03% (2019: 0.03%). These arrears remain very low compared to the national buy-to-let market, with UKF reporting arrears of 0.52% across the buy-to-let sector at 30 September 2020 (2019: 0.42%).

While just over 20% of the Group's buy-to-let customers took payment holidays when offered, less than 5% remained on payment holiday at the year end, with further reductions being seen in October and November. Customer surveys indicated the motivation for taking these holidays was, in many cases, precautionary, to ensure they were well positioned to deal with potential future tenant payment issues. The majority of respondents were also confident in their ability to resume payments after the end of the payment holiday period.

This strong performance reflects the Group's focus on the credit quality and financial capability of its customers, underpinned by a detailed and thorough assessment of the value and suitability of the property as security.

The Group is also confident that its robust approach to valuation and the loan-to-value coverage in its buy-to-let book, at 65.8% (2019: 67.4%) provides it with significant security in the face of the present economic stress. The levels of interest cover and stressed affordability in the portfolio suggest that its customers are also well placed to manage Covid-19 impacts on their businesses in the longer term.

Second charge arrears increased to 0.62% from 0.38% in the year, reflecting the increased seasoning and size of the portfolio. There were no arrears on post-2010 residential lending.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of losses by giving direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. The Group's receiver of rent team worked with tenants through the Covid-19 lockdown to manage the rent position in a responsible manner. At the year end 623 properties were managed by a receiver on the customer's behalf, a reduction of 8.8% since 2019 (2019: 683 properties). Almost all these cases currently relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome for the Group, landlord and tenants.

Outlook

While the impact of Covid-19 means that the short-term macro-economic outlook for the Group and its landlord customers is difficult, the Group remains optimistic about its longer term prospects. The vast majority of customers remain committed to the PRS and their positive experiences of the Group through this period will have enhanced business relationships.

The funding of the PRS is vital to the housing infrastructure of the nation and that will ensure that the demand for the Group's products and services remains into the future.

A4.1.2 Commercial Lending

The Group's Commercial Lending division brings together various streams of predominantly asset-backed lending to, or through, commercial organisations and has been a major focus of growth over recent years.

The proposition is delivered through four key business lines;

- SME lending, providing leasing for business assets and unsecured cash flow lending for professional services firms, amongst other products
- Development finance, funding smaller, mostly residential, property development projects
- Structured lending, providing finance for niche non-bank lenders
- Motor finance, focussed on specialist parts of the sector

In each of its markets the division's competitors are small banks and non-bank lenders. They are markets in which the largest lenders have little presence, creating a credit availability issue for customers and significant opportunities for the Group. The division relies heavily on specialist teams to address the separate business lines, either sourced externally or developed internally.

The Group's strategy in this wider market is to target niches (either product types or customer groups) where its skill sets can be best applied, and its capital effectively deployed to optimise the relationship between growth, risk and return.

Given the nature of the assets financed, in the second half of the year Covid-19 resulted in a material number of customers requesting some form of payment relief and new advances being sharply reduced. However, the SME sector has been the focus of government support programmes and the Group was authorised to provide loans under the CBILS and BBLS initiatives, making advances under these programmes from June onwards.

As part of its strategy for the division the Group continues to enhance its operational functionality in this area, developing technological solutions both to enhance customer service and to assist in the procuration processes, enabling potential customers, or the brokers they use, to access appropriate finance.

The common themes of these diverse business lines are a deep understanding of their respective markets and customer needs, together with expertise in the valuation of any security, collections and asset recovery. In common with the rest of the Group, the division's focus is on the maintenance of strong credit standards and it does not pursue business volumes at the expense of margins.

Work is ongoing to review the division's exposure to climate change risk. In development finance, the focus has been on determining the environmental impact of projects and the energy efficiency of the properties being constructed, whereas in motor finance the assessment has been on the fuel types and emissions of financed vehicles. Within SME lending, work is in progress to classify the sectors in which each of our clients operate with respect to their respective climate change sensitivities, while the potential for green financing solutions is being investigated.

Lending activity

During the first half of the year new business levels were strong across all business lines in the division. The Group's focus on widening the customer base and improving yields delivered both increased loan books and strong credit performance.

The onset of Covid-19 in March 2020 had a significant impact on volumes in the second half-year. The impact on customers' businesses, and the levels of uncertainty for those not directly impacted, reduced the appetite for new finance, while the practical issues of sourcing and delivering new assets in a lockdown situation also had an impact on the leasing business.

The Commercial Lending segment saw an 18.3% reduction in new advances compared to the previous year. While development finance continued to grow, though less strongly than planned (by 6.2%) activity in other areas was more materially reduced. The new lending activity in the segment during the year is set out below.

	2020	2019
	£m	£m
Development finance	**385.3**	362.9
SME lending	**288.0**	406.5
Structured lending	**7.6**	49.7
Motor finance	**109.9**	148.9
	790.8	968.0

The impact of this new business has been to increase the Group's overall Commercial Lending exposure by 4.3% in the year to £1,514.8 million (2019: £1,452.1 million).

SME lending

The SME lending business performed well through the first five months of the financial year, with the Group's customers regaining some level of confidence after the political uncertainties of 2019 and becoming more willing to enter into capital commitments. Advance levels in this period were strengthening and yields were being maintained.

The Covid-19 outbreak reduced new business activity from March, both as a result of customer unwillingness to enter into new commitments and, in the leasing business, as a result of the practical difficulties of sourcing and delivering large pieces of equipment, some internationally, in a global lockdown. Customers' access to other, cheaper funding sources through government sponsored relief schemes also reduced the scope for new business.

As a result of these impacts, new asset finance leasing volumes reduced by 42.5% compared to the comparative period in 2019, to £166.1 million (2019: £288.7 million). Investment in operating leases has also continued with £12.9 million of assets acquired in the period (2019: £11.6 million). Short-term lending to professional services firms, reduced significantly, by 32.9% to £79.1 million (2019: £117.8 million) as Covid-19 related tax deferrals from March meant that customers did not require to draw down in order to satisfy their liabilities. As a result, across all products, SME lending decreased by 29.2% to £288.0 million (2019: £406.5 million).

The Covid-19 crisis saw around 46% of the SME lending business's customers applying for some form of payment relief. Relief in this market is normally given as an interest only period, where the customer continues to make payments. The financial issue for many of the customers, particularly in sectors such as construction, was the inability to generate income from the financed assets during the lockdown period, creating a cash shortfall.

In line with the approach taken on the mortgage book, extended payment holidays were offered to SME Lending customers, but these were taken up by a substantially smaller number than the initial three month reliefs and at the year end only 2.1% of accounts remained on a payment holiday.

The long-term impact of Covid-19 on customers is difficult to predict at this stage, particularly given that many may have received short-term relief in the form of CBILS or BBLS loans from their relationship banks, although feedback from the enhanced customer contact programme is encouraging.

The Group received authorisation to participate in the government-sponsored British Business Bank CBILS and BBLS schemes, providing funding to SMEs under a government guarantee. The Group has used this facility primarily to support its existing customers, completing £25.9 million of loans in the year, and anticipates making further advances, both to new and existing customers into the new financial year. The Group is working to support industry initiatives to establish a common collections framework for CBILS and BBLS, providing certainty to customers and hopes this can be established in the near future.

The Group has continued to focus on improving its operational procedures in this area, to deliver better customer service and enhance margins, focussing on people and processes and on improving the handling and use of data in the business to provide better targeting and analysis and to enhance customer experience. These developments continued to progress through the Covid-19 period, although they were delayed by the demands of the systems and process upgrades required for payment reliefs, CBILS and BBLS. The Group expects these investments to impact positively on efficiency and agility going forwards.

Lending activity into the new financial year will be dependent on the uncertain impact of the ongoing Covid-19 situation, with volumes likely to remain depressed in the short-term. The priority of the business will be to support its customer base through the crisis while working to enhance the proposition for the future.

Development finance

Activity levels in the Group's target market were healthy in the first half of the financial year, with increased enquiry levels and higher levels of new commitments, and prospects looking promising up to the end of February. At that point the onset of the Covid-19 pandemic impacted the market, with levels of lending in March being more subdued. However, demand in the second half of the year rebounded, to some extent, following the easing of the lockdown and this is reflected in longer term sentiment amongst the Group's customers which is less negative than might be expected.

New projects continued to commence throughout the second half of the year, while completed developments resulted in repayment of facilities. The Group remained active in the market throughout the year and this continuity of service was appreciated by our customers over the period.

The Group's target customer is a small-to-medium sized developer of UK residential property. The typical types of projects funded have an average development value of approximately £7 million and are generally focussed on the more liquid parts of the residential market, avoiding developments with high unit values. While the business has been concentrated in the Home Counties, with 67.0% of balances at 30 September 2020 located in London and the South East, the Group's strategic objective is to lend more widely across the UK and this focus continued through the year. Central London property hot spots have been generally avoided.

The Group engages monitoring surveyors to review progress and costs on a regular basis through the build phase of each project, and these activities have generally continued through the Covid-19 period. The maximum level of closed sites during the crisis was 22%, but these were generally quickly reopened. 73% of sites remained active throughout the lockdown period. Many projects have been subject to some level of delay, principally due to access, labour or supply issues, but overall, the level of resilience in the customer base has been impressive.

While uncertainties around Covid-19 remain, prospects for the new financial year appear promising. Undrawn amounts on live facilities at 30 September 2020 of £380.9 million are expected to flow through to advances during the coming year, while the post-offer pipeline of £171.5 million is likely to be drawn down over a longer period, though the timing may be affected by ongoing Covid-19 restrictions. The Group is investing in the business, increasing resources to allow a greater variety of propositions and routes to market to be explored.

The underlying basis of the development finance proposition remains attractive, with positive market sentiment heading into the new financial year. The need for new housing will remain into the future and smaller developers have only a limited number of funding sources, which have reduced further through the Covid-19 crisis, with some non-bank lenders previously active in the sector suffering from limited lending capacity. The Group believes the business is well placed to support its developer customers during and after the pandemic.

Structured lending

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

Motor finance

The Group's strategy for motor finance is to target its offerings on those specialist propositions not typically addressed by mass-market lenders. After a positive first six months of the year, where completions increased while maintaining yield levels, business was sharply reduced in the second half due to the substantially reduced levels of activity seen in the automotive market throughout the Covid-19 crisis.

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	30 September 2020	30 September 2019
	£m	£m
Asset leasing	**478.0**	492.2
Professions finance	**22.3**	46.2
CBILS and BBLS	**25.2**	-
Invoice finance	**13.5**	18.5
Unsecured business lending	**15.0**	19.3
Total SME lending	**554.0**	576.2
Development finance	**609.0**	506.5
Structured lending	**94.9**	88.1
Motor finance	**256.9**	281.3
	1,514.8	1,452.1

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectation allowing for the impact of Covid-19 on the timing of some projects. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 30 September 2020 very few cases had been classified by the monitoring process as being likely to result in a loss, with a number of the problem cases acquired with the business resolved in the year.

While no Covid-19 specific credit concerns have been identified on individual development finance accounts, the Group recognises the potential impact of increased economic uncertainty, including the impact of the end of Stamp Duty relief on the property market, and execution risk on its portfolio. The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 63.1% (2019: 64.8%), which gives the Group a substantial buffer if any project encounters problems.

Credit performance on the division's finance leasing portfolios remains stable, with arrears in asset leasing at 1.75% and motor finance at 1.76% (2019: 0.43% and 1.27% respectively). However, these measures may be distorted by the effect of payment holidays.

Take up of payment reliefs in SME lending was substantial, with 3,526 accounts given relief, representing almost half of the book, although only 326 of these required an extension. 2,899 (16.2%) of the Group's motor finance accounts were granted a payment holiday, with only 419 (2.3%) requiring an extension.

Performance in the structured lending operation has been in line with expectations with satisfactory pricing and no serious concerns with the operation of any of the loan facilities.

Outlook

In the short-term the focus for growth in Commercial Lending will be in development finance, where the fundamentals of product, demand and service remain strong despite Covid-19. In the other business lines the priority will be on the careful management of the books and supporting customers through the ongoing crisis. The underlying long-term prospects for the division remain positive and the Group continues to invest in developing its activities for the future.

A4.1.3 Idem Capital

The Idem Capital segment contains the Group's acquired loan portfolios, together with its pre-2010 legacy consumer accounts. These include mostly second charge and unsecured consumer loans.

The division's strategic focus is on specialist loan portfolios which can augment the organic origination activities of the Group. In these portfolios, it can enhance value through leveraging the Group's originations and collections expertise, together with its access to a variety of retail and wholesale funding. It recognises that this model is essentially opportunistic and that the flow of such opportunities to the market may be sporadic. It carefully considers the capital requirements for any potential acquisition, particularly where asset types offered require relatively large amounts of capital to be held. It also considers the potential for conduct risk issues to arise in portfolios which may contain more vulnerable customers. Many of Idem Capital's customers have been under financial stress in the past and its processes aim to generate fair outcomes for all customers, recognising any vulnerabilities. In the present Covid-19 situation, that objective has an even greater focus.

Overall Idem Capital's success rests on understanding assets, strong analytics, advanced servicing capabilities and the efficient use of funding. All these attributes are vital in its management of the impact of Covid-19 on its customer base.

New business

While the UK loan portfolio purchase market remained active in the period up to the Covid-19 outbreak, and the Group participated in the majority of significant tender processes, there were few opportunities which were particularly appealing, either because of pricing, the nature of the assets or the capital which might have been required. Opportunities were even more limited in the post-Covid-19 environment, although some level of activity did remain in the market.

The Group only pursues transactions where its wider capabilities in administration and funding can provide a real benefit to the project and where the projected return is attractive in comparison to the other opportunities for the deployment of its capital.

During the period, no portfolio acquisitions were completed (2019: none) although, as noted above, the division undertook a limited number of reviews of opportunities that were ultimately not progressed.

The main focus of the business in the year was the careful management of its existing books and ensuring that appropriate processes and systems are in place to address the Covid-19 outbreak with customers, many of whom were already identified as vulnerable.

Performance

The value of the loan balances in the segment are set out below, analysed by business line.

	30 September 2020	30 September 2019
	£m	£m
Second charge mortgage loans	**171.9**	217.6
Unsecured consumer loans	**109.7**	134.7
Motor finance	**15.5**	37.6
	297.1	389.9

The reduction in balances is a result of collections from the brought forward loan portfolios, with receipts remaining relatively strong, despite the impact of Covid-19. The accounting balance was also reduced by £3.7 million at the half-year to allow for potential reductions in future cashflows due to Covid-19. 120 month Estimated Remaining Collections ('ERC') on acquired consumer assets fell to £313.7 million at 30 September 2020 (2019: £366.4 million) for the same reasons.

Collections from customers have, however, held up well in the year, despite the negative economic impacts of Covid-19, with instalment receipts remaining stable despite a temporary downturn in March. Whilst the division's second charge assets are over 10 years seasoned, offering resilience to any potential downturn, the unsecured assets are less seasoned, and their performance will continue to be carefully monitored over the coming year.

Arrears on the segment's secured lending business have risen slightly to 18.8% (2019: 17.2%). These arrears levels remain higher than the average for the sector, but this reflects the seasoning of the balances, while the upward trend reflects the redemption of performing accounts. This book contains a significant number of accounts which are currently making full monthly payments but had missed payments at some point in the past, inflating the arrears rate. Average arrears for secured lending of 8.4% at 30 September 2020 were reported by the Finance and Leasing Association ('FLA') (2019: 8.7%).

Approximately 15.5% of the divisions secured accounts were granted initial payment holidays with 6.5% being granted extensions.

None of the live Idem Capital loan portfolios were regarded as materially underperforming at the year end, with strong overall cash generation, considering the impact of Covid-19. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 30 September 2020 such collections were 109.8% of those forecast to that point (2019: 109.8%). The impact of Covid-19 on the long-term cash forecasts has not been significant.

Operational improvements have continued to be made in systems, processes and employment patterns which are expected to generate operational efficiencies and improve both customer service and customer experience in future periods.

Outlook

The Idem Capital loan book continues to provide strong cash flows and the Group's priority is to effectively manage this collection process while investigating potential portfolio investments which match its risk and reward requirements.

A4.2 Funding

The Group's funding strategy, built on diversification and sustainability, was both enhanced and tested in the period. New initiatives widened the footprint of the retail deposit operation, new forms of liquidity funding were introduced, and additional central bank funding schemes accessed.

This variety of funding options ensures that pricing and availability issues in any individual funding market can be mitigated, while, at the same time, maintaining the flexibility to fund strategic developments. In particular, it protects the Group from the effects of incidents such as the Covid-19 crisis. This saw capital market pricing seriously disrupted while emergency funding from the UK authorities was channelled principally through central bank lending to the UK banking sector.

Throughout the period the Group raised the majority of its new funding through the retail deposit market, where volumes proved robust throughout the Covid-19 crisis, as consumers' appetite for saving increased, either through economic anxiety or through reduced opportunities to spend. The Group's retail deposit balance grew by 22.9% in the year to £7,856.6 million (2019: £6,391.9 million), representing 55.8% of balance sheet funding.

The Group's funding at 30 September 2020 is summarised as follows:

	2020	2019	2018
	£m	£m	£m
Retail deposit balances	**7,856.6**	6,391.9	5,296.6
Securitised and warehouse funding	**3,928.3**	5,206.9	6,490.3
Central bank facilities	**1,854.4**	994.4	1,024.4
Tier 2 and retail bonds	**446.6**	446.1	445.4
Total on balance sheet funding	**14,085.9**	13,039.3	13,256.7
Off balance sheet central bank facilities	**-**	109.0	108.7
Other off balance sheet liquidity facilities	**150.0**	-	-
	14,235.9	13,148.3	13,365.4

The overall UK economic outlook has remained uncertain over the whole year, with the political instability of autumn 2019 followed in turn by the December general election and the Covid-19 crisis, while uncertainty over the final terms of any Brexit settlement continued through the year. All these factors affected market sentiment, generating considerable volatility.

In response, the Group maintained a conservative stance on liquidity throughout the year. £1,701.1 million of cash was available for liquidity and other purposes at the end of the period (2019: £872.1 million). The Group's contingent liquidity policy will be kept under review as the ultimate outcome of the Covid-19 crisis becomes clearer and longer term trends become more evident.

The Group's funding has become increasingly diversified in the years following the authorisation of Paragon Bank in 2014. This is illustrated by the chart below which shows, for each of the financial year ends since 2013, the outstanding funding balance by type.

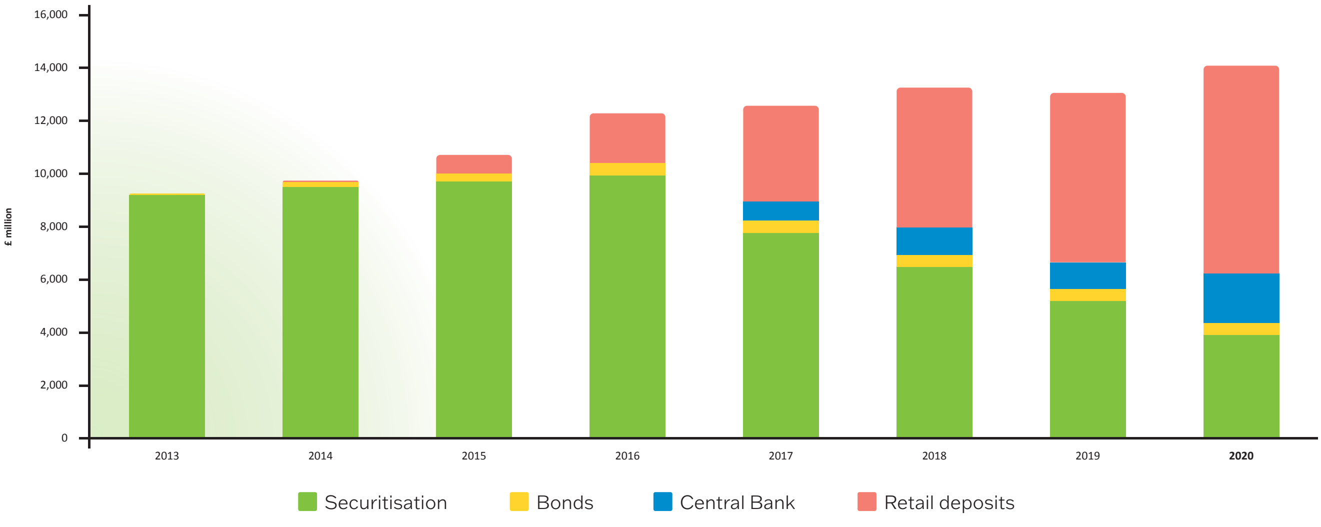
In the short-to-medium term, the Group's principal source of funding will remain retail deposits, which have performed well throughout the Covid-19 crisis to date. These will be supplemented by participation in TFSME, the Bank of England scheme to support lending into the UK economy, especially to SMEs. New public securitisations in the near-term are unlikely, with offerings in the short-term likely to be designed to create securities to support other borrowings.

LIBOR, which had been the principal sterling reference rate used by the Group, is due to be withdrawn by the end of 2021, with regulators confirming their commitment to this deadline, despite the Covid 19 crisis. All Group debt issuance since 2019 has been priced with reference to SONIA, the Sterling Overnight Index Average and, during the year, SONIA became the Group's principal reference rate for hedging operations.

However, much of the Group's outstanding debt issuance is priced by reference to LIBOR and other IBOR rates and the Group is actively participating in industry initiatives to determine the optimal treatment of such securities on the withdrawal of these rates. The Group also has a significant LIBOR-linked asset base, mostly relating to legacy mortgage assets, where it is participating in a Bank of England 'Tough Legacy Task Force' addressing the impact of transition on such products. This aims to ensure fair and consistent outcomes for customers with such exposures.

Funding by type (£m)

30 September 2013 – 2020



Strategic Report

A4.2.1 Retail funding

Retail deposits provide the Group with a reliable, cost effective and scalable source of funding, and continued to remain so in the face of market disruption resulting from Covid-19. The Group offers customers a range of deposit options, offering competitive rates and value for money. This, combined with a strong customer service ethic and the protection provided to depositors by the Financial Services Compensation Scheme ('FSCS'), supports the Group in meeting its funding and margin requirements.

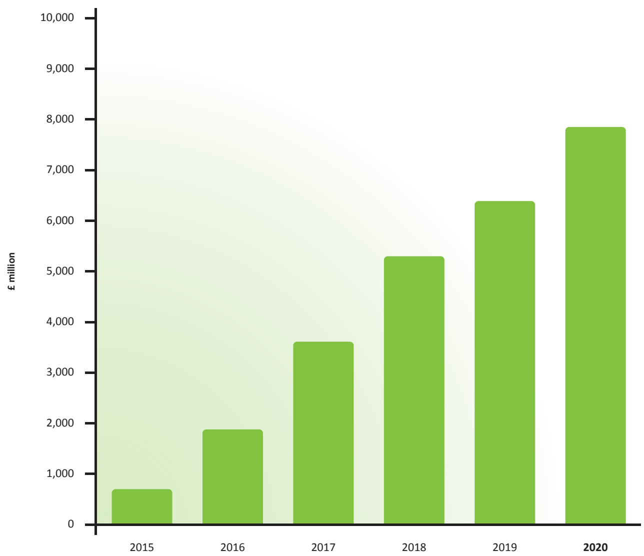
The volume of retail deposits has continued to grow during the period reaching £7,856.6 million at the year end, 22.9% higher than a year earlier (2019: £6,391.9 million). This has been achieved with a reduced funding cost, reflecting the improvements made to the Group's capacity and capability.

The Group's share of the overall UK savings market remains minimal, with household savings balances reported by the Bank of England increasing by 5.5% in the year to £1,287.9 billion (2019: £1,220.4 billion), although these deposits remain overwhelmingly with clearing banks and building societies.

The growth of the retail funding balance since the authorisation of Paragon Bank as a deposit taker in 2014 is shown below.

Retail deposits (£m)

At 30 September 2015 - 2020



At 30 September 2020 the proportion of easy access deposits, which are repayable on demand, was 30.0% of the total deposit base, a little higher than its level at the beginning of the year (30 September 2019: 27.8%), and represented £2,359.6 million of the balance (2019: £1,778.0 million). This percentage is considered to be low compared to the rest of the banking sector and can be expected to rise going forward.

Savings accounts at the financial year end are analysed below.

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

The average initial term of fixed rate deposits was 27 months (2018: 28 months). Market savings rates in the year have fallen substantially, with the Bank of England quoting average interest rates at 30 September 2020 for new 2-year fixed rate deposits at 0.48% (2019: 1.41%) and for instant access balances at 0.07% (2019: 0.42%). Some market disruption was created in the second half-year by the short-term pricing strategy adopted by NS&I, but the strength of the market meant that the Group was able to source its funding requirements throughout the period.

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

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

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

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

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

Customers were also surveyed on the savings business's response to the Covid-19 crisis. 65% of the respondents felt that the Group's clarity of communications with customers had been good, while 99% of respondents said its response to the crisis was at least as good as other providers, including 17% who considered it to be better.

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

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

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

A4.2.2 Wholesale funding

The Group's wholesale funding comprises securitisation funding, warehouse debt and retail and corporate bonds. It has been one of the principal issuers of residential mortgage backed securities ('RMBS') in the UK over many years. The Group's Long-Term Issuer Default Rating was affirmed at BBB by Fitch in the period, albeit with a negative outlook, which was applied to all the major UK banks as a result of the Covid-19 crisis.

Following the UK general election in December 2019 the performance of the capital markets strengthened during the early part of 2020, with increasing transaction volumes and improving margins for issuers. Demand in the markets remained high through the latter part of the year, however, the impact of Covid-19 and the availability of alternative funding sources made the markets unattractive for new public issuance.

Five mature securitisation transactions were refinanced during the year. These included three funding pre-2010 mortgages and two recent transactions which had reached their expected maturity dates and were paid down in accordance with market expectations. Notice was also given that two further legacy securitisations would be paid down after the year end. This will leave only two legacy transactions outstanding on the Group's balance sheet.

On 30 April 2020 the Group completed a fully retained securitisation transaction, Paragon Mortgages (No. 27) PLC, resulting in the issue of £735.8 million of rated notes to group companies. After the year end a further such transaction, Paragon Mortgages (No. 28) PLC issued £703.1 million of notes to group companies on 9 November 2020. These notes will be used as collateral in other funding transactions including central bank schemes.

A further funding option is provided by wholesale warehouse funding, which provides standby capability, particularly in the event of market disruption elsewhere, where funds need to be deployed rapidly or as an alternative to retail deposit funding for liquidity purposes. The Group's £200.0 million facility with Bank of America Merrill Lynch was renewed in October 2019 and again in September 2020, when the commitment was increased to £400.0 million and the interest rate increased to LIBOR plus 1.05%.

During the period the Group also entered into a long / short repo transaction with a major UK bank. This provides £150.0 million of additional liquidity, based on retained securitisation notes, but does not appear on the Group's balance sheet, due to its contractual terms. This is the first such transaction the Group has undertaken, representing a further enhancement to its funding flexibility.

A4.2.3 Central bank facilities

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

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

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

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

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

The Group will continue to access these facilities in future as part of its funding strategy, in accordance with the objectives of these schemes, where such borrowings are appropriate and cost effective.

A4.2.4 Funding outlook

The Group's diversified funding position, with strong wholesale and retail franchises gives it a strong position in the face of economic uncertainties. This reduces its exposure to issues affecting any particular funding source and allows it the flexibility to raise funds in accordance with its own market assessments, rather than being forced into sub-optimal transactions for short-term reasons. This base delivers a robust and adaptable position going forward, supporting the Group's overall business strategy and aspirations.

Further information on all the above borrowings is given in notes 28 to 33.

A4.3 Capital

The Group's capital policy aims to provide appropriate returns to shareholders, whilst maintaining prudent levels of capital to support its strategic objectives and protect the business and its customers in future years. The maintenance of strong regulatory capital and liquidity positions to safeguard its depositors is also a principal strategic objective, supported by detailed capital planning and stress testing procedures.

For regulatory purposes the Group's capital comprises shareholders' equity and tier 2 bonds. It has no outstanding AT1 issuance, but has the capacity to issue such securities, if considered appropriate, under an authority granted by shareholders at the 2020 AGM, which will be proposed for renewal at the forthcoming meeting.

A4.3.1 Dividends and distribution policy

The Group's stated distribution policy over recent years has been to distribute 40% of consolidated earnings to shareholders in ordinary circumstances, achieving a dividend cover ratio of approximately 2.5 times.

In normal years this would be achieved by the payment of an interim dividend following the announcement of the half-year results with a final dividend after the year end making up the balance. However, at the time of the half-year announcement the decision was taken, given the extreme levels of economic uncertainty due to Covid-19, to defer any discussion of dividend levels until after the end of the financial year and consequently no interim dividend was declared (2019: 7.0 pence).

Following the year end the Board considered the appropriateness of declaring a dividend for the year on the basis of the annual results and capital resources; customer and economic experience through the first six months of the Covid-19 crisis; updated business, capital and liquidity forecasts and stress tests; and the most recent economic forecasts. It also considered the most recent regulatory comments and views expressed by shareholder groups.

In determining the level of dividend for the year, the Board has considered the dividend policy, together with the Group's strategy, capital requirements, principal risks, the level of available retained earnings in the Company, its cash resources and the objective of enhancing shareholder value.

The dividend policy is underpinned by the principle of enhancing shareholder returns on a sustainable basis and the Board is proposing, subject to approval at the Annual General Meeting on 24 February 2021, a dividend for the year of 14.4 pence for 2020 (2019: final dividend of 14.2p per share, total dividend of 21.2p per share). This dividend would be in line with the stated policy, giving a dividend cover of 2.50 times (2019: 2.33 times), with the reduction in amount from the previous year corresponding largely to the reduction in group earnings.

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

The directors have considered the distributable reserves of the Company and concluded that such a dividend is appropriate.

The Board also affirmed the existing dividend policy going forward, subject to an assessment of prevailing conditions at the time, but noted that, due to paying the full 2020 dividend as a final dividend, any interim dividend declared for 2021 would not necessarily bear the normal relation to the preceding final distribution.

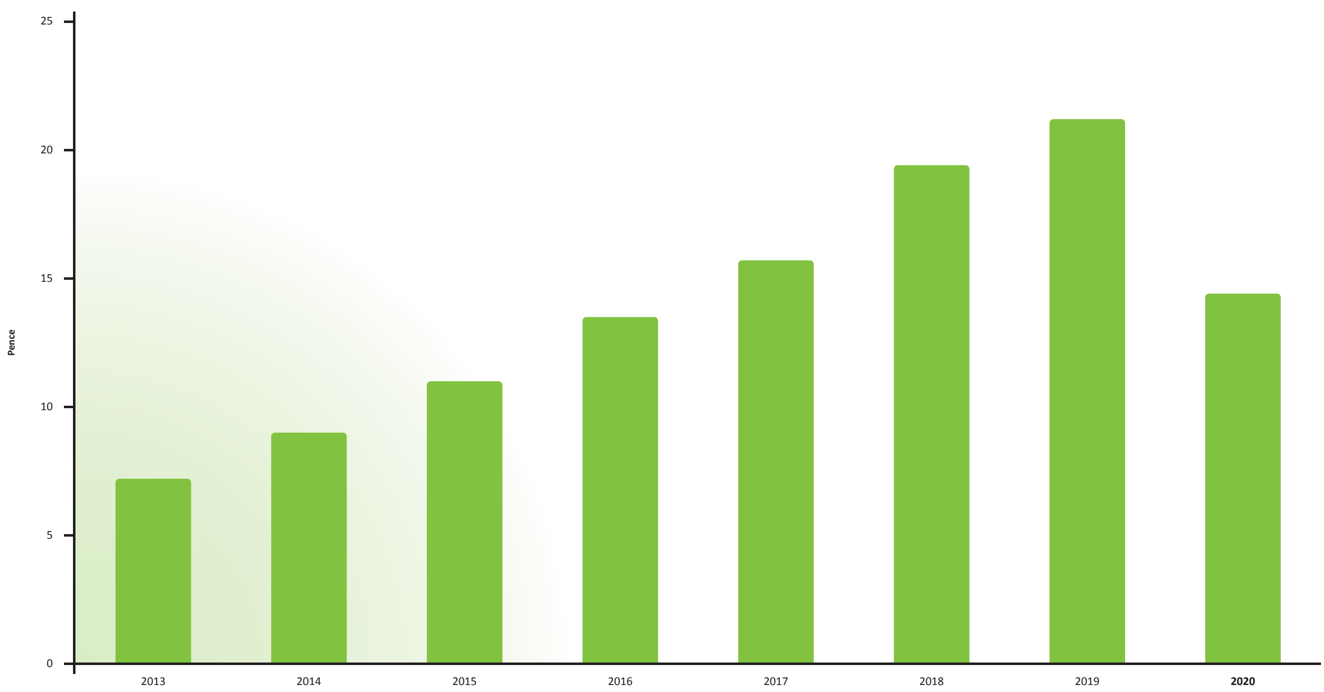
A4.3.2 Regulatory capital

The Group is subject to supervision by the Prudential Regulation Authority ('PRA') on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator will issue an individual capital requirement setting an amount of regulatory capital, defined under the international Basel III rules, currently implemented through the EU Capital Requirements Regulation and Directive regime ('CRD IV'). This capital, which includes elements determined based on the Group's total risk exposure together with fixed elements, is held in order to safeguard depositors in the event of severe losses being incurred by the Group.

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

Dividend for the year (pence)

In respect of the years 2013 - 2020



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

	Basic		Fully loaded	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
CET1 capital	**991.2**	922.0	**948.9**	900.8
Total Regulatory Capital ('TRC')	**1,141.2**	1,072.0	**1,098.9**	1,050.8
Pillar 1 + 2A capital requirement	**749.6**	742.9	**745.3**	741.8

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

The Group's trading performance, including the deferral of bonuses, has led to the increase in capital shown above, with the basic measure, discounting IFRS 9 impairment charges, growing faster than the fully loaded measure. However, the amount of headroom over the Pillar 1 + 2A requirement, even on the fully loaded basis which allows for IFRS 9 provisioning, is significant.

Available capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of total risk exposure. While the CCoB remained at 2.5%, its long-term rate, throughout the year, the CCyB was cut from 1.0% to zero during the period as a regulatory response to the pandemic. However, it was also announced that the long-term normal rate of the CCyB in the UK would be 2.0%. CET1 capital required to cover these buffers therefore reduced to £173.7 million at the year end on the regulatory basis (2019: £235.3 million). Further buffers may be set by the PRA on a firm-by-firm basis but may not be disclosed.

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

The Group's capital ratios are set out below.

	Basic		Fully loaded	
	2020	2019	**2020**	2019
CET1 ratio	**14.3%**	13.7%	**13.7%**	13.4%
Total capital ratio	**16.4%**	15.9%	**15.9%**	15.7%
UK leverage ratio	**7.1%**	6.7%	**6.8%**	6.6%

Capital ratios have strengthened on the fully loaded basis, even allowing for the payment of the proposed dividend, and are considerably stronger on the basic regulatory basis due to the reliefs described above.

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

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

A4.3.3 Liquidity

The Group's operational capital and funding requirements are also influenced by the Group's policy to hold sufficient liquidity in the business to meet its cash requirements in the short and long-term, as well as to provide a buffer under stress. There is also a regulatory requirement to hold liquidity in Paragon Bank.

The Board regularly reviews liquidity risk appetite and closely monitors a number of key internal and external measures. The most significant of these, which are calculated for the Paragon Bank regulatory group on a basis which is standardised across the banking industry, are the Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR').

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

A4.3.4 Capital outlook

The maintenance of strong capital and liquidity positions has been a central part of the Group's strategic thinking over many years, leaving it well placed to deal with stresses. Actions taken during the year, including the passing of the interim dividend and the deferral of senior management bonuses in shares, have maintained the strength of that position.

While the short-term regulatory capital reliefs put in place by regulators in response to Covid-19 are welcome, the Group considers itself to be well capitalised, even on a fully loaded basis.

This position is built upon strong businesses, careful management and a flexible funding base. Regular reviews of capital requirements by the Board form part of the planning and strategic development process, considering the level and form of capital demanded by current business, regulatory and economic conditions and future developments as well as the Group's strategic objectives.

This is designed to deliver a future capital position which is prudent and sustainable, even under stress, protecting the viability of the Group's business, for the benefit of all its stakeholders.

A4.4 Financial results

The impacts from Covid-19 and the associated policy response have been included in the reported outcomes for 2020. These impacts include slower customer demand in the second half, a material reduction in interest rates which had an initially adverse effect on net interest margins and higher expected levels of loan impairments. Under IFRS 9, impairments are charged on an expected loss basis.

A4.4.1 Consolidated results

Underlying operating profit for 2020 was 27.0% below 2019's level at £120.0 million (2019: £164.4 million) (Appendix A). On a statutory basis profit was reduced by 25.5% to £118.4 million (2019: £159.0 million). The single largest contributor to this reduction came from the charge for loan impairments, which was 503.8% higher than in 2019.

Consolidated results

For the year ended 30 September 2020

	2020	2019
	£m	£m
Interest receivable	**491.7**	505.7
Interest payable and similar charges	**(213.6)**	(227.3)
Net interest income	**278.1**	278.4
Net leasing income	**3.0**	3.8
Gain on derecognition of financial assets	-	9.7
Other income	**14.0**	15.4
Total operating income	**295.1**	307.3
Operating expenses	**(126.8)**	(125.2)
Provisions for losses	**(48.3)**	(8.0)
	120.0	174.1
Fair value net (losses) / gains	**(1.6)**	(15.1)
Operating profit being profit on ordinary activities before taxation	**118.4**	159.0
Tax charge on profit on ordinary activities	**(27.1)**	(31.6)
Profit on ordinary activities after taxation	**91.3**	127.4

	2020	2019
Dividend – rate per share for the year	**14.4p**	21.2p
Basic earnings per share	**36.0p**	49.4p
Diluted earnings per share	**35.6p**	48.2p

Income

Net interest income was broadly unchanged when compared to 2019 at £278.1 million (2019: £278.4 million). Within this figure, average loan balances rose by 2.2% and the Group's net interest margin ('NIM') fell by 5 basis points to 224 basis points.

The reduction in base rates to just 10 basis points generated a short-term reduction in the Group's NIM, with the reduction applying to both the investment rate earned on the Group's cash investments and also to variable rate loans, where the full reduction in rates was passed on to customers. Funding deposit costs have also reduced in the second half, but initially at a slower pace. After reporting 229 basis points of NIM at the first six months of the year, margins reduced for much of the second half but had recovered most of the lost ground by the year end.

With slower levels of new business growth in 2020, the effect of the amortisation of the Idem Capital portfolio had a greater effect on the mix of yields in the loan book and hence on reported net interest margins. The Idem-specific net interest margin fell to 7.60% for 2020 (2019: 11.94%), reflecting a combination of continued reductions in the loan book, changes in the mix of products and lower future cash flow expectations. The largest element of this cash flow re-estimate was a result of a detailed review on the basis of the Covid-19 economic outlook, where £3.7 million was written off, reversing income taken in previous years.

Net interest margin for the Group excluding Idem increased from 1.92% in 2019 to 2.09% in 2020. This reflects structural change in the loan book, with new buy-to-let and commercial loans carrying higher margins than the legacy buy-to-let portfolio. The scale of change in this ratio (+17 basis points) was lower than the +39 basis points reported for 2019 as a result of the base rate changes reported above.

The progression of the Group's NIM, including and excluding the Idem Capital division, over the past five years is set out below.

	Total	**Excluding Idem Capital**
	Basis points	**Basis points**
Year ended 30 September		
2020	**224**	**209**
2019	229	192
2018	219	153
2017	213	141
2016	215	139

Other operating income was £17.0 million for the six months, compared with £19.2 million reported in 2019. This reduction reflected lower account fee income, which is attributable to the changing profile of the portfolio, and reduced levels of broking income in the year.

Costs

Operating expenses were 1.3% above their 2019 level at £126.8 million (2019: £125.2 million). The Group had been anticipating a higher rate of increase than this, but Covid-19 served to delay the implementation of certain projects, with these costs now expected to be incurred during 2021 and 2022.

The cost base for the year does, however, reflect the Group's continued investment in IT infrastructure and operational resilience, an approach which has helped support its response to the Covid-19 pandemic. An updated broker portal for the Mortgage Lending division and new treasury systems came on stream during the early part of the year and developments continued, even during the lockdown period, with enhancements to the SME lending customer experience a particular focus.

While staff numbers remained stable and all employees remained on full pay throughout the Covid-19 crisis, savings arose from lower senior management cash bonuses and share-based remuneration charges. The accounting effect of the deferral in shares of 100% of the executive bonuses and large proportions of other senior management bonuses is to remove these costs from the 2020 cost base, instead spreading them over future periods.

The Group outsources its savings deposit administration, the costs of which relate to the size and activity levels of the savings portfolio rather than being linked to general cost inflation. As the Group refocuses its funding model to have a greater retail deposit weighting, operating costs will therefore tend to grow at rates above the general inflation rate. Savings related overheads grew by £1.6 million in the year.

The progress of the Group's cost income ratio over the last five year is set out below.

	Underlying %	Statutory %
Year ended 30 September		
2020	**43.0**	**43.0**
2019	42.1	40.7
2018	40.6	37.8
2017	40.5	40.5
2016	37.9	37.9

Impairment provisions

Impairment charges totalled £48.3 million for 2020 compared to £8.0 million during 2019. The major factors driving this increase were the impact of Covid-19 on expected customer behaviour and the impact of lower projected asset values in the event of default. Up to the point of the impact of Covid-19 on the UK in March, the Group's provision data was largely positive, with charges remaining in line with expectations. However, from the half-year onwards the Group factored the potential impact of Covid-19 into its consideration of expected credit losses. While IFRS 9 is intended to provide for expected future losses, the unprecedented and unexpected nature of the Covid-19 crisis resulted in a sharp increase in provisions to reflect the fundamental change in economic outlook.

In addition to applying a more severe suite of economic projections to the Group's IFRS 9 impairment models, the year end analysis also takes explicit account of payment holidays granted to customers during the year, together with adjusting for the lagging effect government policy has had, and potentially continues to have, on observable impairment. Careful consideration was also given to the extent to which the Group's base models, derived on the basis of historic data, can accurately predict behaviour in these unprecedented circumstances.

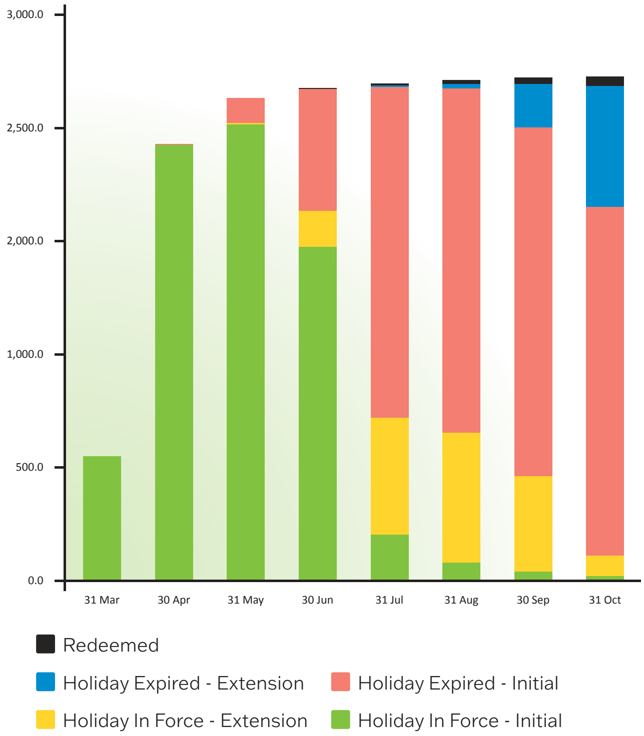
The impairment calculations generate £62.0 million of the £81.8 million total balance sheet provision, with the balancing £19.8 million being post model adjustments ('PMAs') based on management's judgement of the effects of lagging and payment reliefs.

Payment holidays

Over £2.6 billion of customer balances were granted Covid-19 payment reliefs at some point during the year, with some of these holidays extended beyond the year end.

The table below shows how this position developed throughout 2020, including October 2020's results, which gives the most up-to-date view on the flows.

Payment holidays



Month End	Relief in force Initial £m	 Extension £m	Relief expired Initial £m	 Extension £m	Redeemed £m	Total £m
March	658.2	-	0.2	-	0.3	658.7
April	2,306.9	-	2.4	-	0.6	2,309.9
May	2,414.7	7.3	130.3	-	1.4	2,553.7
June	1,767.6	190.6	642.9	1.3	3.3	2,605.7
July	245.7	619.4	1,752.6	9.6	9.2	2,636.5
August	94.4	688.0	1,825.3	23.2	21.8	2,652.7
September	46.1	506.0	1,843.7	230.2	33.3	2,659.3
October	24.1	111.5	1,844.8	638.7	49.1	2,668.2

Strategic Report

	Currently business as usual			Between relief and BAU	Current relief	
	No relief	Single relief only	Extended relief		Extended	Original
	£ billion	£ billion	£ billion	£ billion	£ billion	£ billion
Balance	10.20	1.84	0.62	0.03	0.11	0.03
Proportion	79.5%	14.4%	4.8%	0.2%	0.9%	0.2%
% with arrears deterioration	0.9%	1.5%	6.8%	10.0%	2.8%	1.7%
% with arrears improvement	3.0%	1.1%	7.8%	1.5%	3.5%	2.8%

Payment holiday status (2 November 2020)

The position at 31 October 2020 is summarised in the table above, which analyses the values of accounts by payment relief status and which also highlights, for each of those groups, the relative change between the October 2020 arrears position and the 29 February 2020, pre-Covid-19 position. Cases where the payment holiday has ended, but no payment is yet due are shown separately.

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

Multiple economic scenario summary and outputs

The Group creates four macro-economic scenarios to underpin its IFRS 9 impairment modelling, and business forecasting. These comprise a base case position, an upside, a downside and a severe case. Covid-19 has had a material impact on the most recent iteration of these forecasts when compared to the Group's 2019 economic outlook for the same periods. The year-on-year differences in a selection of the variables defining these scenarios are set out below on a weighted average basis.

The forecast economic assumptions within each scenario, and the weightings applied are set out in more detail in note 19 to the accounts.

Scenarios used at 30 September 2019

	Weighted scenario outcome at					
	2019	2020	2021	2022	2023	2024
GDP (indexed to Sep 2019)	100.0	101.0	102.8	106.4	108.3	110.3
House prices (indexed to Sep 2019)	100.0	100.9	103.0	106.8	111.4	116.2
Unemployment rate (absolute value)	3.8%	4.5%	4.6%	4.5%	4.4%	4.2%

Scenarios used at 30 September 2020

	Weighted scenario outcome at					
	2019	2020	2021	2022	2023	2024
GDP (indexed to Sep 2019)	100.0	94.5	99.5	102.3	104.6	108.3
House prices (indexed to Sep 2019)	100.0	105.0	97.6	96.0	102.0	106.1
Unemployment rate (absolute value)	3.8%	4.8%	7.0%	5.8%	5.1%	4.4%

Change

	Weighted scenario change				
	2020	2021	2022	2023	2024
GDP (indexed to Sep 2019)	(6.5)	(3.3)	(4.1)	(3.7)	(4.0)
House Prices (indexed to Sep 2019)	4.1	(5.4)	(10.8)	(12.9)	(14.2)
Unemployment rate (absolute value)	+0.3%	+2.4%	+1.3%	+1.0%	+0.9%

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

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

Impairment cover ratios and trends

The combination of harsher economic forecasts and the approach to assessing payment reliefs have led to materially higher provisions and cover ratios, as set out below.

	30 Sep 2019	31 Mar 2020	**30 Sep 2020**
	£m	£m	**£m**
Calculated provision	41.9	42.7	**62.0**
Overlay	-	24.0	**-**
PMAs (for payment relief and lagged effects)	-	-	**19.8**
Total	41.9	66.7	**81.8**
Cover ratio	0.34%	0.53%	**0.64%**

Fair value movements

The material reductions in both spot and forward rates during 2020 have resulted in a fair value charge of £1.6 million for the year arising from the Group's hedging activities. This compares to a charge of £15.1 million during 2019. The fair value movements reflect non-cash items and revert to zero over the lives of the instruments involved.

Tax

The effective tax rate applied to the Group's profits in 2020 has increased from 19.9% in 2019 to 22.9% during 2020. While the standard tax rate applying to the Group remained at 19.0%, the proportion of Group profits arising in Paragon Bank and consequently attracting the banking surcharge, increased. This caused the surcharge amount to increase by £1.9m, equivalent to an increase of 190 basis points on the tax rate.

The reduction in UK corporation tax rates to 17.0% which had been previously legislated for, and hence accounted for, was reversed in the year, with the impact of this on the Group's deferred tax balances affecting the year's charge.

The Group remained up-to-date with all payments of national and local taxes throughout the Covid-19 period.

Results

As noted above, there were no one-off gains or losses included in the 2020 result, whereas 2019 benefitted from a £9.7 million gain on the disposal of the Group's residual interest in one of its legacy securitisations. Profit before tax for the year was 25.5% lower than 2019's outturn at £118.4 million (2019: £159.0 million).

Basic earnings per share for 2020 were 36.0 pence (2019: 49.4 pence) and the diluted measure was 35.6 pence per share (2019: 48.2 pence), reflecting the fall in profit.

This result increased equity to £1,156.0 million (2019: £1,108.6 million), representing a tangible net asset value of £3.90 per share (2019: £3.71 per share) and a net asset value on the statutory basis of £4.57 per share (2019: £4.39 per share) (Appendix D).

A4.4.2 Assets and liabilities

Summary balance sheet

30 September 2020

	2020	2019	2018
	£m	£m	£m
Investment in customer loans			
Mortgage Lending	**10,819.5**	10,344.1	10,449.5
Commercial Lending	**1,514.8**	1,452.1	1,131.3
Idem Capital	**297.1**	389.9	519.8
	12,631.4	12,186.1	12,100.6
Derivative financial assets	**463.3**	592.4	855.7
Cash	**1,925.0**	1,225.4	1,310.6
Intangible assets	**170.1**	171.1	169.3
Other assets	**315.7**	220.5	51.7
Total assets	**15,505.5**	14,395.5	14,487.9
Equity	**1,156.0**	1,108.6	1,073.5
Retail deposits	**7,856.6**	6,391.9	5,296.6
Other borrowings	**6,229.7**	6,648.4	7,961.2
Derivative financial assets	**132.4**	80.5	4.7
Pension deficit	**20.4**	34.5	19.5
Other liabilities	**110.4**	131.6	132.4
Total equity and liabilities	**15,505.5**	14,395.5	14,487.9

The Group's loan portfolio grew by 3.7% during 2020, with growth in each of its Mortgage Lending and Commercial Lending divisions and continued amortisation of balances in Idem Capital. More detail on these movements is given in section A4.1. This increase, together with the Group's liquidity and capital policy, determines its funding requirements and hence the level of its liabilities.

Funding structure and cash resources

The Group's funding increased by 8.0% during the year in response to the growth of the business and a cautious outlook on funding and liquidity. The proportion represented by retail deposits increased to 55.8% in accordance with the Group's long-term funding strategy (2019: 49.0%). The cautious approach to liquidity and capital resulted in the increased cash balance, which increased by £699.6 million in the period. Movements in funding balances are discussed in more detail in section A4.2.

Derivatives

Movements in derivative financial assets principally relate to the retirement of certain of the Group's currency denominated floating rate notes and their related hedging instruments in the period. These swaps decreased by £137.4 million over the year. These movements do not impact the Group's results.

Derivative assets and liabilities used for interest rate hedging increased by £6.6 million and £51.5 million respectively, as a result of interest rate movements. These were largely offset by a £45.5 million increase in the hedging adjustment on loans to customers, included in sundry assets above, and a £4.5 million increase in the adjustment on retail deposits, included in sundry liabilities.

Pension obligations

The IAS 19 valuation of the Group's defined benefit pension scheme deficit reduced by £14.1 million in the period, less than the £20.0 million additional cash contribution made by the Group in the year. Market implied gilt yields, which are used to value future liabilities, reduced by less in the year than bond yields, which are used to estimate the discount rates applied to them, and hence the discounted value of the liability increased. The deficit at 30 September 2020 stood at £20.4 million (2019: £34.5 million).

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the deficit at 30 September 2020 was estimated at £9.7 million, a reduction of £19.5 million in the period (2019: £29.2 million), representing a 93.9% funding level (2019: 80.0%).

Other assets and liabilities

Sundry assets have increased since 30 September 2019 by £95.2 million. This increase was driven principally by movements in swap rates which generated the £45.5 million movement in fair value hedging referred to above and required a £31.3 million increase in CSA collateral deposits as a result of the increased value of derivative liabilities. Other movements included the inclusion of a tax current debtor of £5.7 million, with payments on account in the year being greater than the calculated tax payable; an increase of £3.7 million in mandatory CRD deposits at the Bank of England, which are calculated based on the size of the Group's deposit base; and the recognition of £7.0 million of right-of-use assets on the adoption of IFRS 16 (note 61).

Within sundry liabilities, which reduced by £21.2 million, the absence of a current tax liability (2019: £15.2 million), as referred to above, and a reduction in accrued investment interest receivable as a result of reduced interest rates, are offset by the lease liability recognised on transition to IFRS 16.

A4.4.3 Segmental results

The underlying operating profits of the three segments described in the Lending Review in section A4.1 are detailed fully in note 2 and are summarised below.

	2020	2019
	£m	£m
Segmental profit		
Mortgage Lending	**154.3**	167.9
Commercial Lending	**45.9**	43.8
Idem Capital	**19.6**	48.0
	219.8	259.7
Gains on disposals	**-**	9.7
Unallocated central costs and other one-off items	**(99.8)**	(95.3)
	120.0	174.1

The Group's central administration and funding costs, principally the costs of service areas, establishment costs and bond interest have not been allocated.

Mortgage Lending

The Mortgage Lending division has maintained a strong position in its market throughout the year, increasing its average net loan balance by 1.8%, despite the impact of Covid-19 through the second half of the year. Average NIM improved by 9 basis points over the year as a result of business initiatives and the replacement of legacy assets with higher yielding accounts. This generated a 6.9% increase in net interest. However, the impact of the virus on loss expectations generated impairment charges for the year of £25.8 million (2019: £1.0 million), increasing the cost of risk to 0.24% (2019: 0.01%).

The impact of this increased provision saw segmental profit decrease by 8.1% to £154.3 million, from the previous year (2019: £167.9 million).

Commercial Lending

Segmental profit in Commercial Lending was £45.9 million in the period (2019: £43.8 million), an increase of 4.8% even after allowing for the impact of Covid-19 on provisions. This resulted from the 14.8% growth in average loan balances, year-on-year, principally attributable to the strength of growth in the development finance business.

Coupled with a strategic focus on yield which saw NIM in the segment increased by 50 basis points in the year, this growth generated a rise of 21.1% in total operating income in the segment. With the cost base broadly similar to the previous period, the increase in operating income was offset by the £14.5 million increase in provision arising from the worsening economic outlook reflected in the Group's IFRS 9 impairment scenarios.

Idem Capital

The result for the Idem Capital division continues to be driven by the rate of portfolio run-off, with no new deals completed in the year. The average loan balance reduced by 24.5% in the year while average NIM continued to reduce with high-yielding assets paying down more rapidly than lower yielding secured balances.

Unsecured consumer assets in the division are valued based on future expected cash flows. The reforecast of these balances in the light of Covid-19 generated a write-down of expected interest of £3.7 million, which has also impacted NIM in the segment. However actual performance in the last six months of the year has been encouraging.

This, together with the Covid-19 provisioning on the secured assets, impacted on segment profit, which fell to £19.6 million (2019: £48.0 million).

A4.5 Operations

The major factor impacting the Group's operational capabilities in the year was the Covid-19 pandemic, which affected all business areas. The achievement of the Group's objectives is heavily reliant on its people, business partners, suppliers, systems and governance structures, with a single framework covering all locations and operations. This framework has been successfully reconfigured in response to Covid-19.

The development of the Group's operations has continued despite the virus. Both before the outbreak of Covid-19 and during the pandemic, the Group has continued to invest in its infrastructure, particularly in customer and broker facing systems. The Group's planned change programme progressed throughout the year with minimal impact from the pandemic, delivering new technology and operational enhancements which will generate efficiencies and improve customer experiences.

A4.5.1 Covid-19 response

The Group's operational response to Covid-19 has focussed on enabling its businesses to continue operating as normally as possible whilst supporting its customers and protecting employees and other stakeholders. Operating in a key economic sector, it recognised the need for service levels to be preserved as far as possible and the difficulties in achieving that. The Group is proud of what has been achieved and is confident that it has in place the operational infrastructure to deliver the levels of customer service and employee safety required both during and after the pandemic.

The Group's operational functions faced three major challenges as a result of the Covid-19 situation:

- To develop processes and IT systems to deliver appropriate financial reliefs to customers, in line with the structures set out by the UK Government
- To enable working from home to be widely available amongst the workforce while preserving the Group's culture and retaining a strong compliance and cyber-security framework
- To develop the systems and procedures to offer the CBILS and BBLS products introduced across the financial services industry to support its customers

The UK Government announced the initial package of Covid-19 reliefs that it expected lenders to grant on 17 March 2020 and the Group was able to develop and put in place the necessary processes and systems before the first large batch of payments fell due on 31 March, 14 days later. This involved a significant amount of work by operational and IT staff to ensure that not only were the appropriate reliefs given, but also that they were given in a way that would not adversely impact customers' credit records. Systems have continued to develop as reliefs have been extended and amended through the second half of the year.

Prior to the announcement of the UK lockdown the Group was already planning for that eventuality, with groups of employees trialling working from home while on-site social distancing was enhanced. Following the announcement, a programme was quickly put in place to convert as many people as possible to working from home, including customer service and contact centre employees. This involved both the transfer of significant amounts of IT equipment to employees' homes and also changes to the Group's networks and systems. These changes were required to enable remote working, while still retaining appropriate controls over data and system security as well as the levels of monitoring required by regulators, particularly in a contact centre environment.

The operation saw the conversion of around 1,000 previously office-based employees to home working. This involved the provision of desktop computers, screens and related IT equipment at 425 homes, an additional 50 users being provided with laptop computers, and additional equipment being provided to many other employees already equipped for home working.

By 31 March 2020, the Group had enabled 90% of employees to work from home on a sustained basis whilst maintaining service levels for all its customers. Almost all the Group's offices have been temporarily closed with employees identified as critical being retained in a handful of premises, mostly in roles which require the employees' physical presence, such as those maintaining council waste disposal vehicles funded by the Commercial Lending division. Other than these workshop personnel, almost all remaining on-site employees are based in the head office in Solihull.

At the year end most employees were still working from home and while plans had been made to bring some people back to the Group's offices, those plans were put on hold following the worsening of the Covid-19 situation in the autumn, with a large scale return to office working not expected before March 2021 at the earliest. The Group has not placed any employee on a furlough scheme, nor made any employee redundant following the Covid-19 outbreak, and has no current intention of doing so.

This approach has allowed the Group to provide operational capacity to support its customers, who may themselves be suffering from the effects of the Covid-19 crisis. Data relating to both the period of transition and the period since, with customer-facing employees mostly working from home, demonstrated no significant increase in complaint levels.

The protection of the health and wellbeing of the Group's employees has been a principal objective of its Covid-19 response. Increased hygiene products and more frequent cleaning routines were introduced across the Group's offices from February. Throughout March a coordinated approach was implemented to identify and protect the Group's most vulnerable employees, as defined by the UK Government, and these people were immediately sent home and subsequently, as described above, provided with the necessary IT infrastructure to work from home effectively. Social distancing, in line with UK government guidance was implemented across all open offices during March and this remains in place.

Ensuring regular engagement with employees working from home during the crisis has been an area of focus. Regular briefings by the CEO and senior team, delivered online, have spearheaded a coordinated and regular programme of communications for all employees, as well as specific communications for line managers. Additional learning opportunities have been provided to managers and employees addressing physical and emotional wellbeing with a focus on working from home effectively and managing teams remotely. Further support is provided by the Group's team of emotional wellbeing volunteers, set up in 2018, and all identified and trained with the assistance of the charity Mind.

In addition, quarterly engagement pulse surveys have monitored employees' overall physical and mental wellbeing, enabling the Group to respond quickly to any emerging needs. Fortnightly meetings with the Group's elected People Forum representatives, attended by senior management, as well as two members of the Board on one occasion during the pandemic, have provided a further source of feedback to ensure employees have been considered throughout the Group's response to the pandemic.

All activity is in line with the advice of the UK Government. In addition, an ongoing programme of development activity has taken place through the second half of this year. This is delivered through both learning and virtual group sessions and covers such topics as: effective use of Office 365 applications, including Microsoft Teams; the importance of communication; how to motivate and engage people; and delivering effective performance management whilst working remotely.

Overall, the Group is satisfied with its operational performance during the first six months of the Covid-19 crisis, which has justified its investment in contingency planning and operational resilience over recent years. It is proud of the response to the crisis by its people throughout the operation, without whom this could not have been achieved.

A4.5.2 Management and people

The Group employs just under 1,400 people, with the majority of employees being based at its Solihull head office. The Group is proud of its strong culture; our employees and leadership live by our values and we believe that this is one of our differentiators that makes us a great place to work.

During the period the Group commissioned an independent review of its culture from PwC which concluded that "there is a strong working relationship across the leadership team and consistent alignment on the firm's values and desired behaviours as it pertains to good customer outcomes".

Governance and management

The Group's business continuity governance processes were invoked once it became clear that the Covid-19 pandemic was likely to impact the UK. In addition to the governance provided by senior management, the Board increased its oversight with an additional series of director updates, issued by the Chair of the Board and the CEO, specifically discussing the impact of Covid-19 on the Group and its market. Ad hoc meetings of the Board and committees have also taken place. Board and committee meetings have been held remotely since March 2020. The impact of the pandemic on the Group's stakeholders, including its customers and employees, and the Group's response to it have been thoroughly communicated to the Board and discussed at board meetings.

Since 1 October 2019 the Company has been subject to the 2018 UK Corporate Governance Code (the 'Code'). This includes significant changes from the 2016 edition of the Code and work was undertaken during the year ended 30 September 2019 to ensure compliance with the Code. The enhancements made to the Group's governance arrangements in response to the Code are discussed further in section B of this annual report. The Company has complied with the principles of the Code during the year.

In January 2020 the Group and the Board offered their thanks and best wishes on his retirement to John Heron who was the Group's longest serving employee and Managing Director - Mortgages. John had been an executive director since 2003 and was instrumental in establishing and building both the Group's buy-to-let mortgage offering and the buy-to-let sector as a distinct part of the UK mortgage market.

Peter Hartill reached nine years' service on the Board in February 2020, and it had previously been announced that he intended to step down from the Board at that point. However, the Board announced in December 2019 that it considered Peter's independence, skills and experience allowed him to continue to make a very effective contribution as a non-executive director, Senior Independent Director and Audit Committee Chair and that it had therefore asked him to postpone his resignation. This was in order to ensure that the Board would not have to compromise on either the quality of candidate or a suitable transition period in finding a replacement for him.

In March 2020 Alison Morris was appointed to the Board and succeeded Peter as Chair of the Audit Committee, chairing her first meeting in September 2020. Alison is a chartered accountant and recently retired as a partner in PwC's Financial Services Assurance Practice. She joined PwC in 1982 and spent her entire career with the organisation in a range of internal and external audit roles across the Asset and Wealth Management practice and Banking and Capital Markets business unit.

A thorough handover from Peter to Alison took place over the summer and Peter stepped down from the Board on 30 September 2020. Peter retires from the Board with the thanks of the Chair and the Board for his commitment to the Group and his professionalism and dedication in the role of Audit Committee Chair and, latterly, Senior Independent Director.

Hugo Tudor replaced Peter as Senior Independent Director on 23 July 2020 and and continues to chair the Remuneration Committee.

Following the year end, the Group announced the appointment of Peter Hill as a non-executive director, following a robust search and selection process. Peter was CEO of Leeds Building Society from 2011 until his retirement in 2019 and is currently a non-executive director of Pure Retirement Limited and chairman of its risk committee. He is also Chair of Mortgage Brain and brings with him a wealth of experience in financial services and a proven track record in risk oversight, gained during his executive and non-executive career.

Peter will become Chair of the Risk and Compliance Committee with effect from 31 December 2020 to allow for a managed and orderly transition from the current committee chair, Finlay Williamson, who has announced his intention to step down from the Board on 31 December 2020.

Finlay was appointed to the Board in 2017 and is Chair of the Risk and Compliance Committee and a member of the Audit Committee. Finlay will also be stepping down at the same time from the Board of Paragon Bank PLC, to which he was appointed in 2015. He leaves with the Board's thanks for the contribution he has made to embedding the Group's Risk Management Framework. He has brought humour, great experience and energy to his role and his input will be missed.

Following these changes, women will comprise 37.5% of the Board.

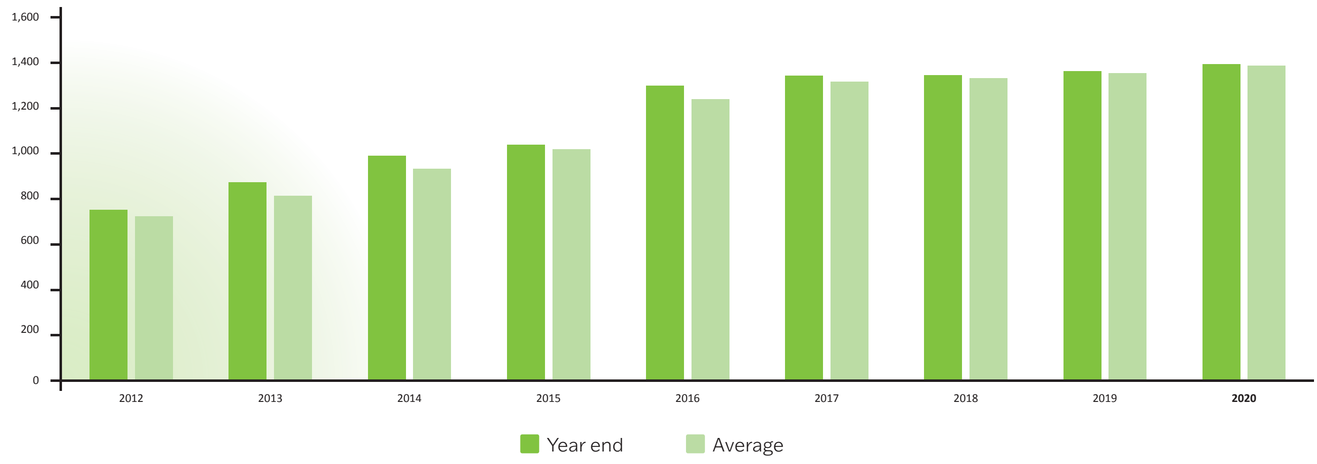
People and development

The Group continues to focus on maintaining an efficient and effective workforce, increasing employee numbers by 1.4% over the year. It maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation.

Retention of employees continues to remain high, with the attrition rate of 10.4% continuing to track below the national average of 21.7%. These high levels of retention are further bolstered by 24.7% of employees achieving over 5 years' service, 13.3% achieving over 20 years with the Group and 4.5% achieving over 30 years' service.

Employee numbers

At 30 September and average for the year



Retaining this level of skill and knowledge within the Group has helped to navigate the challenges that remote working has presented during the Covid-19 pandemic and enabled operational challenges to be met, with employees redeployed to meet operational needs. The Group believes that these levels of retention are driven by a culture of continuing to provide employees with opportunities for personal development and career progression; 25% of the Group's vacancies during the year were filled internally.

The Group has continued to recruit and develop the best talent over the year; adapting how this is achieved through the Covid-19 pandemic. Most of the Group's employees were moved to work from home in the space of a week; new hires were virtually onboarded; and the provision of day-to-day training moved online. The Group has seen its employees pull together and demonstrate their resilience over the course of the year, with some employees temporarily moving into new roles to ensure operational needs are met and customer service standards maintained.

This year it has been more important than ever to continue to promote wellbeing and the Group's Wellbeing Network has organised numerous initiatives to support our people's mental and physical health.

The Group's senior leadership development programme has continued during the year. This is aimed at developing those identified as successors for the executive management team and their direct reports. During this year four members of this programme have secured promotions within the Group. Additionally, the Group continued its participation in the Women Ahead 30% Club cross-company mentoring scheme.

The Group has also continued to take on new apprentices during the period with 46 apprentices currently in place across various business functions. The Group's intern opportunities also continued to be successful, with interns undertaking placements in Finance and Treasury during the year and recruitment taking place over the summer despite the pandemic.

The Group rolled out its 'Leadership Blueprint' in October 2019. This personal development initiative is designed to build the capability of line managers and drive consistency in the way the Group manages its people. It focuses on developing the behaviours of line managers and leaders and measuring the impact that these improvements have on business outcomes.

The Group also focussed on the provision of professional qualifications training during the period, with an additional 37 employees commencing their Certificate in Mortgage Advice and Practice during the period, and other employees being supported in qualifications relevant to their specialism.

During the year the Group also complied with the FCA requirement for the Senior Managers and Certification Regime ('SMCR') to be extended to all regulated legal entities. People performing Senior Management Functions ('SMFs') for its solo regulated businesses (Paragon Finance PLC, Mortgage Trust Services PLC, The Business Mortgage Company Services Limited, Premier Asset Finance Limited, Paragon Technology Finance Limited and Paragon Commercial Finance Limited) have been identified and approved by the FCA.

Alison Morris, non-executive director, became the Group's Whistleblowing Champion this year and all members of the Whistleblowing Committee received training from Protect on how to develop robust whistleblowing arrangements and achieve a culture where employees feel able to raise concerns.

Equality and diversity

The Group continued to make progress with its Equality, Diversity and Inclusion strategy during the year. In January 2020 the Group enhanced its maternity provision, to 18 weeks leave at full pay from 6 weeks at 90%, to support the retention and career progression of female employees. The Group has continued its participation in the 'Women Ahead 30% Club' cross-company mentoring scheme, providing ten trained mentors to support female mentees from other companies, whilst nominating ten female mentees from the Group's workforce to receive external mentoring support at the same time. This is an annual programme and feedback from both mentors and mentees has been very positive. It is the Group's second year of involvement.

The Group has been a signatory of the Women in Finance Charter, sponsored by HM Treasury, since 2016. The Charter's objectives reflect the Group's own aspirations for gender diversity and the Group published its first set of internal targets under the Charter in January 2017.

The Group submitted its latest progress report at 30 September 2020; unfortunately, the proportion of female senior managers fell to 33.9% during the period (2019: 35.9%). This reduction is primarily due to reporting line changes within the senior management population and plans are in place to ensure that the Group can achieve its 35% target by the January 2022 deadline.

At the time of setting its Women in Finance target, the Group set additional targets which it is making excellent progress towards. In particular:

- 50.1% of employees receiving management development / leadership training are female (compared to 42.7% in 2019)
- 24.3% of the workforce are on flexible working contracts (compared to 35.8% in 2019)
- 82% of flexible working available is on a part-time basis (compared to 65.9% in 2019)

The Group continues to monitor external developments and is confident that the practices and plans that are in place are aligned to best practice and reflect the recommendations made by the Hampton Alexander review.

The Group calculated its gender pay gap at April 2020. This calculation shows that median female pay in the Group was 36.9% less than the median male pay (2019: 33.9%). This is broadly in line with the results reported by other financial services companies and the 35.9% gap for the sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings ('ASHE') published in October 2020. Analysis of the gender pay gap data indicates that the Group's gap arose principally as a result of the distribution of roles between the genders, highlighting the importance of the Women in Finance initiative in addressing these issues.

The Group has begun to increase its focus on other diversity strands during the period; rolling out new recruitment technology to reduce the likelihood of unconscious bias in the early stages of candidate selection.

The Group is also in the process of rolling out an Equality, Diversity and Inclusion Network, an employee resource group which consists of people who are passionate about supporting the Group's target of becoming more inclusive for all employees. Richard Rowntree, Managing Director-Mortgages is the executive sponsor for the network and progress will be reported to the Nomination Committee.

A4.5.3 Environment and social

Climate change

During April 2019 the PRA published a Policy Statement noting that climate change, and society's response to it, present financial risks which are relevant to its objectives. Furthermore, the PRA released a 'Dear CEO' letter in July 2020 emphasising their expectations for firms to have fully embedded their approaches to managing climate related financial risks by the end of 2021.

The Group is developing an enhanced approach to identifying and managing the potential impacts of climate change in its business in order to meet these requirements.

In order to provide the appropriate governance, the Board has been engaged in the process for developing and accepting climate change as a principal risk. The Group has established a project and working group reporting to the Executive Risk Committee which is chaired by the CEO. The working group contains personnel from across the business to manage the broad scope of climate change. The working group's remit includes but is not limited to:

- Ensuring the financial risks from climate change are managed effectively following its allocation as a principal risk
- Keeping up-to-date with emerging best practice across the financial services industry
- Developing a clear understanding of how our current products impact the UK's progression to net zero by 2050
- Embedding climate change risk within established risk types such as operational risk and credit risk to ensure a consistent approach is taken across the business

The Group is also cooperating with several industry initiatives on climate change, including projects led by the Green Finance Institute to investigate how financing solutions can support increasing energy efficiency in the UK property sector.

Operationally the Group has taken the decision to move away from diesel vehicles in its company fleet in favour of electric or hybrid vehicles which will reduce greenhouse gas emissions as new cars join the fleet. The Group has also relaunched its cycle-to-work scheme.

More detail on the Group's response to climate change is included in section A6.4.

Charitable activity

As part of its response to Covid-19, and its ongoing commitment to the communities in which it operates, the Group has donated £100,000 to charities supporting people impacted by the pandemic. These included organisations supporting NHS staff, homeless people and elderly people. It has also recognised the difficulties faced by the employee charity committee in fundraising, with so many of the Group's people working off site, and pledged to double the amount raised by staff in the 'Move for Macmillan' challenge. This initiative both supported this year's company charity and promoted exercise and wellbeing amongst people working from home.

A4.5.4 Risk

The effective management of risk remains crucial to the achievement of the Group's strategic objectives. It operates a risk governance framework designed around a formal three lines of defence model (business areas, risk and compliance function and internal audit) supervised at board level.

During the year the focus of the Group's risk management has inevitably been heavily focussed on managing the impacts of Covid-19. The Group has responded effectively to the changes in risk profile arising from the impact of the pandemic.

The Group's risk management framework has provided a robust mechanism to ensure that new risks are promptly identified, assessed, managed and appropriately overseen from a risk governance perspective. As the pandemic unfolded a dedicated Risk Working Group ('RWG') reporting to the Crisis Management Team, was established to oversee all significant process and lending changes resulting from Covid-19, providing independent challenge and oversight, and ensured that all risk aspects were fully considered.

In particular, the RWG and the independent risk function have provided assurance over the following:

- New risks arising from the provision of CBILS and BBLS lending including process changes and underwriting decisions
- Changes to technology and infrastructure required to facilitate mass home working especially in the many customer-facing roles where this practice was new
- Revised credit policies and decisioning to reflect the challenges in applying existing lending criteria

- Implementation of payment holidays in accordance with regulatory initiatives together with other payment reliefs across all product lines
- Planning for a Covid-19 safe return to office-based working and the implications for the longer term workplace strategy

In addition to the challenges of Covid-19, the Group has continued to evolve and embed its risk management framework and in particular has focussed on:

- Anticipating the level of change in product design, funding and operations which will be required in preparation for the withdrawal of LIBOR in 2021
- Embedding operational resilience capabilities which have also been critical in handling the Covid-19 situation. This has included refinement of critical business services and tolerances and ensuring these considerations are embedded as part of day-to-day operations
- Addressing the impact of climate change on managing financial risks
- Developing advanced models and the overarching model risk framework to enhance credit risk management and support the Group's IRB application process
- Evolution and embedding of the Group's approach to managing the risks and oversight of its outsourced relationships and important suppliers
- Enhancing stress testing procedures to ensure the robustness of capital and liquidity positions
- Ensuring effective cyber-security controls and a robust data protection approach

The Group continues to review its exposure to emerging developments in the Brexit process once the transition period ends on 31 December 2020, given the remaining potential of no deal being agreed for the terms of exit. While the Group does not have operations outside the UK it has continued to review the capital, liquidity and operational implications of the stresses which might be caused by the process. The Board has monitored the position throughout the year and the Group considers itself well placed to address the challenges. However, the position remains uncertain and will continue to be subject to detailed monitoring given the imminent deadline.

The principal challenges in the risk environment faced by the Group during the year and moving forward into 2021 include:

- Management of those risks arising from changes introduced in response to Covid-19. As payment reliefs end and the wider economic impacts of the crisis are felt, there will be a need to ensure appropriate treatment of ongoing arrears and the ongoing position of affected customers. Key to this will be ensuring that the treatment of customers is fair and conduct principles remain at the forefront of all interactions
- Management of the transition from LIBOR to alternative benchmark rates given the commitment by the regulators to the transfer being fully completed by 31 December 2021
- Whilst Covid-19 has underlined the need to ensure the Group is fully resilient, the unprecedented crisis has identified a number of industry-wide issues which will need to be built into the resilience frameworks going forward. Further clarification on the broader industry approach is expected with the publication of a consultation paper in late 2020. The Group is committed to strengthening its operational resilience as a core priority in 2021

Further details regarding the governance model, together with the principal risks and uncertainties faced by the Group, the ways in which they are managed and mitigated and the extent to which these have changed in the year are detailed within Section B8 of this annual report.

A4.5.5 Regulation

The Bank is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes continue to pose a significant risk for the Group.

Since March 2020, the impact of Covid-19 has largely driven regulatory priorities and the Group continues to respond effectively to these ongoing challenges. Overall, the Covid-19 response has included reviewing the Group's arrangements to address an evolving situation, whilst maintaining clear focus on customers, staff and the marketplace. Across all product areas the Group continues to provide support and service to its customers.

In response to the economic shock from Covid-19, regulators have sought to alleviate some of the pressures on the banking sector. These regulatory responses include:

- 'Quick Fix' amendments to the CRR discussed in the capital section, A4.3, alleviating the short-term impact of Covid-19 on regulatory capital. These have been reviewed, and where relevant, incorporated into capital and corporate planning
- Guidance from accounting and financial services regulators on the application of IFRS 9 in the Covid-19 environment, including the treatment of payment reliefs and the need to pay regard to the impact of government support measures. These are discussed in Section A4.4.
- Guidance on payment deferrals by the FCA for mortgages, unsecured consumer credit and motor finance to enable customers suffering Covid-19 related financial difficulties to be supported without impact on their credit files. The Group has applied the guidance in full and has worked with customers to ensure they are supported throughout the deferral period, and affordable repayment arrangements are put in place following any such relief

In addition to requirements introduced in response to Covid-19, the following developments currently in progress are particularly relevant to the Group:

- Both the PRA and FCA have been active in ensuring an orderly transition from LIBOR to alternative benchmark measures, both in terms of the impact on financial markets and the impact on customers. A project has been established to oversee the Group's LIBOR transition plan to ensure the regulatory deadlines and requirements are met
- Due to Covid-19 the consultation period for proposed PRA and FCA operational resilience requirements was extended to 1 October 2020, with final rules expected to be published in early 2021. The FCA has also requested that firms comply with the EBA Guidelines on ICT and security risk, particularly focusing on business continuity. The business has reviewed the guidelines and confirmed its proportionate adherence to the requirements. A gap analysis of the Operational Resilience Consultation Paper has been completed, and a plan to ensure compliance within appropriate timeframes is in place

- The FCA published updated guidance on vulnerable customers this year, and HM Treasury has continued work on its proposed Breathing Space scheme. The Group has amended processes and updated procedures to reflect these changes, and to take account of temporary guidance for those experiencing financial difficulties linked to Covid-19
- The FCA has further developed its messaging on culture during 2019/20, broadening its focus from 'Tone at the Top', to a wider view of culture across firms. The FCA has cautioned firms against measuring culture too narrowly. Culture remains a key focus for the Board, senior management and throughout the business
- The PRA published a Policy Statement in July 2020 confirming its expectations of firms when managing the key prudential risks associated with asset encumbrance, specifically in the contexts of managing liquidity and funding risks, recovery planning and resolution. The Group has reviewed the Policy Statement and considers itself to be in a good position to meet these expectations and related PRA rules
- The PRA has confirmed that it expects firms to have fully embedded their approaches to managing climate-related financial risks by the end of 2021. To help firms understand the risks and opportunities that arise from climate change, and to provide support on how to integrate these risks into strategy and decision-making processes, the Climate Financial Risk Forum Guide was published in June 2020. The Group continues to develop its strategy in respect of climate change, in line with this guidance, to ensure it is well-positioned to address these emerging challenges
- The PRA is undertaking a consultation on proposed amendments to the Capital Requirements Directive ('CRD V'). CRD V builds on the existing CRD IV, introducing further measures covering capital, remuneration and governance. It also introduces a number of EU-specific measures designed to further harmonise micro and macroprudential supervision and to introduce greater proportionality in prudential requirements. Whilst the Group awaits the outcome of this consultation, it believes it will be well placed to meet the final requirements

Certain regulations applying in the financial services sector only affect entities over a certain size, which the Group might meet within its current planning horizon. The Group considers whether and when these regulations might apply to it in light of the growth implicit in its business plans and puts appropriate arrangements in place to ensure it would be able to comply at that point.

The Group, along with the rest of the UK corporate sector, continues to lack clear visibility on potential regulatory changes that may be introduced following the end of the Brexit transition period on 31 December 2020. HM Treasury has extended the temporary transitional powers for the regulators until 31 March 2022. Regulatory obligations for firms will generally remain the same for that period.

The governance and risk management framework within the Group continues to be developed to ensure that the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible. Regular reports on key regulatory developments are received at both executive and board risk committees.

Overall, the Group considers that it is well placed to address all the regulatory changes to which it is presently exposed.

A5. Future prospects

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

- Explain how they have assessed the prospects of the Group and whether, on this basis, they have a reasonable expectation that the Group will be able to continue in operation (the 'viability statement')

- State whether they consider it is appropriate for the Group to adopt the going concern basis of accounting in the preparation of the financial statements presented in Section D (the 'going concern statement')

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

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Chairman's Statement in Section A1, Chief Executive's review in Section A3 and review of the business in Section A4. The principal risks and uncertainties affecting the Group, and the steps taken to mitigate these risks are described in Section B8.5.

Section B8 of this annual report describes the Group's risk management system and the three lines of defence model which it is based upon.

Note 54 to the accounts includes an analysis of the Group's working and regulatory capital position and policies, while notes 55 to 58 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting judgements and estimates affecting the results and financial position disclosed in this annual report are discussed in notes 63 and 64.

Financial forecasts

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed annual plans are produced for two-year periods with longer term forecasts covering a five-year period, which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short-term and strategic basis.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was reviewed in detail during the year as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle, where testing considered the impact of a number of severe scenarios.

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

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

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

The key stresses modelled in detail to evaluate the forecast were:

- An increase of 10% in buy-to-let volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements

- Higher funding costs – 20bps higher cost on all new savings deposits throughout. This scenario illustrates the impact of a significant margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios

- An increase in impairment due to more Covid-19 disruption. This scenario models a significant short-term profitability stress and the consequent stress on capital

- A 10% reduction in development finance volumes. Development finance is the highest yielding product and this scenario illustrates the effect of product mix on contribution and other ratios

- A stress combining higher funding costs and more Covid-19 disruption, without reducing lending. Although it is not deemed likely that such a scenario would materialise, since severe stresses almost always result in lower lending volumes, the output from this stress provides a benchmark for a plausible worst-case position that impacts all aspects of business performance and ratios, in particular, capital

These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern and viability assessments. Under all these scenarios, the Group had the ability to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

A further, more material impairment stress was modelled, based on the Group's severe macroeconomic scenario. This, together with the outputs from the other stresses described, presents the Board with enough information to assess the Group's ability to continue on a going concern basis and ensure that there are enough management actions within their control to mitigate any plausible and foreseeable failure scenario.

The Group started the Covid-19 period with a strong capital surplus and has also built up a significant liquidity buffer during the second half of the year, as described below, to ensure that any significant outflows of deposits and / or reduced inflows from customer receipts can be managed. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

Risk assessment

During the year the Board discussed, reviewed and approved the amended principal risks identified for the Group. This process included debate and challenge regarding the most material areas for focus on an ongoing basis and resulted in the addition of principal risks in relation to strategic risk, climate change risk, reputational risk and model risk.

Each of these principal risks is considered on an ongoing basis at each Executive Risk Committee meeting and each meeting of the board-level Risk and Compliance Committee.

The work of the Risk and Compliance Committee, of which all directors are members or attendees included:

- Consideration of new or emerging risks and regulatory developments
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the Group's compliance with the risk appetites set by the Board and the continuing appropriateness of these risk appetites
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

In addition, the directors held 'deep dive' sessions into key areas of risk focus; including the potential for (and impact of) negative interest rates, possible risk arising from a change of government, LIBOR transition, introduction of CBILS and BBLS and Covid-19 payment reliefs. The results of these exercises were fed back into the Group's risk management process.

Throughout the second half of the year, the directors received regular analysis and management information illustrating the impacts of Covid-19 on the Group and its risk profile. They considered this information, taking into consideration regulatory impacts, conduct risks in dealing with customer vulnerabilities arising from the pandemic, customer credit and the changes in the Group's operational processes. The results of these considerations fed into the Group's forecasting and risk assessment.

The potential impact of negative interest on the Group's operations and margins was a particular area of risk focus in the year. The directors also continued to monitor the potential impact of the UK Brexit process as the situation developed through the year.

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, Internal Liquidity Adequacy Assessment Process ('ILAAP') and its Recovery Plan ('RP').

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 set out in Section B8.5 of the Risk Management Report.

Availability of funding and liquidity

The Group's retail deposits of £7,856.6 million (note 28), raised through Paragon Bank, are repayable within five years, with 71.9% of this balance (£5,650.2 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2020 Paragon Bank held £1,637.1 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 15). A further £150.0 million of liquidity was provided by an off balance sheet swap arrangement (note 57), bringing the total to £1,787.1 million.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved ILAAP. The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support drawings of £684.0 million. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2020 the Group had £1,063.5 million of such notes available for use, of which £872.9 million were rated AAA.

The Group's securitisation funding structures, described in note 57, ensure that a significant proportion of its originated loan portfolio is match-funded, although this was reduced in the period by the retirement of five securitisation transactions. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the year, the market has remained active throughout the Covid-19 crisis and remains a potential funding source.

The earliest maturity of any of the Group's working capital debt is in December 2020, when the first of the Group's retail bond issues, of £60.0 million matures. The Group's TFS borrowings also start to mature in the coming financial year, with £700.0 million falling due within twelve months.

The Group's access to debt is enhanced by its corporate BBB rating, affirmed by Fitch Ratings in March 2020, and its status as an issuer is evidenced by the BB+ rating of its £150.0 million Tier 2 bond. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

The Group's cash analysis, which includes the impact of these repayments, continues to show a strong cash position, even after allowing scope for significant discretionary payments, and its securitisation investments produce substantial cash flows.

As described in note 54 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2020 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case.

Viability statement

In considering making the viability statement the directors considered the three-year period commencing on 1 October 2020. This aligns with the horizons used in the Group's analysis of risk and includes the two years covered by the detailed group forecast, together with one year of the less detailed forecasting period.

The directors considered:

- The Group's financial and business position at the year end, described in Sections A3 and A4
- The Group's forecasts, and the assumptions on which they were based
- The Group's prospective access to future funding, both wholesale and retail
- Stress testing carried out as part of the Group's ICAAP and forecasting processes
- The activities of the Group's risk management process throughout the period
- Risk monitoring activities carried out by the Risk and Compliance Committee
- Internal Audit reports in the year

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

On this basis, the directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period commencing on 1 October 2020.

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

Going concern statement

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

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

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

A6. Citizenship and sustainability

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

A6.1 Non-Financial Information Statement

The Group includes information on certain environmental, social and governance matters in its strategic report in accordance with sections 414CA and 414CB of the Companies Act 2006.

In addition to the description of the Group's business model, discussed in Section A2, the Group's remaining disclosures are included in this Section A6. This includes a discussion of the Group's risk, policies, outcomes and key performance indicators with respect to each of the areas set out in the Act, as follows:

	Area	Reference
(a)	Environmental matters	Section A6.4
(b)	Employees	Section A6.3
(c)	Social matters	Section A6.5
(d)	Respect for human rights	Section A6.6
(e)	Anti-corruption and anti-bribery matters	Section A6.7

This section also includes the information on the directors engagement with employees required by schedule 7.11(1)(b) of the Act (in Section A6.3) and the information on business relationships required by schedule 7.11B(1) of the Act (in Section A6.7).

A6.2 Customers

The Group's strategic objective is to be a prudent, risk focussed, specialist bank with a closely controlled, cost efficient operating model which places the delivery of fair customer outcomes at its core.

Putting customers' interests at the heart of the business is therefore integral to the achievement of that objective, and the Group's culture. We want our customers to be confident that we will always consider their needs and act fairly and responsibly in our dealings with them. We strive to ensure that all our customers can be confident that:

- Products and services are designed to meet their needs
- Our employees are appropriately skilled and experienced to provide the services they require
- The information given to them will be clear and jargon free
- Products will perform as they are led to expect
- They will not face unreasonable post-sale barriers to change a product, switch provider, submit a claim or make a complaint
- All complaints will be listened to and claims assessed carefully, fairly and promptly
- Where applicable, they will be made aware of how they can refer their complaint to the FOS
- If they are vulnerable and / or in financial difficulties, we will provide a high level of support and make sure they are signposted to sources of independent advice
- They will be made aware of the FSCS and the protection this provides for them

The desire to achieve positive outcomes for our customers is an important commercial differentiator which has helped the Group build strong relationships over many years. This is supported by a focus in employee training programmes on areas which impact on customer outcomes, such as the correct approach to working with vulnerable customers. This pro-active approach accords with the FCA's Principles for Business, particularly with regard to ensuring good customer outcomes, preventing customer harm and ensuring that all communications are clear, fair and not misleading. We ensure that we know how well we are performing in respect of these requirements, regularly adjusting what we do to deliver better customer solutions.

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

Complaints

There will be occasions where the Group does not get things right, and as a consequence this will give customers cause to complain. The effective resolution of complaints is a key focus, with all business areas following the FCA's Dispute Resolution Sourcebook ('DISP') to ensure consistent and fair customer outcomes.

Handling

The Group aims to resolve complaints at the first point of contact, where possible, but acknowledges that some complaints will require further specialist investigation and time to resolve. Where this is the case, regular contact is maintained with the customer to keep them informed of the progress of their complaint. The Group has also established contacts within previous service providers to ensure any relevant complaint is resolved at the earliest possible opportunity.

Where applicable, 'Alternative Dispute Resolution' information is provided to customers to allow them to appeal to independent parties if they are not satisfied with our response. These include the FOS, and the FLA. Where customers feel the need to appeal, the Group co-operates fully and promptly with any settlements and awards made by these parties.

Monitoring

The Group has established complaint reporting forums in all business areas, to enable the effective discussion of complaint volumes, trends and Root Cause Analysis. This ensures that all business lines effectively resolve customer complaints, and learn from the issues raised to address the causes of those complaints. The effectiveness of this activity is regularly assessed through independent first line outcomes testing to ensure ongoing agent competence in the identification and resolution of complaints ensuring the delivery of fair customer outcomes. The reporting of this activity flows to the Customer and Conduct Committee ('CCC'), ensuring complaint visibility goes right to the top of the organisation.

The number of complaint cases reported to FOS in the six months ended 31 December 2019 was 83, with an uphold rate of 48.2%. The number of cases reported in the six months ended 30 June 2020, including the first three full months of the Covid-19 crisis, was 40 with an uphold rate of 41.3%, below the FOS disclosure threshold.

Metrics on customer complaints are an important management information measure for the Board and form part of the determination of management bonuses and the vesting conditions for the share-based remuneration described in the Directors' Remuneration Report (Section B7).

A6.3 People

The Group employs just under 1,400 people with a variety of expertise and experience to ensure it is best placed to serve its customers and achieve its strategic priorities. The Group prides itself on its culture and how employees demonstrate its values every day. PwC's review of the Group's culture noted that:

"There is strong collaboration across the leadership team, and a real sense of being part of a 'family'. This alignment means that the leadership work well together, particularly when there are challenges/issues to resolve, and role model the desired behaviours consistently."

During the period employees have benefited from the introduction of new HR technology, with a digital self-service platform introduced in February 2020. This has improved the employee experience by creating process efficiencies such as online appraisals and also through new functionality, such as online expenses, introduced in April 2020.

Employment conditions

All of the Group's employees are based in the UK and it is committed to upholding all aspects of employment law. The Group believes that its strategic objectives are best served by building a stable, permanent skill base and therefore minimises its use of short-term and temporary staff.

At 30 September 2020, employees on temporary or short-term contracts accounted for 1.5% of the workforce (2019: 2.1%) and no use was made of zero-hours contracts. The Group's annual employee turnover for the year was 10.4% (2019: 11.5%).

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

Flexible working arrangements are in place for 24.3% of our employees, with 82% of these working part time. The Covid-19 pandemic has meant the Group has had to rethink what flexible working arrangements are available, both on a formal and informal basis.

A significant number of employees have needed to juggle childcare and home schooling commitments whilst working at home during the pandemic, and the Group has supported employees to change working hours or patterns, and in some circumstances also offered paid leave, to allow our employees to fulfil these commitments. This has meant that a far higher percentage of employees than reported have been able to work informally on a flexible basis, to some degree.

No employees were put on furlough or made redundant as a result of Covid-19 and no use was made of the UK Government's Coronavirus Job Retention Scheme. Where any employee was requested to 'shield' due to vulnerability and was unable to work from home, they did so on full pay.

The Group generally only employs persons over the age of 18, except in connection with apprenticeship or other training arrangements.

Remuneration packages across the business are compliant with the UK's national minimum wage rates. In addition, the Group has been accredited as a Living Wage employer since June 2016, by the Living Wage Foundation. The independent Living Wage Foundation sets an hourly rate, the 'real Living Wage', calculated according to the cost of living in the UK which is updated annually. This is a higher rate than the government's National Living Wage. Accredited employers such as the Group must not only pay this rate to their own employees, but also ensure that any contractors used undertake to do so.

The Group has decided that, despite the impact of Covid-19, the increase in the real Living Wage announced by the Living Wage Foundation in November 2020 will be passed on to employees.

The Group runs a Worksave defined contribution pension scheme in line with UK legal requirements. During the year the Group increased its maximum contribution for each employee to 10% of salary, for those employees making a maximum contribution of 6%. It was gratifying that this both incentivised employees already in the scheme to increase their contributions and led to a greater uptake of the scheme as a whole, increasing the levels of saving for retirement amongst the workforce.

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

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

Equality and diversity

The Group is committed to creating a culture where employees feel able to 'bring their whole self to work'. Creating an inclusive environment where this is possible will contribute to the success of the business but most importantly, it is quite simply the right thing to do.

The progress that has been made on gender diversity over recent years continued in this period, and additionally the focus has widened to consider how we can do more to attract, develop and retain employees from other under-represented groups.

As well as eLearning for all employees, the Group continues to combat unconscious bias through the use of recruitment technology that was introduced in 2019. The new recruitment technology anonymises applications before hiring managers see them, and therefore ensures applications from under-represented groups are given full and fair consideration.

The Group launched its Equality, Diversity and Inclusion ('EDI') Network in October 2020. The network is made up of employees from across the Group, selected through a formal application process, and aims to make the Group a more inclusive place to work. The progress on the initiatives the EDI Network undertakes will be reported to the Nomination Committee, as the board committee responsible for diversity issues.

The Group has set a target level of minority ethnic employees holding 10% of management grade positions, increasing from the current 2.2% (2019: 1.8%). Continued progress will be a key focus for the EDI Network and its support is an important step towards this.

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

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

and that they should not be disadvantaged by unjust or unfair conditions or requirements. The Group is committed to provide all employees with access to the same training, development and job opportunities.

Every effort is made to retrain and support employees who suffer from disabilities during their employment, including the provision of flexible working to assist their return to work. Ensuring that opportunities and progression within the Group are available to people with disabilities is an important part of its inclusivity and diversity strategy and will form a strand of the work of the EDI Network.

Women in Finance

The Group understands the significance and value of building strong and diverse teams, with leaders from all backgrounds. Gender diversity is an important element of the Group's people strategy and the Women in Finance Charter was signed in 2016.

The Women in Finance Charter, which is sponsored by HM Treasury, is an initiative amongst financial services companies in the UK, aimed at promoting equality of opportunity in the workplace. The CFO is the project sponsor and progress against the Charter requirements is monitored by the executive management.

In January 2017 the Group's first set of internal targets under the charter was published on its website. They include a target of 35% female representation in senior management roles by January 2022, increasing from 26% at the time the targets were set. All of the Group's diversity targets are published within the 'Sustainability' section of the Group's website, together with annual progress updates.

The definition of senior management used in the Group's 'Women in Finance' targets is the same as that used by the Hampton-Alexander Review. The proportion of female senior managers on this basis at 30 September 2020 was 33.9% (2019: 35.9%), unfortunately not maintaining our target position. This is largely due to changes to organisational structures that impact the classification of senior management. The Group is confident that it will meet its target over the coming year.

During the year the Group continued to monitor the levels of women taking up training opportunities, with particular initiatives focussed on female talent, as described below.

The Group has also extended the availability of maternity pay, so that employees now generally receive 18 weeks leave at full pay, rather than six weeks at 90% pay. It is hoped that this will help in the retention and career progression of women in the organisation.

Gender Pay

As required by legislation, the Group has calculated its gender pay gap as at April 2020. The results will be published on the government website and on the Group's own website and are summarised below.

	April 2020	April 2019
Median gender pay gap	**36.9%**	33.9%
Mean gender pay gap	**40.7%**	41.3%
Median bonus pay gap	**2.5%**	1.2%
Mean bonus pay gap	**82.6%**	76.9%

The median pay gap is broadly in line with the 35.9% median pay gap in the financial services sector reported by the Office of National Statistics ('ONS') in their Annual Survey of Hours and Earnings published in October 2020. The mean pay gap is somewhat higher than the 28.8% mean pay gap reported by the ONS, but this is attributable to the Group's limited representation of females in senior roles.

While the gender pay gap has increased year-on-year, the Group's initial analysis of the most recent figures indicates that this is principally driven by a small number of senior appointments, which, despite gender-balanced candidate pools being considered, have been filled by men. The Group remains committed to increasing the representation of women in its senior roles, which will reduce the gender pay gap in the longer term.

88.0% of male employees and 90.3% of female employees received a bonus (2019: 88.0.% and 90.1%), as defined by legislation, which includes payments under the Group's profit related pay scheme. The difference between the mean and median bonuses reflects the impact of a very small number of bonus payments to executive directors and other very senior staff.

The Group analyses gender pay gap data on an ongoing basis as part of the Women in Finance initiative, to identify potential issues and determine what action might be required. However, work during the year, reviewing groups of directly comparable positions, did not suggest evidence of systematic gender bias or unequal pay practices.

The Group welcomes the interest in this issue generated by the public reporting of gender pay but would favour a review of the detail of the legislation in the light of experience to date to ensure all disclosures required are comparable and understandable.

Composition of the workforce

During the year the workforce has grown by 2.1% to 1,391 people (2019: 1,362). Information on the composition of the workforce at the year end is summarised below:

	2020 Females	**2020 Males**	2019 Females	2019 Males
Employees				
Number	**735**	**656**	711	651
Percentage	**52.8%**	**47.2%**	52.2%	47.8%
Management grade employees				
Number	**119**	**190**	115	210
Percentage	**38.5%**	**61.5%**	35.4%	64.6%
Senior managers				
Number	**6**	**33**	7	30
Percentage	**15.4%**	**84.6%**	18.9%	81.1%
Directors				
Number	**3**	**6**	2	7
Percentage	**33.3%**	**66.7%**	22.2%	77.8%

Of these employees, ethnic minority employees comprised 13.2% of the workforce (2019: 13.4%) and 1.8% of management grade employees (2019: 1.8%).

The definition of 'senior manager' used in the table above is that required by the Companies Act 2006 (Strategic Report and Directors Report) Regulations 2013 which differs from that used by the Hampton-Alexander Review.

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

In June 2020 the Group conducted its fourth annual diversity survey to obtain anonymous feedback from employees on their age, gender, ethnicity, sexual orientation, religious beliefs and disability. A response rate of 72% was received (2019: 67%) and, as expected, the survey illustrated that our workforce continues to be diverse. The results of the 2019 survey informed action plans that have been executed over this period. We also continue to monitor recruitment data relating to the provision of equal opportunities.

Health and wellbeing

The welfare of the Group's employees has never been so important and throughout the year it has been monitored regularly using employee surveys. The Group's Wellbeing network has been extremely active during the period, activities they have undertaken include; running internal communications campaigns on ways to adjust to remote working; launching a new wellbeing app that provides access to a wide range of resources; arranging virtual fitness classes for employees; and holding introductory wellbeing meetings with all employees who joined the Group during the pandemic.

An employee engagement survey had been planned for June 2020; in light of Covid-19 this was replaced by shorter, regular pulse checks (three took place between April and September) and a full employee engagement survey is now planned for early 2021. The latest employee check-in survey was completed by over 70% of employees and results indicated that 85% of employees were happy with communications from their line managers, and 86% were happy with communications from the Chief Executive, Nigel Terrington.

This sentiment is echoed by the Group's People Forum, who had the opportunity to speak to non-executive directors and provide feedback on how the Group has managed during the Covid-19 pandemic. The People Forum has been a valuable channel of engagement with employees during the year and has contributed to changes such as changing the supplier of our recognition awards and supported the introduction of new HR systems.

Training and development

Even throughout the Covid-19 pandemic, the Group has remained focussed on providing opportunities to develop all employees and on average, employees received 4.2 days training in the year (2019: 6.9 days). This continues to place the Group significantly higher than the average figure quoted by the Chartered Institute of Personnel and Development ('CIPD') of between 2.8 and 3.3 days for the private sector. This included online training undertaken by all employees on various matters including regulatory requirements.

The Group created a new team focussed solely on technology-related training in 2019 and the benefits of this have been immeasurable during the Covid-19 crisis. The team were established to support the Group's digital agenda and drive for greater innovation, but throughout the pandemic they have been pivotal in supporting employees to adapt to remote working and maximise the use of the newly upgraded Microsoft Office suite of products. The learning and development team have also created virtual induction programmes for new joiners and adapted how customer facing employees are provided with the right training and support for their roles whilst working remotely.

Another area of focus for the Group's learning and development team during the period has been ensuring employees understand how to support the Group's most vulnerable customers. A bespoke training course has been created and all customer facing employees are expected to undertake this annually. The Group's operational training team has also ensured that all employees who have been seconded to meet increased volumes of customer queries throughout the pandemic were appropriately trained and inducted into their new roles.

All employees receive an appraisal at least annually; this year 99.3% of employees used the Group's new HR technology to log their performance review. The annual performance management and talent management processes not only support individual performance and personal development, but also help the Group to effectively manage rising talent and fulfil its succession planning objectives. The Group's Senior Leadership Development programme is one initiative that has supported the delivery against succession plans over the past year, with four members of the programme being promoted internally, including one promotion to the Executive Management team.

The Group has continued to focus on developing female talent during the year to support our Women in Finance Charter targets. Over 50% of employees receiving management development or leadership training are female compared to 42.7% in 2019, and the Group continues to be a member of the Women Ahead 30% Club cross-company mentoring scheme. Feedback from both mentors and mentees on the programme has been overwhelmingly positive and the third cohort of employees on the programme started this year.

The Group has continued to draw down on Apprenticeship Levy funds to support its development objectives and the internal Management Academy was certified with the Chartered Management Institute ('CMI') to facilitate this. The Group currently has 46 apprentices (3.3% of employees) registered under the levy scheme, utilising 41% of its levy pot in the past 12 months. These apprenticeships cover a range of specialist and operational roles including IT, finance, underwriting, and first line management. Whilst a higher take-up would be desirable, the requirement for apprentices to spend 20% of their time out of the business makes identifying suitable roles challenging.

There are currently 120 people completing professional qualifications across the Group, including 54 employees undertaking their CeMap mortgage qualification. Of these, 64% are female compared to 40% in 2019, contributing towards the Women in Finance agenda.

Recruitment

Headcount has continued to grow over the period, and whilst recruitment volumes reduced due to the pandemic, roles which were deemed critical, such as customer-facing positions and those needed to comply with regulatory requirements, continued to be offered. Over 50 new hires have been successfully onboarded remotely since March. New HR technology has also made the experience of joining the Group more efficient and a more engaging experience.

The Group also runs a successful 'refer a friend' scheme whereby employees receive a referral fee if an individual they refer for a role passes probation. This year 18 individuals were successfully recruited through this scheme (2019: 55), the reduction a function of the overall reduction in numbers of recruits.

Employees' involvement

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

During the period the Forum has been designated as the primary channel through which the Board receives information on the views of the workforce, either by attendance at the meetings or through the People Director who attends all Forum meetings and reports to ExCo and the Nomination Committee on matters raised.

During the period non-executive directors have attended several People Forum meetings and discussed topics such as pay, reward and the impact that the Covid-19 pandemic has had on the workforce and the business.

Executive directors provide biannual updates on business progress to the entire workforce, either in person or through recorded messages, with the frequency of such communications increased during the Covid-19 crisis.

To involve employees in the Group's performance, the Company operates a Sharesave share option scheme and a profit sharing scheme, both of which enable eligible employees to benefit from the performance of the business. In 2020 72% of employees signed up to take part in the most recent offer under the Sharesave scheme.

To reward employees for their contribution during the Covid-19 crisis, a one-off grant of shares worth £1,000, deferred for three years is to be made to all employees below senior management level. This will increase the extent to which employees can benefit from the Group's performance.

Health and Safety

Through to year end the Group has remained compliant with all applicable health and safety legal requirements and implemented best practice management standards across its businesses. This is combined with a commitment to providing a healthy and safe working environment for all employees, contractors and visitors to its premises, and those impacted by its operations in public areas.

While the Group's primary source of health and safety related risk remains with the vehicle maintenance operations of Specialist Fleet Services Limited ('SFS') the significant focus for the vast majority of this year has been on mitigating the risk to our employees from Covid-19.

We began monitoring the epidemic in China in January 2020 and initiated an enhancement programme regarding all aspects of hygiene across all the Group's sites. On escalation to a pandemic and in line with the Government advice in March, we succeeded in transitioning 82.69% of our employees to home working prior to the 23 March lockdown, with the number rising over 90% shortly thereafter.

Where employees were transferred to working from home ('WFH'), workstation assessments have been carried out at critical intervals to ascertain that they have a healthy and safe environment with access to appropriate equipment.

For those who remained in the office, a Covid-19 secure configuration of premises was introduced to facilitate an increase in physical distancing. Building works at premises under direct control were only permitted where they were deemed as necessary to meet statutory requirements or were business critical. Risk assessments, procedures and documentation were reviewed to consider Covid-19 measures, and an e-learning module created and made available to all employees to provide awareness regarding the Covid-19 secure measures.

The offices that remained open continue to comply with all health and safety rules, with the number of fire marshals, first aiders and other qualified personnel continuing to be sufficient, this is regularly monitored based on the number of occupants. All temporarily vacated premises are monitored under current contractual arrangements to ensure they remain fit for occupation when the time arises.

Throughout the pandemic employee engagement has been a key factor. Field teams have carried out risk assessments, equipment has been issued for employee safety and enhanced processes have been implemented to permit public facing appointments as and when appropriate. Ongoing consultations are taking place as government guidance develops.

Employees are provided with appropriate levels of information, instruction, training and supervision, to empower them to take ownership of their responsibility for a healthy and safe environment and are encouraged to report any concerns in line with the Group's stated health and safety objectives, whether in the office or home based.

The Group has a dedicated health and safety manager who reports, ultimately, to the Chief Operating Officer, the executive committee member responsible. Health and safety incidents are classified as operational risk incidents for the purposes of the Group's risk management system and monitored through the operational risk management system and the Operational Risk Committee ('ORC').

The Group (excluding SFS) remains certified to ISO45001:2018 and its Occupational Health and Safety Management System ('OHSMS') is audited for compliance bi-annually by a UKAS accredited auditor.

SFS has its own health and safety manager and OHSMS. Incidents are investigated locally with access to Group resources as required. The operation is currently certificated to BS:18001 and intends to migrate to ISO45001:2018 during its next compliance audit cycle.

During the year, only 11 incidents were reported (2019: 19), all of a minor nature with no lost time. SFS have reported one incident, due to lost time, under the Reporting of Incidents, Disease and Dangerous Occurrences Regulations 2013 ('RIDDOR') (2019: 0)

Health and safety performance continues to be good with the number of accidents and incidents remaining at a low level. During the financial year ended 30 September 2020 there were no prosecutions or any enforcement action from visits by the authorities for non-compliance in respect of health and safety matters.

A6.4 Environmental impact

The Group's environmental impacts can be considered under two headings, its operational (or internal) impacts and the impact of its lending activities – the external or downstream impacts. Until recently the focus of the Group's environmental policies has been on its own activities, which are described further below, but it is clearly true that the use to which customers put the funds which are advanced to them will also have an impact.

External Impact

Climate change is one of the biggest challenges faced by the world today. The UK Government confirmed its goal of net zero carbon by 2050 in November 2020 and the Group, and the rest of the financial services industry have a vital role to play in that project.

Alongside the widespread societal concerns, financial regulators have also increased their focus on climate change. The PRA has published a Policy Statement, setting out its expectations of the type of strategic approach it expects firms to adopt in managing the financial risks of climate change. The Group is in the process of completing a plan of work which adheres to the requirements set out. This plan also reflects subsequent statements by the PRA and will continue to be updated as the regulators develop their thinking.

Impacts of climate change

The use to which customers put the funds advanced to them by the Group gives rise to two related issues:

- Climate change and other environmental factors may, of themselves, increase financial risks. As an example, increased flooding risk might have an adverse impact on security asset valuations. These are the physical risks of climate change
- Regulatory and governmental pressure might be brought to bear on lenders, amongst other businesses, to reduce the environmental impacts of their product chains. Such regulation might impact on the ability to realise security or to continue business lines. These are the transitional risks

The Group uses these classifications to categorise the financial risks of climate change and is working to further embed the consideration of both forms of risk across all its lending. Risks in each of these categories may impact over the short (one to five year), medium (five to ten year) or long (over ten year) term.

The Group already considers these types of issues in its underwriting and credit risk processes to some extent. Examples of how the Mortgage Lending business manages its exposure to climate change effects, and seeks to promote environmentally positive behaviour by customers, are given in section A4.1.1.

Governance

During the year the Board has designated climate change as a principal risk within the Group's Risk Management Framework. This means information and measures on climate change risks are considered at board level and the Group's responses considered within the Board's overall strategy. The CFO has been designated as the director responsible for climate change matters.

A climate change working group has been established, working under the oversight of ERC. The working group reports to ERC and to the Board on a regular basis. The working group aims to embed Climate Change Risk into the Group's operational culture, recognising the potential impact on current and future business activities.

Risk management

Due to the nature of climate change and its wider consequences, climate change risk can impact across many of the Group's business areas. Work is underway to embed the consideration of climate change risk across the relevant risk sub-committees, initially focussing on the Credit and Operational Risk Committees.

Assessment of current environmental risks and forward-looking climate change risks are already factored into the Group's business. When assessing the appropriateness of a property as security on a buy-to-let mortgage, factors such as the energy performance certificate ('EPC') rating of the property, flood risk, risk of coastal erosion and ground stability are considered. It is essential for the Group to ensure that a property is, and remains, insurable.

As part of the climate change agenda, the Group intends to make enhanced use of the environmental data currently held on the mortgage book, and to expand on currently available information. Work is taking place to enable the collection of increased and more detailed environmental data as part of the valuation process. The Group can then use its core data analytics skills in developing the tools necessary to run longer term climate related scenarios, which run beyond normal planning horizons and consider various policy and environmental developments.

Similar activity is planned to ensure any other lending subsets which might be particularly exposed to physical or transitional climate change risk can be identified and monitored.

Quantifying our climate exposure

During the year the Group has made progress in assessing the potential financial impact of climate change on its buy-to-let mortgage book. This has been initially focussed on the physical risk posed by flooding. Analysis used granular postcode level data and indicated that only a small proportion of security properties were located within medium or high-risk zones.

The initial focus in the assessment of transitional risk has been on the energy efficiency of mortgaged properties, measured by their EPC grades. The UK Government has announced initiatives to improve energy efficiency and it is likely that policies based on EPC levels will be used to help the UK's transition and reduce its property stock's emissions, with a potentially adverse impact on the valuation of properties not meeting required standards.

The table below summarises the highlights of the preliminary climate risk assessment work performed to date across our mortgage lending exposure in England and Wales.

Indicator	Measure	2020	Coverage
EPC	Grading A to C	37.7%	85.0%
	Grading A to E	98.1%	85.0%
Flood risk	High risk properties	0.4%	99.0%
	High or medium risk properties	2.2%	99.0%

Flood risk above is based on exposure to flooding from rivers and seas only. In the underwriting process flood risk from other sources is also considered. Work is ongoing to incorporate these additional risks into the Group's risk metrics.

In the Group's SME Lending business, limited company customers have been broadly analysed by SIC codes to identify those operating in high carbon intensive industries. The results are set out below:

Indicator	Measure	2020	Coverage
Sector	Water, sewerage and waste	3.54%	100%
	Extractive industries	1.75%	100%
	Power generation	0.01%	100%
	Total carbon intensive industries	5.30%	100%

Measures addressing other risk elements including those in other business streams, eg classifications of business assets and motor vehicles financed by environmental impacts, and classification of development finance projects by environmental rating, are under development. These will be aligned to the UK's new Green Taxonomy recently announced at the Green Horizon Summit.

Future developments

In addition to the work currently in progress and described above, the Group's climate change strategy also includes:

- Developing climate change scenario analysis and embedding this in stress testing programmes, leveraging off Bank of England scenarios
- Further embedding climate change risk management across the business
- Enhancement of the business' understanding of the climate change impact of the Group's lending
- Continued engagement with external climate change initiatives. This includes involvement in industry initiatives, particularly through the Green Finance Institute
- Development of formal climate related risk appetites and a full suite of Key Risk Indicators and Key Performance Indicators

The Group will also be expected to report its climate change exposures in accordance with the recommendations of the Taskforce on Climate-related Financial Disclosure ('TCFD') which are being introduced into UK listing requirements from the financial year ending 30 September 2022. This reporting will be developed alongside the other initiatives.

Operational Impact

The Group is mainly engaged in mortgage, consumer and commercial finance and therefore the overall environmental impact of its operations is considered to be low.

SFS leases refuse collection vehicles to local authorities throughout the UK. SFS undertake additional aftersales activities that include servicing, maintenance and breakdown support, hence has the most significant potential environmental impacts.

The main environmental impacts of the Group's other operations are limited to universal environmental issues such as resource use, procurement in offices and business travel.

Policy

The Group complies with all applicable laws and regulations relating to the environment. The Group's environmental commitment is included within the Health, Safety and Environmental policy that is approved by the CEO and the People Director. Its environmental commitments are expressed in its Green Charter which is approved by the CEO and kept under regular review.

Groupwide recycling and awareness campaigns are also run to reduce various forms of waste such as food, consumables or energy.

Risk management

The environmental risk inherent in the Group's operations is managed by the Group Property function and is within the remit of the Chief Operating Officer. It is monitored within the Group's operational risk management framework by the second line Operational Risk function and the ORC.

Energy data is collated by Group Property, the division responsible for managing the Group's premises. Consumption figures for all locations occupied, whether directly owned or tenanted, are actively monitored. This is reported upwards to board level.

SFS operates from several workshops around the UK and has exposure to several waste streams (oils, vehicle parts etc) that come from its workshop activities. These are effectively managed under an environmental management system that is certificated to an International Standard – ISO14001:2015. A dedicated health and safety manager has direct responsibility for environmental issues at all SFS sites.

The Group complies with the Energy Savings and Opportunities Scheme ('ESOS'). This is a UK Government initiative, under an EU Directive, and requires the Group to identify and reduce its energy consumption. The Group submitted its ESOS compliance notification to the Environment Agency in December 2019.

Supply chain and procurement

The principal suppliers of the Group comprise its outsourced savings administrator, legal and professional services providers, building lessors and IT service providers. They therefore are exposed to similar operational environmental risks to those of the Group.

The Group remains committed to identifying, targeting and addressing inefficiencies within its supply chain. The procurement function is currently working with key suppliers to identify solutions to continue to reduce the environmental impacts of our business activities, whether direct or indirectly.

All pre-printed stationery items used by the Group are from renewable sources certified by FSC.

84.0% (2019: 80.3%) of the purchased electricity in the year was obtained from sources certified as renewable by the Office of Gas and Electricity Markets ('OFGEM').

Across the year ending 30 September 2020, the Group increased the percentage of its total stationery and consumables expenditure going towards green products to 55.3% from 32.0% achieved in the previous period.

Environmental initiatives

All the general waste produced at the Group's principal sites was disposed through an approved waste contractor using Waste to Energy initiatives, resulting in no waste being disposed at landfill.

During a refurbishment of the external welfare area at the Group's head office building, bird boxes were installed within the treescapes to encourage wildlife to coexist with our employees. Further initiatives are under development to include beehives, and to roll out this initiative to other sites under the Group's direct control. Areas of land will be given over to wild space to encourage plant and animal species and improve biodiversity.

The Group's other environmental initiatives in the period include:

- Reducing the product range of office consumables to steer employees towards selecting more environmentally friendly products
- Moving to fortnightly stationery deliveries thereby reducing the carbon footprint of procurement activities
- Undertaking refurbishment work to the washroom facilities at the head office building employing touchless energy and resource saving technology. All construction wastes were segregated and disposed of responsibly by the contractor
- Modernising the key components of the Heating, Ventilation and Air Conditioning ('HVAC') systems at the head office site, reducing the Global Warming Potential ('GWP') of chiller plant used during the summer months.

The financial year ending 30 September 2021 will see objectives being established against current energy performance to further reduce consumption through energy initiatives, new plant and technology.

Performance indicators

The environmental key performance indicators for the Group, determined having regard to the Reporting Guidelines published by the Department of Business, Energy and Industrial Strategy ('BEIS') and the Department for Environment, Food and Rural Affairs ('DEFRA') in March 2019, are set out below.

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

This information is presented for the twelve months ended 30 September in each year and includes all entities included in the Group's financial statements. Information for acquired entities is included from the acquisition date. Normalised data is based on adjusted total operating income of £295.1 million (2019: £297.6 million excluding the £9.7 million gain on derecognition).

Greenhouse gas ('GHG') emissions

	2020 Tonnes CO_2	2019 Tonnes CO_2
Scope 1 (Direct emissions)		
Combustion of fuel:		
Operation of gas heating boilers	**452**	519
Petrol and diesel used by company cars	**402**	679
Operation of facilities:		
Air conditioning systems	**33**	24
	887	1,222
Scope 2 (Energy indirect emissions)		
Directly purchased electricity	**697**	995
Total scope 1 and 2	**1,584**	2,217
Normalised tonnes - scope 1 and 2 CO_2 per £m income	**5.4**	7.5
Scope 3 (Other indirect emissions)		
Fuel and energy related activities not included in scope 1 or 2	**325**	542
Water consumption	**12**	14
Waste generated in operations	**61**	88
Total scope 3	**398**	644
Total scopes 1, 2 and 3	**1,982**	2,861
Normalised tonnes scope 1,2 and 3 CO_2 per £m income	**6.7**	9.6

CO_2 equivalent values above are calculated based on the BEIS / DEFRA guidelines published in June 2020. These guidelines showed a significant increase in the conversion factor for the Group's landfill waste, increasing from 99.8 kg CO_2 per tonne in the 2019 conversion tables to 458.2 kg CO_2 per tonne in the new edition. Given the magnitude of this change, the amount stated for 'waste generated in operations' for 2019 above has been restated using the 2020 conversion factor.

The amounts shown above for total scope 1 and scope 2 emissions are those required to be reported under the Companies Act (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. Other scope 3 emissions not reported above are not considered to be significant.

The reduction in emissions in the year is principally driven by the Covid-19 crisis. The majority of emissions included above relate to the provision of heat, light and power to the Group's premises. Several office buildings were closed for long periods and the social distancing rules meant that the scope for business travel, for meetings, property surveys and other normal parts of the business process was sharply reduced for a significant part of the year.

Emissions attributable to employees working from home are not included within the scope of the regulations, at present.

It is unlikely that this performance would be repeated in a normal operating environment.

The Group has not been involved in any prosecutions, accidents or similar non-compliances in respect of environmental matters, nor incurred any fines in respect of such matters.

Power usage

The Group uses mains electricity and natural gas from the UK grid to provide heat, light and power to its office buildings. It also uses fuel in company vehicles, which is included in Scope 1 above and through business travel of employees, which is included in Scope 3. The amount of power used in the year ended 30 September 2020 is shown below.

	2020 MWh	2019 MWh	2018 MWh
Renewable electricity	**2,509.3**	3,123.5	
Other electricity	**478.2**	768.1	
Electricity	**2,987.5**	3,891.6	4,107.5
Natural gas	**2,450.9**	2,817.1	3,547.6
Motor fuel	**1,900.3**	3,099.9	2,913.9
	7,338.7	9,808.6	10,569.0
Normalised MWh per £m income	**24.9**	33.0	38.6

Consumption levels have reduced significantly in the year, principally as a result of the closure of some of the Group's buildings for long periods, and the reduced utilisation of others.

Gas and electricity usage are based on consumption recorded on purchase invoices. Vehicle fuel usage is based upon expense claims and recorded mileage. Renewable energy is supplied through the grid with OFGEM accreditation received from the suppliers. No separate conversion factor is stated by BEIS / DEFRA for electricity from renewables and therefore the Group receives no benefit for this in the GHG emissions table above.

Water usage

The Group's water usage is limited to the consumption of piped water in the UK and no water is extracted directly. Water usage in the year ended 30 September 2020 was 11,950m^3 (2019: 13,010m^3), based upon consumption recorded on purchase invoices, a normalised amount of 40.5m^3 per £m income (2019: 43.7m^3 per £m income). The reduction in usage is a result of reduced office occupancy offset by additional consumption generated by Covid-19 cleaning and hygiene guidance.

A water saving initiative remains in place which is intended to reduce long-term year-on-year water usage across the sites where the Group has full responsibility for the premises occupied.

Waste

SFS are the Group's primary waste producers. Their vehicle servicing activities generate a variety of different waste streams – including various grades of oil, and a range of metals and plastics. These wastes are managed responsibly in accordance with an ISO14001:2015 certificated management system. Waste streams generated by SFS are disposed of in accordance with the waste hierarchy before being consigned to approved waste transfer stations under contract and Waste Transfer Notes obtained.

The Group's waste output outside SFS consists of a mixture of general office waste types which includes principally paper and cardboard with some wood, plastic and metals. The Group provides facilities in its offices for recycling paper, cardboard, newspapers, glass, plastics and aluminium and steel cans. Batteries and printer and photocopier cartridges are collected and sent for recycling. The largest part of the Group's recycled outputs relates to waste paper.

All the Group's waste is either recycled, used in waste to energy initiatives or sent to landfill. Amounts of waste generated in the year ended 30 September 2020 together with the methods of disposal are shown below.

	2020 Tonnes	2019 Tonnes	2018 Tonnes
Recycled	**61**	122	202
Waste to Energy Initiatives	**29**	-	-
Landfill	**131**	187	154
	221	309	356
Normalised tonnes per £m income	**0.75**	1.04	1.30

Waste generation data is based upon volumes reported on disposal invoices.

The reduction in waste generation is principally a result of lower occupancy of the Group's premises, with the amount of recycled paper generated being substantially reduced.

The Group's long-term strategy is to increase the proportion of waste which is either recycled or used in Waste to Energy initiatives.

A6.5 Social and community

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

Where possible, it uses its lending relationships to promote good practice. In particular, its buy-to-let mortgage division demands minimum standards from landlords in the properties it funds. This form of intervention should drive up standards in the private rented sector.

Industry initiatives

The Group is active within trade organisations in the UK, helping to formulate public policy and sharing experience on best practice to drive forward better financial provision. The Group has been particularly active in initiatives to enable the private rented sector to more effectively serve the UK housing market.

Membership of bodies such as UK Finance and the FLA enables the Group to be part of shaping the future of financial services provision to the benefit of the whole community. This year this has been enhanced by work done by the Mortgage Lending business with the Green Finance Institute on the potential for greening the buy-to-let mortgage market. In particular the business worked with the Coalition for Energy Efficient Buildings formed by the Institute.

The Group contributes to registered charities providing debt advice to support its vulnerable customers. Contributions of £1,110,000 (2019: £1,522,000) were made by the Group during the year to the work of the Foundation for Credit Counselling which operates the StepChange Debt Charity.

Supporting the community

The Group actively supports charity initiatives, focussing on organisations serving the communities in which it operates. Contributions made in the year totalled £157,800 (2019: £24,200).

Contributions were increased as part of the Group's response to Covid-19, with donations including; £50,000 to NHS charities to help frontline staff needing accommodation and food while caring for patients during the Covid-19 pandemic and to provide iPads to enable patients in isolation to keep in contact with their family and friends; a £20,000 donation to Change into Action which provides support to homeless people; and £10,000 to Age UK to support elderly people who are isolated and alone during the pandemic.

Other charities which benefitted from the Group's charitable donations include several local schools, sports clubs, hospitals and hospices, the Downs Syndrome Association, Get Set Girls, Great Ormond Street Hospital and Lupus UK, amongst others.

Before activities were stopped due to the pandemic, employees continued to make a difference to the local community in many ways, achieving 23.5 volunteering days. Activities have included:

- Volunteering at SIFA Fireside, a specialist centre in the centre of Birmingham dedicated to supporting homeless people in Birmingham
- Supporting literacy in local primary schools
- Volunteering at a 'Ready for Work' initiative run by Business in the Community that supports getting homeless people back into the workplace

The Group is in the process of identifying ways to continue volunteering activities remotely, such as career mentoring opportunities.

At Christmas 2019, food parcels were collected amongst the employees for Christians Against Poverty, with 134 food parcels delivered to 80 families.

The Group also supports Paragon's Charity Committee, consisting of volunteer employees, which organises a variety of fundraising activities throughout the year. In the calendar year 2019, £28,700 was raised for Dementia UK, while in the first nine months of 2020, £26,500 has been raised for Macmillan through events such as Paragon's Biggest Coffee Morning, Move for Macmillan and employees taking part in sponsored events. Given the restrictions imposed on office-based fund-raising activities by working from home, this is an impressive achievement by the Committee and the Group's people.

Each year all employees are given the opportunity to nominate a charity and a vote is carried out amongst the employees to select the charity or charities to benefit from the following year's fundraising activities.

Taxation policy and payments

Materially all of the Group's taxable income arises in the UK and therefore it has no presence in jurisdictions considered to enable tax base erosion and profit shifting.

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

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

During each financial year the Group publishes a tax strategy document for that year on its website, in accordance with the Finance Act 2016. This document addresses the following matters:

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

The fourth such statement was published during the year and can be found in the investor relations section of the Group's website.

The published strategy is owned by the Board collectively in accordance with HMRC's published expectations. The CFO has been designated as the Senior Accounting Officer for tax purposes and, as such, reviews compliance with the Group's policies each year.

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

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

	2020	2019
	£m	£m
Corporation tax	46.1	39.4
PAYE and NI	32.8	27.3
VAT	2.7	2.1
Stamp duty	-	0.1
Total national taxation	81.6	68.9
Business rates	1.4	1.4
	83.0	70.3

In response to the Covid-19 crisis the UK Government permitted companies to defer VAT payments due between 20 March 2020 and 30 June 2020. The Group did not take advantage of this concession and paid its liabilities in accordance with the statutory provisions.

A6.6 Human rights

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

The Group's commitment to supporting its people's employment rights is described in section A6.3.

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

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

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

The Group's compliance with human rights regulation falls within its overall compliance regime, and any breaches or potential breaches would be investigated and addressed through the Group's risk management framework.

The Group supports the objective of the Modern Slavery Act 2015, in raising awareness of modern slavery and human trafficking. The Group's annual Modern Slavery Statement is published on its website and also reflected in relevant policies.

The Group is committed to ensuring that there is no modern slavery or human trafficking in its supply chains or in any part of the business and to acting ethically and with integrity in all business relationships. It actively engages with suppliers to ensure that compliance with Modern Slavery legislation is achieved.

The statement describing the Group's policies for achieving this can be found on the Group's website: www.paragonbankinggroup.co.uk.

The Group undertakes extensive monitoring of the implementation of all of its policies and has not been made aware of any incident in which the organisation's activities have resulted in an abuse of human rights or a breach of Modern Slavery legislation. No fines or prosecutions in respect of non-compliance have been incurred.

A6.7 Business practices

Business partners

The Group's business model relies on maintaining good relationships with its principal business partners, primarily financial intermediaries, such as mortgage brokers, and purchase ledger suppliers including those for establishment costs and professional services.

The Group is committed to the fair treatment of all suppliers. In return, we expect suppliers to help to deliver a high standard of service to our customers and act responsibly.

The Group introduced a Supplier Code of Conduct during the year, which sets out our overall approach to supplier engagement and corporate responsibility and, importantly, the standards of behaviour that we expect from our suppliers.

It includes the minimum standards we expect from suppliers and our conduct commitments and expectations around bribery and corruption, data protection and modern slavery. It also includes important information concerning our employment practices, health and safety, community and environmental matters.

The Group is a signatory to the UK's Prompt Payment Code, administered by the Chartered Institute of Credit Management and as such commits to paying invoices within 60 days, unless there is good reason for non-payment, and aims to make payment within 30 days where correct procedures are followed.

Anti-corruption

The Group carries out its business fairly, honestly and openly. It has a comprehensive anti-bribery and corruption policy, endorsed by the directors, covering all employees and operated throughout the Group. It will not make or accept bribes, nor will it condone the offering or receiving of bribes on its behalf. The Group will always avoid doing business with those who do not accept its values and who may harm its reputation.

The Group carries out an annual risk assessment as required by the Bribery Act 2010 and continues to conclude that it is not a company with a high risk of bribery. The Group conducts all of its business within the UK and its only significant outsourcing arrangement relates to the administration of its savings operations by the outsourcing arm of a major UK building society. The UK is not considered a jurisdiction with a high incidence of corrupt practices, ranking twelfth safest in the Corruption Perceptions Index for 2019, out of 198 countries. However, the Group takes its responsibilities seriously and will not tolerate bribery in any form on any scale and as such, its policies and procedures are kept under regular review. The Group will self-report any serious incidence of bribery or corruption that is identified.

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

All employees are required to read the Group's anti-bribery and corruption policy and undertake annual on-line training to assess their understanding. The anti-bribery culture forms part of the induction course for all new employees and is reinforced at subsequent training sessions. Any employee found to be in breach of these policies will be subject to disciplinary action. No such disciplinary action has taken place in the year ended 30 September 2020.

The CRO, in conjunction with the Head of Financial Crime, who are both part of the 'second line' Risk and Compliance function, are responsible for ensuring the Bribery Act risk assessment and resulting policies and procedures are in place and reviewed on a regular basis. They are also responsible for ensuring any changes in the law are noted and applied to the Group's policies and procedures, where appropriate. In the last year there have been no material changes in legislation or guidance in the UK.

The Group has not been involved in any incidents resulting in prosecutions, fines, or penalties or in similar incidents of non-compliance in respect of bribery, corruption or other illegal business practices (2019: none).

Anti-money laundering

As a financial services entity, the Group also has procedures in place to ensure it cannot be used to facilitate money laundering, sanctions abuse or other forms of financial crime. Employees receive regular annual training in these areas, with their understanding being tested and levels of completion reported to regulators. The Group's money laundering reporting officer is the Head of Financial Crime.

All business heads are responsible for having the appropriate controls in place to ensure that employees adhere to the anti-bribery and corruption policies and procedures and other policies relating to business practices at all times. This is monitored as part of the Group's risk management process and reviewed, as appropriate by the Internal Audit function.

Whistleblowing

A whistleblowing hotline, run by an independent third party, Protect, is available to staff who have concerns over any aspects of the Group's business practices. This is described further in Section B4.5.

A7. Approval of Strategic Report

Section A of this Annual Report comprises a Strategic Report for the Group. The information on how the directors have discharged their duties under s172 of the Companies Act 2006 included in Section B4.3 of the corporate governance report is also included in this strategic report by reference.

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

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

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

Marius van Niekerk

Company Secretary

3 December 2020