

D. The Accounts

Showing the financial position, results and cash flows of the Group and the Company prepared in accordance with IFRS and UK law

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D1. Primary Financial Statements

D1.1 Consolidated statement of profit or loss

For the year ended 30 September 2020

	Note	2020 £m	2020 £m	2019 £m	2019 £m
Interest receivable	4		491.7		505.7
Interest payable and similar charges	5		(213.6)		(227.3)
Net interest income			278.1		278.4
Other leasing income	6	19.2		18.3	
Related costs	6	(16.2)		(14.5)	
Net leasing income		3.0		3.8	
Gain on derecognition of financial assets	7	-		9.7	
Other income	8	14.0		15.4	
Other operating income			17.0		28.9
Total operating income			295.1		307.3
Operating expenses	9		(126.8)		(125.2)
Provisions for losses	19		(48.3)		(8.0)
Operating profit before fair value items			120.0		174.1
Fair value net (losses)	11		(1.6)		(15.1)
Operating profit being profit on ordinary activities before taxation			118.4		159.0
Tax charge on profit on ordinary activities	12		(27.1)		(31.6)
Profit on ordinary activities after taxation for the financial year			91.3		127.4
	Note		2020		2019
Earnings per share					
- basic	14		36.0p		49.4p
- diluted	14		35.6p		48.2p

The results for the current and preceding years relate entirely to continuing operations.

D1.2 Consolidated statement of comprehensive income

For the year ended 30 September 2020

	Note	2020 £m	2020 £m	2019 £m	2019 £m
Profit for the year			91.3		127.4
Other comprehensive income					
<i>Items that will not be reclassified subsequently to profit or loss</i>					
Actuarial (loss) on pension scheme	53	(7.4)		(16.5)	
Tax thereon		2.1		2.4	
			(5.3)		(14.1)
<i>Items that may be reclassified subsequently to profit or loss</i>					
Cash flow hedge gains taken to equity	20	(0.6)		0.5	
Tax thereon		0.1		(0.1)	
Reclassification on derecognition	7	-		(0.9)	
Tax thereon		-		0.2	
			(0.5)		(0.3)
Other comprehensive income for the year net of tax			(5.8)		(14.4)
Total comprehensive income for the year			85.5		113.0

D1.3 Consolidated balance sheet

For the year ended 30 September 2020

	Note	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Assets					
Cash – central banks	15	1,637.1	816.4	895.9	895.9
Cash – retail banks	15	287.9	409.0	414.7	414.7
Loans to customers	16	12,741.1	12,250.3	12,076.5	12,103.7
Derivative financial assets	20	463.3	592.4	855.7	855.7
Sundry assets	21	128.0	92.8	19.0	19.0
Current tax assets	22	5.7	-	-	-
Deferred tax assets	23	6.2	6.2	-	-
Property, plant and equipment	24	66.1	57.3	56.8	56.8
Intangible assets	25	170.1	171.1	169.3	169.3
Total assets		15,505.5	14,395.5	14,487.9	14,515.1
Liabilities					
Short-term bank borrowings		0.4	1.0	1.1	1.1
Retail deposits	28	7,867.0	6,395.8	5,292.4	5,292.4
Derivative financial liabilities	20	132.4	80.5	4.7	4.7
Asset backed loan notes	29	3,270.5	4,419.4	5,554.7	5,554.7
Secured bank borrowings	30	657.8	787.5	935.6	935.6
Retail bond issuance	31	296.8	296.5	296.1	296.1
Corporate bond issuance	32	149.8	149.6	149.3	149.3
Central bank facilities	33	1,854.4	994.4	1,024.4	1,024.4
Sundry liabilities	34	100.0	112.7	114.4	114.4
Current tax liabilities	22	-	15.2	21.4	21.4
Deferred tax liabilities	23	-	-	0.8	5.6
Retirement benefit obligations	53	20.4	34.5	19.5	19.5
Total liabilities		14,349.5	13,287.1	13,414.4	13,419.2
Called up share capital	38	261.8	261.6	281.6	281.6
Reserves	39	932.0	887.3	895.9	918.3
Own shares	40	(37.8)	(40.5)	(104.0)	(104.0)
Total equity		1,156.0	1,108.4	1,073.5	1,095.9
Total liabilities and equity		15,505.5	14,395.5	14,487.9	14,515.1

Approved by the Board of Directors on 3 December 2020.

Signed of behalf of the Board of Directors

N S Terrington

Chief Executive

R J Woodman

Chief Financial Officer

D1.4 Company balance sheet

For the year ended 30 September 2020

	Note	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IAS 39 £m
Assets				
Cash – retail banks	15	12.6	14.1	24.9
Sundry assets	21	84.6	107.3	217.0
Current tax assets	22	-	2.8	-
Property, plant and equipment	24	17.4	-	-
Investment in subsidiary undertakings	27	1,030.1	940.7	984.4
Total assets		1,144.7	1,064.9	1,226.3
Liabilities				
Retail bond issuance	31	296.8	296.5	296.1
Corporate bond issuance	32	149.8	149.6	149.3
Sundry liabilities	34	43.1	27.4	128.5
Deferred tax liabilities	23	1.8	1.6	1.8
Total liabilities		491.5	475.1	575.7
Called up share capital	38	261.8	261.6	281.6
Reserves	39	414.4	351.2	460.8
Own shares	40	(23.0)	(23.0)	(91.8)
Total equity		653.2	589.8	650.6
		1,144.7	1,064.9	1,226.3

Approved by the Board of Directors on 3 December 2020.

Signed of behalf of the Board of Directors

N S Terrington

Chief Executive

R J Woodman

Chief Financial Officer

D1.5 Consolidated cash flow statement

For the year ended 30 September 2020

	<i>Note</i>	2020	2019
		£m	£m
Net cash generated by operating activities	42	1,028.7	397.9
Net cash (utilised) / generated by investing activities	43	(2.8)	8.3
Net cash (utilised) by financing activities	44	(325.7)	(491.3)
Net increase / (decrease) in cash and cash equivalents		700.2	(85.1)
Opening cash and cash equivalents		1,224.4	1,309.5
Closing cash and cash equivalents		1,924.6	1,224.4
Represented by balances within:			
Cash	15	1,925.0	1,225.4
Short-term bank borrowings		(0.4)	(1.0)
		1,924.6	1,224.4

D1.6 Company cash flow statement

For the year ended 30 September 2020

	<i>Note</i>	2020	2019
		£m	£m
Net cash generated by operating activities	42	129.8	170.9
Net cash (utilised) by investing activities	43	(94.7)	(105.1)
Net cash (utilised) by financing activities	44	(36.6)	(76.6)
Net (decrease) in cash and cash equivalents		(1.5)	(10.8)
Opening cash and cash equivalents		14.1	24.9
Closing cash and cash equivalents		12.6	14.1
Represented by balances within:			
Cash	15	12.6	14.1
Short-term bank borrowings		-	-
		12.6	14.1

D1.7 Consolidated statement of changes in equity

For the year ended 30 September 2020

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	91.3	-	91.3
Other comprehensive income	-	-	-	-	(0.5)	(5.3)	-	(5.8)
Total comprehensive income	-	-	-	-	(0.5)	86.0	-	85.5
Transactions with owners								
Dividends paid (note 41)	-	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(5.2)	(5.2)
Exercise of share awards	0.2	0.4	-	-	-	(7.7)	7.9	0.8
Charge for share based remuneration (note 50)	-	-	-	-	-	2.7	-	2.7
Tax on share based remuneration	-	-	-	-	-	(0.3)	-	(0.3)
Net movement in equity in the year	0.2	0.4	-	-	(0.5)	44.8	2.7	47.6
Opening equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4
Closing equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0

For the year ended 30 September 2019

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	127.4	-	127.4
Other comprehensive income	-	-	-	-	(0.3)	(14.1)	-	(14.4)
Total comprehensive income	-	-	-	-	(0.3)	113.3	-	113.0
Transactions with owners								
Dividends paid (note 41)	-	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	-	(34.3)	(34.3)
Exercise of share awards	1.6	2.5	-	-	-	(2.5)	2.3	3.9
Charge for share based remuneration (note 50)	-	-	-	-	-	5.9	-	5.9
Tax on share based remuneration	-	-	-	-	-	0.4	-	0.4
Net movement in equity in the year	(20.0)	2.5	21.6	-	(0.3)	(32.4)	63.5	34.9
Opening equity								
As previously reported	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9
Change of accounting policy (note 61)	-	-	-	-	-	(22.4)	-	(22.4)
As restated	281.6	65.8	28.7	(70.2)	3.3	868.3	(104.0)	1,073.5
Closing equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4

D1.8 Company statement of changes in equity

For the year ended 30 September 2020

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	96.0	-	96.0
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	96.0	-	96.0
Transactions with owners							
Dividends paid (note 41)	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.4	-	-	-	-	0.6
Charge for share based remuneration (note 50)	-	-	-	-	2.7	-	2.7
Net movement in equity in the year	0.2	0.4	-	-	62.8	-	63.4
Opening equity	261.6	68.3	50.3	(23.7)	256.3	(23.0)	589.8
Closing equity	261.8	68.7	50.3	(23.7)	319.1	(23.0)	653.2

For the year ended 30 September 2019

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	9.9	-	9.9
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	9.9	-	9.9
Transactions with owners							
Dividends paid (note 41)	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	(26.7)	(26.7)
Exercise of share awards	1.6	2.5	-	-	-	-	4.1
Charge for share based remuneration (note 50)	-	-	-	-	5.9	-	5.9
Net movement in equity in the year	(20.0)	2.5	21.6	-	(133.7)	68.8	(60.8)
Opening equity	281.6	65.8	28.7	(23.7)	390.0	(91.8)	650.6
Closing equity	261.6	68.3	50.3	(23.7)	256.3	(23.0)	589.8

D2. Notes to the Accounts

For the year ended 30 September 2020

1. General information

Paragon Banking Group PLC is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 2336032. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Group's operations and its principal activities are set out in the Strategic Report in Section A2.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Group operates.

The remaining notes to the accounts are organised into four sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Employment costs – providing information on employee and key management remuneration arrangements including share schemes and pension arrangements
- Capital and Financial Risk – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the financial statements

D2.1 Notes to the Accounts - Analysis

For the year ended 30 September 2020

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Group and the Company.

2. Segmental information

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

- Mortgage Lending, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's equipment leasing activities, development finance, structured lending and other offerings targeted towards SME customers, together with its motor finance business
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

Gains on derecognition of financial assets have not been allocated to segment results.

Loans to customers and operating lease assets are allocated to segments as are dedicated securitisation funding arrangements and their related cross-currency basis swaps and cash balances.

Retail deposits and their related costs are allocated to the segments based on the utilisation of those deposits. Retail deposits raised in advance of lending are not allocated.

Other assets and liabilities are not allocated between segments.

All of the Group's operations are conducted in the UK, all revenues arise from external customers and there are no inter-segment revenues. No customer contributes more than 10% of the revenue of the Group.

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below.

Year ended 30 September 2020

	Mortgage Lending	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	344.9	112.9	30.4	3.5	491.7
Interest payable	(154.9)	(30.8)	(4.3)	(23.6)	(213.6)
Net interest income	190.0	82.1	26.1	(20.1)	278.1
Other operating income	6.5	9.9	0.6	-	17.0
Total operating income	196.5	92.0	26.7	(20.1)	295.1
Direct costs	(16.4)	(24.4)	(6.3)	(79.7)	(126.8)
Provisions for losses	(25.8)	(21.7)	(0.8)	-	(48.3)
	154.3	45.9	19.6	(99.8)	120.0

Year ended 30 September 2019

	Mortgage Lending	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	342.1	95.7	61.3	6.6	505.7
Interest payable	(164.3)	(30.7)	(7.0)	(25.3)	(227.3)
Net interest income	177.8	65.0	54.3	(18.7)	278.4
Other operating income	6.8	11.0	1.4	9.7	28.9
Total operating income	184.6	76.0	55.7	(9.0)	307.3
Direct costs	(15.7)	(25.0)	(7.9)	(76.6)	(125.2)
Provisions for losses	(1.0)	(7.2)	0.2	-	(8.0)
	167.9	43.8	48.0	(85.6)	174.1

The segmental profits disclosed above reconcile to the group results as shown below.

	2020	2019
	£m	£m
Results shown above	120.0	174.1
Fair value items	(1.6)	(15.1)
Operating profit	118.4	159.0

The assets and liabilities attributable to each of the segments at 30 September 2020, 30 September 2019 and 1 October 2018 on the basis described above were:

	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2020					
Segment assets					
Loans to customers	16	10,819.5	1,514.8	297.1	12,631.4
Operating lease assets	24	-	39.5	-	39.5
Cross-currency basis swaps	20	445.3	-	-	445.3
Securitisation cash	15	223.4	-	-	223.4
		11,488.2	1,554.3	297.1	13,339.6
Segment liabilities					
Allocated deposits		7,692.2	1,882.2	236.1	9,810.5
Securitisation funding		3,928.3	-	-	3,928.3
		11,620.5	1,882.2	236.1	13,738.8
	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2019					
Segment assets					
Loans to customers	16	10,344.1	1,452.1	389.9	12,186.1
Operating lease assets	24	-	36.3	-	36.3
Cross-currency basis swaps	20	582.7	-	-	582.7
Securitisation cash	15	353.1	-	-	353.1
		11,279.9	1,488.4	389.9	13,158.2
Segment liabilities					
Allocated deposits		5,367.2	1,822.5	303.1	7,492.8
Securitisation funding		5,206.9	-	-	5,206.9
		10,574.1	1,822.5	303.1	12,699.7
	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
1 October 2018					
Segment assets					
Loans to customers	16	10,449.5	1,131.3	519.8	12,100.6
Operating lease assets	24	-	35.4	-	35.4
Cross-currency basis swaps		829.7	-	-	829.7
Securitisation cash	15	319.0	-	19.8	338.8
		11,598.2	1,166.7	539.6	13,304.5
Segment liabilities					
Allocated deposits		4,702.4	1,443.5	411.0	6,556.9
Securitisation funding		6,457.2	-	33.1	6,490.3
		11,159.6	1,443.5	444.1	13,047.2

An analysis of the Group's financial assets by type and segment is shown in note 16. All of the assets shown above were located in the UK.

The additions to non-current assets, excluding financial assets, in the year which are included in segmental assets above are investments of £12.9m (2019: £11.6m) in assets held for leasing under operating leases, included in the Commercial Lending segment.

No other fixed asset additions were allocated to segments.

The segmental assets and liabilities may be reconciled to the consolidated balance sheet as shown below.

	2020 £m	2019 £m
Total segment assets	13,339.6	13,158.2
Unallocated assets		
Central cash and investments	1,701.6	872.3
Unallocated derivatives	18.0	9.7
Operational property, plant and equipment	26.6	21.0
Intangible assets	170.1	171.1
Other	249.6	163.2
Total assets	15,505.5	14,395.5

	2020 £m	2019 £m
Total segment liabilities	13,738.8	12,699.7
Unallocated liabilities		
Unallocated retail deposits	(1,953.9)	(1,100.9)
Derivative financial instruments	132.4	80.5
Central borrowings	2,301.4	1,441.5
Tax liabilities	-	15.2
Retirement benefit obligations	20.4	34.5
Other	110.4	116.6
Total liabilities	14,349.5	13,287.1

3. Revenue

	Note	2020 £m	2019 £m
Interest receivable	4	491.7	505.7
Operating lease income	6	19.2	18.3
Gain on derecognition of financial assets	7	-	9.7
Other income	8	14.0	15.4
Total revenue		524.9	549.1
Arising from:			
Mortgage Lending		351.4	348.9
Commercial Lending		139.0	121.2
Idem Capital		31.0	62.7
Total revenue from segments		521.4	532.8
Unallocated revenue		3.5	16.3
Total revenue		524.9	549.1

4. Interest receivable

	2020 £m	2019 £m
Interest receivable in respect of		
Loan accounts	440.4	449.3
Finance leases	44.3	44.5
Invoice finance income	2.4	3.1
Interest on loans to customers	487.1	496.9
Other interest receivable	4.6	8.8
Total interest on financial assets	491.7	505.7

The above interest arises from:

	2020 £m	2019 £m
Financial assets held at amortised cost	447.4	461.2
Finance leases	44.3	44.5
	491.7	505.7

5. Interest payable and similar charges

	Note	2020 £m	2019 £m
On retail deposits		129.7	114.2
On asset backed loan notes		42.2	63.4
On bank loans and overdrafts		5.4	9.6
On corporate bonds		10.9	10.9
On retail bonds		18.5	18.6
On central bank facilities		4.5	8.0
Total interest on financial liabilities		211.2	224.7
On pension scheme deficit	53	0.4	0.5
Discounting on contingent consideration	35	0.4	0.5
Discounting on lease liabilities		0.2	-
Other finance costs		1.4	1.6
		213.6	227.3

All interest payable on financial liabilities relates to financial liabilities held at amortised cost.

6. Net operating lease income

	<i>Note</i>	2020	2019
		£m	£m
Income			
Operating lease rentals		14.5	14.0
Maintenance income		4.7	4.3
Total operating lease income		19.2	18.3
Costs			
Depreciation of lease assets	24	(8.3)	(7.6)
Maintenance salaries	50	(2.1)	(1.9)
Other maintenance costs		(5.8)	(5.0)
Total operating lease costs		(16.2)	(14.5)
Net operating lease income		3.0	3.8

7. Gain on derecognition of financial assets

During the year ended 30 September 2019, on 26 June 2019, the Group disposed of its residual interest in the Paragon Mortgages (No. 12) PLC ('PM12') securitisation transaction for a cash payment, in order to optimise capital usage. This participation, which exposed the Group to materially all of the credit risk in the securitised assets and entitled it to any net yield from these assets, was determined to give the Group control of the entity, as defined by IFRS 10. On disposal of the participation, this control ceased and hence the assets and the related external funding were derecognised.

Loans to customers of £695.8m and borrowings of £784.1m were derecognised on the completion of this transaction and a gain of £9.7m was recognised in profit.

The cash flow hedge in the securitisation vehicle, ceased to be recognised in the Group at the point of the transaction and consequently an amount of £0.9m, less related tax of £0.2m, was recycled to profit and loss, and is included in other comprehensive income for the year ended 30 September 2019.

Information on the Group's continuing involvement with the PM12 transaction is given in note 46.

8. Other income

	2020	2019
	£m	£m
Loan account fee income	5.7	7.2
Broker commissions	1.7	2.2
Third party servicing	5.0	5.0
Other income	1.6	1.0
	14.0	15.4

All loan account fee income arises from financial assets held at amortised cost.

9. Operating expenses

	<i>Note</i>	2020	2019
		£m	£m
Employment costs	50	77.6	79.3
Auditor remuneration	10	2.0	1.8
Amortisation of intangible assets	25	2.0	2.4
Depreciation of operational assets	24	3.5	1.5
Operating lease rentals payable	47	-	2.9
Other administrative costs		41.7	37.3
		126.8	125.2

Operating lease rentals in 2019 included amounts no longer recognised immediately under IFRS 16 (note 36).

10. Auditor remuneration

The analysis of fees payable to the Company's auditors (KPMG LLP) and their associates, excluding irrecoverable VAT, required by the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 is set out below. This analysis includes amounts charged to the profit and loss account or included within the issue costs of debt in respect of fees paid to the Group auditors and their associates.

	2020	2019
	£000	£000
Audit fee of the company	478	462
Other services		
Audit of subsidiary undertakings pursuant to legislation	990	890
Total audit fees	1,468	1,352
Audit related assurance services		
Interim review	133	90
Other	35	22
Total fees	1,636	1,464
Irrecoverable VAT	327	293
Total cost to the Group (note 9)	1,963	1,757

Fees paid to the auditors and their associates for non-audit services to the Company are not disclosed because the consolidated accounts of the Group are required to disclose such fees on a consolidated basis.

11. Fair value net (losses) / gains

	2020	2019
	£m	£m
Ineffectiveness of fair value hedges (note 20)		
Portfolio hedges of interest rate risk		
Deposit hedge	0.2	(0.2)
Loan hedge	0.1	(6.3)
	0.3	(6.5)
Ineffectiveness of cash flow hedges	-	-
Other hedging movements	(2.9)	(5.8)
Net (losses) / gains on other derivatives	1.0	(2.8)
	(1.6)	(15.1)

The fair value net (loss) / gain represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses and gains are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

12. Tax charge on profit on ordinary activities

(a) Analysis of charge in the year

	2020	2019
	£m	£m
Current tax		
UK Corporation Tax on profits of the period	25.5	36.3
Adjustment in respect of prior periods	0.5	(2.4)
Total current tax	26.0	33.9
Deferred tax	1.1	(2.3)
Tax charge on profit on ordinary activities	27.1	31.6

The standard rate of corporation tax in the UK applicable to the Group in the period was 19.0% (2019: 19.0%), based on currently enacted legislation. During the period, legislation was substantively enacted, reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. Consequently, temporary differences which had been expected to reverse at a tax rate of 18.0% in the current year, or 17.0% in subsequent years, have either reversed or are expected to reverse at a rate of 19.0%. The impact of this change has been accounted for in the year.

The Bank Corporation Tax Surcharge subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional 8.0% of tax to the extent these profits exceed £25.0m. The effect of the surcharge shown in note (c) below.

(b) Deferred tax charge / (credit) for the year

The deferred tax charge / (credit) in the income statement comprises the following temporary differences:

	2020	2019
	£m	£m
Accelerated tax depreciation	(0.4)	0.2
Retirement benefit obligations	1.2	0.3
Impairment and other provisions	(1.2)	(2.1)
Utilisation of tax losses	(0.9)	(0.2)
Other timing differences	2.8	(1.9)
Deferred tax charge / (credit) for the year	1.5	(3.7)
Prior period adjustment	(0.4)	1.4
Deferred tax charge / (credit) (note 23)	1.1	(2.3)

The expected impact on deferred tax balances of the withdrawal of the reduction in the rate of Corporation Tax to 17.0% described above was accounted for in the year, the effect of the expected change having been accounted for when originally enacted.

(c) Factors affecting tax charge for the year

Accounting standards require companies to explain the difference between the effective rate of tax in the accounts and the 'applicable rate', generally the domestic rate of tax levied on corporate income in the jurisdiction in which the entity operates.

The Group operates wholly in the UK and all but a nominal amount of the Group's income arises in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (a) above, the UK corporation tax rate applicable to the Group for the year was 19.0% (2019: 19.0%).

The impact of the Banking Surcharge is shown as a difference between tax at this rate and the actual tax charge in the table below.

	2020	2019
	£m	£m
Profit on ordinary activities before taxation	118.4	159.0
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	22.5	30.2
Effects of:		
Permanent differences		
Recurring disallowable expenditure and similar items	0.1	0.4
Mismatch in timing differences	0.2	0.3
Change in rate of taxation on deferred tax assets and liabilities	0.1	(0.6)
Bank Corporation Tax Surcharge	4.0	2.1
Tax losses created with no corresponding deferred tax asset recognised	-	0.1
Prior year charge / (credit)	0.2	(0.9)
Tax charge for the year	27.1	31.6

The timing difference mismatch arises because tax relief for share based payments is given on a different basis from that on which the accounting charge for the provision of these awards is recognised under IFRS 2.

(d) Factors affecting future tax charges

Whilst practically all of the Group's profit is subject to UK corporation tax, the relationship of its future effective tax rate to the standard rate of UK corporation tax is expected to be primarily driven by the proportion of its taxable profit subject to the Bank Surcharge.

The Group includes various asset leasing businesses within its Commercial Lending division. Whilst such businesses do not, in general, have significant permanent differences, the taxable profits in a given accounting period are usually significantly different from the accounting profits due to temporary differences. Consequently, the operation will have no material impact on the effective tax rate, but may have on the Group's tax payments.

At the balance sheet date there were no material tax uncertainties and no significant open matters with the UK tax authorities. The Group has no material exposure to any other tax jurisdiction.

As a wholly UK based business the Group does not expect to be significantly impacted by the OECD project on Base Erosion and Profit Shifting ('BEPS').

13. Profit attributable to members of Paragon Banking Group PLC

The Company's profit after tax for the financial year amounted to £96.0m (2019: £9.9m). A separate income statement has not been prepared for the Company under the provisions of Section 408 of the Companies Act 2006.

The Company has no other items of comprehensive income for the years ended 30 September 2020 or 30 September 2019.

14. Earnings per share

Earnings per ordinary share is calculated as follows:

	2020	2019
Profit for the year (£m)	91.3	127.4
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	253.6	257.6
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	2.5	6.7
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	256.1	264.3
Earnings per ordinary share		
- basic	36.0p	49.4p
- diluted	35.6p	48.2p

15. Cash and cash equivalents

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England. It is analysed as set out below.

	2020 £m	2019 £m	2018 £m
Deposits with the Bank of England	1,637.1	816.4	895.9
Balances with central banks	1,637.1	816.4	895.9
Deposits with other banks	287.9	409.0	393.1
Money Market Fund investments	-	-	21.6
Balances with other banks	287.9	409.0	414.7
Cash and cash equivalents	1,925.0	1,225.4	1,310.6

Not all of the Group's cash is immediately available for its general purposes, including liquidity management. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements.

Cash held by the Trustee of the Group's employee share ownership plan ('ESOP') may only be used to invest in the shares of the Company, pursuant to the aims of that plan.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below:

	2020 £m	2019 £m	2018 £m
Available cash	1,701.1	872.1	962.9
Securitisation cash	223.4	353.1	338.8
ESOP cash	0.5	0.2	8.9
	1,925.0	1,225.4	1,310.6

The 'Cash and Cash Equivalents' amount of £12.6m (2019: £14.1m; 2018: £24.9m) shown in the Company balance sheet is not subject to restrictions. This amount includes £nil of Money Market Fund investments (2019: £nil; 2018: £150.0m).

Cash and cash equivalents are classified as Stage 1 exposures (see note 19) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

16. Loans to customers

	Note	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Loan accounts	17	11,907.0	11,394.3	11,381.5	11,407.4
Finance lease receivables	18	724.4	791.8	719.1	720.4
Loans to customers		12,631.4	12,186.1	12,100.6	12,127.8
Fair value adjustments from portfolio hedging	20	109.7	64.2	(24.1)	(24.1)
		12,741.1	12,250.3	12,076.5	12,103.7

The Group's loans to customers at 30 September 2020, analysed between the segments described in note 2 are as follows:

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2020				
First mortgages	10,636.9	-	-	10,636.9
Consumer loans	182.6	-	281.6	464.2
Motor finance	-	256.9	15.5	272.4
Asset finance	-	478.0	-	478.0
Development finance	-	609.0	-	609.0
Other commercial loans	-	170.9	-	170.9
Loans to customers	10,819.5	1,514.8	297.1	12,631.4

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2019				
First mortgages	10,172.5	-	-	10,172.5
Consumer loans	171.6	-	352.3	523.9
Motor finance	-	281.3	37.6	318.9
Asset finance	-	492.2	-	492.2
Development finance	-	506.5	-	506.5
Other commercial loans	-	172.1	-	172.1
Loans to customers	10,344.1	1,452.1	389.9	12,186.1

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 1 October 2018				
First mortgages	10,308.3	-	-	10,308.3
Consumer loans	141.2	-	447.0	588.2
Motor finance	-	256.4	72.8	329.2
Asset finance	-	402.3	-	402.3
Development finance	-	352.9	-	352.9
Other commercial loans	-	119.7	-	119.7
Loans to customers	10,449.5	1,131.3	519.8	12,100.6

The Group's purchased loan portfolios are analysed below.

	2020	2019
	£m	£m
First mortgage loans	15.0	15.7
Consumer loans	220.3	275.4
Motor finance loans	15.5	37.6
	250.8	328.7

Information on the Estimated Remaining Collections ('ERCs'), the undiscounted forecast collectible amounts, for first mortgages and consumer loans is given in note 56. All other loans above are internally generated or arise from acquired operations.

17. Loan accounts

Loan accounts at 30 September 2020, 30 September 2019, 1 October 2018 and 30 September 2018, which are all denominated and payable in sterling, were:

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
First mortgage loans	10,636.9	10,172.5	10,308.3	10,332.2
Second charge mortgage loans	354.5	389.2	414.4	415.9
Other unsecured consumer loans	109.7	134.7	173.8	173.7
Development finance loans	609.0	506.5	352.9	352.8
Other secured commercial lending	134.4	125.9	72.8	72.9
Other commercial loans	62.5	65.5	59.3	59.9
	11,907.0	11,394.3	11,381.5	11,407.4

First mortgages are secured on residential property within the UK; second charge mortgage loans enjoy second charges on residential property.

Other secured commercial lending includes structured lending, aviation mortgages and invoice finance.

Other commercial loans includes principally professions finance, discounted receivables and other short-term commercial balances.

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 33 or under the securitisation and warehouse funding arrangements described in notes 29 and 30 are shown below. These include notes retained by the Group described in note 57. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	First Mortgages	Consumer Finance	Other	Total
	£m	£m	£m	£m
30 September 2020				
In respect of:				
Asset backed loan notes	4,106.5	-	-	4,106.5
Warehouse facilities	881.9	-	-	881.9
Central bank facilities	2,875.3	-	-	2,875.3
Total pledged as collateral	7,863.6	-	-	7,863.6
Prepositioned with Bank of England	1,072.3	-	-	1,072.3
Other assets not pledged as collateral	1,701.0	464.2	805.9	2,971.1
	10,636.9	464.2	805.9	11,907.0
30 September 2019				
In respect of:				
Asset backed loan notes	4,338.3	-	-	4,338.3
Warehouse facilities	948.1	-	-	948.1
Central bank facilities	1,734.4	-	-	1,734.4
Total pledged as collateral	7,020.8	-	-	7,020.8
Prepositioned with Bank of England	1,873.7	-	-	1,873.7
Other assets not pledged as collateral	1,278.0	523.9	697.9	2,499.8
	10,172.5	523.9	697.9	11,394.3
1 October 2018				
In respect of:				
Asset backed loan notes	5,037.8	40.4	-	5,078.2
Warehouse facilities	1,023.8	-	-	1,023.8
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,731.7	40.4	-	7,772.1
Prepositioned with Bank of England	1,171.0	-	-	1,171.0
Other assets not pledged as collateral	1,405.6	547.8	485.0	2,438.4
	10,308.3	588.2	485.0	11,381.5

18. Finance lease receivables

The Group's finance leases can be analysed as shown below.

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
Motor finance	272.4	318.9	329.2	329.4
Asset finance	452.0	472.9	389.9	391.0
Carrying value	724.4	791.8	719.1	720.4

With effect from 1 October 2019, the Group's finance leases have been accounted for in accordance with IFRS 16 (note 61). Balance shown in preceding periods are accounted for in accordance with IAS 17, however both standards require the same accounting treatment.

The minimum lease payments due under these loan agreements are:

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
Amounts receivable				
Within one year	269.5	292.9	258.5	259.5
Within one to two years	221.5	256.8	239.9	240.3
Within two to three years	163.6	177.2	165.6	165.8
Within three to four years	104.1	101.6	94.9	95.0
Within four to five years	43.2	31.1	29.0	29.1
After five years	41.6	40.2	30.9	30.9
	843.5	899.8	818.8	820.6
Less: future finance income	(103.4)	(101.4)	(95.2)	(95.2)
Present value	740.1	798.4	723.6	725.4

The present values of those payments, net of provisions for impairment, carried in the accounts are:

	2020	2019	2018	2018
	IFRS 9	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m	£m
Amounts receivable				
Within one year	236.5	255.8	225.5	226.4
Within two to five years	467.1	506.6	470.8	471.7
After five years	36.5	36.0	27.3	27.3
Present value	740.1	798.4	723.6	725.4
Allowance for uncollectible amounts	(15.7)	(6.6)	(4.5)	(5.0)
Carrying value	724.4	791.8	719.1	720.4

None of the Group's finance lease receivables were pledged as collateral for liabilities at 30 September 2020 or 30 September 2019.

19. Impairment provisions on loans to customers

This note sets out information on the Group's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 16, including both finance leases, accounted for under IFRS 16, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

- (a) Basis of provision
- (b) Impairments by stage and division
- (c) Movements in impairment provision in the period
- (d) Impairments charged to income
- (e) Economic inputs to provision calculations
- (f) Sensitivity analysis

(a) Basis of provision

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. The provision may be based on either twelve month or lifetime ECL, dependent on whether an account has experienced a significant increase in credit risk ('SICR').

Calculation of expected credit loss ('ECL')

For the majority of the Group's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Group's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed. The Group utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values, net of likely costs of recovery. These calculations allow for the Group's potential case management activities. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful (eg where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

Notwithstanding the mechanical procedures discussed above, the Group will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

In extreme or unprecedented economic conditions, such as the Covid-19 pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. In these circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2020 the effects of the material reductions in GDP since the onset of the Covid 19 crisis had not yet been evidenced in customer credit performance and defaults, due to the lagging effect of government policy interventions. Where customers were given payment reliefs, arrears and adverse credit indicators were not recorded by the Group or other lenders, meaning that both internal credit metrics and external credit bureau data might not accurately reflect the customer's credit position leading to modelled PDs being underestimated.

While forecast economics assume the current economic situation, the future, generally upward, trends also tend to reduce PDs, in a way that may not be justifiable where an underlying credit issue on an account has not emerged, which may result in default as government support initiatives unwind.

In reviewing the subsequent payment patterns of accounts that have been granted Covid-19 reliefs, it is evident that there is higher payment volatility (both in terms of account improvement and deterioration) so whilst credit risk is increased, it is not significant in scale in all cases. The Group has reflected this position by applying PD floors to its payment holiday population in the main portfolios at Stage 1, and moved accounts with payment holiday extensions to Stage 2, again with floors reflecting extrapolations of recent cohort experience to reflect the more adverse economic conditions forecast within the Group's macroeconomic scenarios and to allow for the potential under-recognition of losses caused by these effects.

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Group's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Group assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Group's hands concerning the customers' present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which provide evidence of SICR have been considered.

In determining whether an account has an SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of initial Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

For customers with extended payment reliefs in place, the account has been placed in Stage 2, regardless of other indicators, as a result of the analysis described above. This aligns the Group's approach to regulatory guidance which suggested that while initial payment reliefs should not automatically be taken as an indication of an SICR, an extension to such a relief was more likely to be so.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

The Group uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point it is one day past due until it is thirty days past due.

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The Group's definitions of default for its various portfolios are aligned to its internal operational procedures and the regulatory definitions of default used internally. In particular the Group's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

IFRS 9 provides a rebuttable presumption that an account is in default when it is ninety days overdue and this was used as the basis of the Group's definition. A combination of qualitative and quantitative measures were used in developing the definitions. These include account management activities and internal statuses.

Credit Impaired loans

IFRS 9 defines a credit impaired account as one where an account has suffered one or more event which has had a detrimental effect on future cash flows. It is thus a backward-looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

All default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than ninety days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance. In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between receiver of rent accounts, accounts subject to realisation / enforcement procedures and long-term managed accounts, all of which are treated as credit impaired.

(b) Impairments by stage

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been an SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of lifetime ECLs.

For assets which were 'Purchased or Originated as Credit Impaired' ('POCI') accounts (ie considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

An analysis of the Group's loan portfolios between the stages defined above is set out below.

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £m
30 September 2020					
Gross loan book					
Mortgage Lending	9,822.6	903.2	127.0	15.0	10,867.8
Commercial Lending	1,384.2	132.3	20.2	6.7	1,543.4
Idem Capital	122.9	9.9	28.9	140.3	302.0
Total	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment provision					
Mortgage Lending	(5.0)	(12.6)	(30.7)	-	(48.3)
Commercial Lending	(17.0)	(3.0)	(8.2)	(0.4)	(28.6)
Idem Capital	(0.2)	(0.2)	(4.5)	-	(4.9)
Total	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Net loan book					
Mortgage Lending	9,817.6	890.6	96.3	15.0	10,819.5
Commercial Lending	1,367.2	129.3	12.0	6.3	1,514.8
Idem Capital	122.7	9.7	24.4	140.3	297.1
Total	11,307.5	1,029.6	132.7	161.6	12,631.4
Coverage ratio					
Mortgage Lending	0.05%	1.40%	24.17%	-	0.44%
Commercial Lending	1.23%	2.27%	40.59%	5.97%	1.85%
Idem Capital	0.16%	2.02%	15.57%	-	1.62%
Total	0.20%	1.51%	24.65%	0.25%	0.64%

	Stage 1 £m	Stage 2* £m	Stage 3* £m	POCI £m	Total £m
30 September 2019					
Gross loan book					
Mortgage Lending	9,847.7	378.2	129.3	15.7	10,370.9
Commercial Lending	1,376.7	64.6	8.2	13.3	1,462.8
Idem Capital	158.2	15.7	30.4	190.0	394.3
Total	11,382.6	458.5	167.9	219.0	12,228.0
Impairment provision					
Mortgage Lending	(0.4)	(2.0)	(24.4)	-	(26.8)
Commercial Lending	(5.4)	(1.3)	(4.0)	-	(10.7)
Idem Capital	(0.2)	(0.4)	(3.8)	-	(4.4)
Total	(6.0)	(3.7)	(32.2)	-	(41.9)
Net loan book					
Mortgage Lending	9,847.3	376.2	104.9	15.7	10,344.1
Commercial Lending	1,371.3	63.3	4.2	13.3	1,452.1
Idem Capital	158.0	15.3	26.6	190.0	389.9
Total	11,376.6	454.8	135.7	219.0	12,186.1
Coverage ratio					
Mortgage Lending	-	0.53%	18.87%	-	0.26%
Commercial Lending	0.39%	2.01%	48.78%	-	0.73%
Idem Capital	0.13%	2.55%	12.50%	-	1.12%
Total	0.05%	0.81%	19.18%	-	0.34%

* Stage 2 and 3 balances are analysed in more detail below.

Finance leases included above, analysed by staging, were:

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2020					
Gross loan book	676.6	33.6	14.4	15.5	740.1
Impairment provision	(9.3)	(0.9)	(5.5)	-	(15.7)
Net loan book	667.3	32.7	8.9	15.5	724.4
Coverage Ratio	1.37%	2.68%	38.19%	-	2.12%
30 September 2019					
Gross loan book	734.2	21.0	5.7	37.5	798.4
Impairment provision	(3.2)	(0.7)	(2.7)	-	(6.6)
Net loan book	731.0	20.3	3.0	37.5	791.8
Coverage Ratio	0.44%	3.33%	47.37%	-	0.83%

In terms of the Group's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated. Additional provision arising on these assets post-acquisition is shown as 'Impairment Provision' above.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above.

Acquired portfolios within the Mortgage Lending and Idem Capital segments which were largely non-performing at acquisition, and which were purchased at a deep discount to face value are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

The table below analyses the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information and accounts more than one month in arrears, which are automatically deemed to have an SICR.

Levels of Stage 2 assets have been increased significantly as a result of the Covid-19 outbreak. This is seen in an increased level of assets where an SICR has been identified in the absence of arrears on the account, particularly through the evaluation of the potential significance of extended payment holidays. In Mortgage Lending and Idem Capital the level of Stage 2 arrears accounts has fallen, due to regulatory interventions preventing arrears being recorded.

Coverage levels have increased in both Mortgage Lending and Commercial Lending, as a consequence of the harsher economic assumptions applied in 2020 and the PD floors applied to accounts with payment holiday extensions. Reduced expectations of security values have also increased provision requirements. Impacts on the highly seasoned Idem Capital books have been less and the levels of such assets in Stage 2 remain relatively small.

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2020			
Gross loan book			
Mortgage Lending	879.9	23.3	903.2
Commercial Lending	113.2	19.1	132.3
Idem Capital	4.8	5.1	9.9
Total	997.9	47.5	1,045.4
Impairment provision			
Mortgage Lending	(12.0)	(0.6)	(12.6)
Commercial Lending	(2.5)	(0.5)	(3.0)
Idem Capital	(0.1)	(0.1)	(0.2)
Total	(14.6)	(1.2)	(15.8)
Net loan book			
Mortgage Lending	867.9	22.7	890.6
Commercial Lending	110.7	18.6	129.3
Idem Capital	4.7	5.0	9.7
Total	983.3	46.3	1,029.6
Coverage ratio			
Mortgage Lending	1.36%	2.58%	1.40%
Commercial Lending	2.21%	2.62%	2.27%
Idem Capital	2.08%	1.96%	2.02%
Total	1.46%	2.53%	1.51%

	< 1 month arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2019			
Gross loan book			
Mortgage Lending	336.3	41.9	378.2
Commercial Lending	57.2	7.4	64.6
Idem Capital	7.7	8.0	15.7
Total	401.2	57.3	458.5
Impairment provision			
Mortgage Lending	(1.3)	(0.7)	(2.0)
Commercial Lending	(1.0)	(0.3)	(1.3)
Idem Capital	(0.2)	(0.2)	(0.4)
Total	(2.5)	(1.2)	(3.7)
Net loan book			
Mortgage Lending	335.0	41.2	376.2
Commercial Lending	56.2	7.1	63.3
Idem Capital	7.5	7.8	15.3
Total	398.7	56.1	454.8
Coverage ratio			
Mortgage Lending	0.39%	1.67%	0.53%
Commercial Lending	1.75%	4.05%	2.01%
Idem Capital	2.60%	2.50%	2.55%
Total	0.62%	2.09%	0.81%

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between accounts in the process of enforcement or where full recovery is considered unlikely ('Realisations' in the table), loans being managed on a long-term basis where full recovery is possible but which are considered in default for regulatory purposes and buy-to-let mortgages where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customer's behalf. RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

Accounts which no longer meet default criteria but which are being retained in Stage 3 for a probationary period are included with the > 3 month arrears accounts below.

The impact of Covid-19 on the Group's Stage 3 loans can be seen mostly in the level of > 3 month arrears accounts shown below, both in terms of increased numbers and in higher provision coverage. The impact is proportionally less in Idem Capital where there is a significant balance of second charge loans which are long-term arrears balances, the customer making regular payments, but not reducing arrears. Government and regulatory policy intervention have reduced the likelihood of new enforcement actions, particularly on consumer portfolios.

In Mortgage Lending the overall level of Stage 3 balances has continued to reduce, despite Covid-19, as the managed work-out of legacy receiver of rent cases continued in the period. Coverage for Stage 3 RoR managed and realisations cases has increased over the year as a result of a less positive outlook for property sale values. The coverage ratio for Commercial Lending is subject to large fluctuations, as the number and absolute value of Stage 3 cases are relatively low and hence the specific details of individual cases will influence the ratio.

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
30 September 2020				
Gross loan book				
Mortgage Lending	19.4	86.7	20.9	127.0
Commercial Lending	11.4	-	8.8	20.2
Idem Capital	24.3	-	4.6	28.9
Total	55.1	86.7	34.3	176.1
Impairment provision				
Mortgage Lending	(1.7)	(20.8)	(8.2)	(30.7)
Commercial Lending	(4.2)	-	(4.0)	(8.2)
Idem Capital	(2.8)	-	(1.7)	(4.5)
Total	(8.7)	(20.8)	(13.9)	(43.4)
Net loan book				
Mortgage Lending	17.7	65.9	12.7	96.3
Commercial Lending	7.2	-	4.8	12.0
Idem Capital	21.5	-	2.9	24.4
Total	46.4	65.9	20.4	132.7
Coverage ratio				
Mortgage Lending	8.76%	23.99%	39.23%	24.17%
Commercial Lending	36.84%	-	45.45%	40.59%
Idem Capital	11.52%	-	36.96%	15.57%
Total	15.79%	23.99%	40.52%	24.65%

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
30 September 2019				
Gross loan book				
Mortgage Lending	8.3	106.3	14.7	129.3
Commercial Lending	1.7	-	6.5	8.2
Idem Capital	26.0	-	4.4	30.4
Total	36.0	106.3	25.6	167.9
Impairment provision				
Mortgage Lending	(0.4)	(19.3)	(4.7)	(24.4)
Commercial Lending	(0.5)	-	(3.5)	(4.0)
Idem Capital	(1.9)	-	(1.9)	(3.8)
Total	(2.8)	(19.3)	(10.1)	(32.2)
Net loan book				
Mortgage Lending	7.9	87.0	10.0	104.9
Commercial Lending	1.2	-	3.0	4.2
Idem Capital	24.1	-	2.5	26.6
Total	33.2	87.0	15.5	135.7
Coverage ratio				
Mortgage Lending	4.82%	18.16%	31.97%	18.87%
Commercial Lending	29.41%	-	53.85%	48.78%
Idem Capital	7.31%	-	43.18%	12.50%
Total	7.78%	18.16%	39.45%	19.18%

The security values available to reduce exposure at default in the calculation shown above for Stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in the Central scenario. Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	2020	2019
	£m	£m
First mortgages	71.9	65.7
Second mortgages	17.3	14.0
Asset finance	6.7	2.2
Motor finance	1.5	1.0
	97.4	82.9

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and this long-term, stable situation underpinned their treatment as not impaired under IAS 39, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

Idem Capital balances with over three months arrears comprise principally second charge mortgage accounts originated over ten years ago which have been over three months in arrears for some time. These accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

Buy-to-let receiver of rent cases (Stage 3)

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the Group has the power to appoint a receiver of rent under the Law of Property Act. The receiver will then manage the property on behalf of the customer, collecting rents and remitting them to make payments on the account. While the receiver has the power to sell the property, in many cases they will operate it as a buy-to-let on at least a short to medium term basis, potentially longer, depending on the individual circumstances of the case. This causes less disruption to the tenants and may result in the mortgage account returning to performing status and the property being handed back to the customer.

The following table analyses the number and gross carrying value of RoR managed accounts shown above by the date of the receivers' appointment, illustrating this position.

	30 September 2020		30 September 2019	
	No.	£m	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	369	62.4	402	70.5
2011 to 2013	72	12.4	86	17.3
2014 to 2016	29	4.2	31	4.5
2016 and later	46	7.7	84	14.0
Total managed accounts	516	86.7	603	106.3
Accounts in the process of realisation	104	19.7	80	11.9
	620	106.4	683	118.2

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above.

In addition to the cases analysed above, 3 POCI mortgage accounts also had a receiver of rent appointed (2019: 3), making a total of 623.

(c) Movements in impairment provision by stage

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgage Lending	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At 30 September 2019	26.8	10.7	4.4	41.9
Provided in period (note 19(d))	25.8	22.7	1.3	49.8
Amounts written off	(4.3)	(4.8)	(0.8)	(9.9)
Assets derecognised	-	-	-	-
At 30 September 2020	48.3	28.6	4.9	81.8
At transition – 1 October 2018	36.1	6.6	11.5	54.2
Provided in period (note 19(d))	1.2	7.2	0.3	8.7
Amounts written off	(6.5)	(3.1)	(7.4)	(17.0)
Assets derecognised	(4.0)	-	-	(4.0)
At 30 September 2019	26.8	10.7	4.4	41.9

Accounts are considered to be written off for accounting purposes if a balance remains once standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

At 30 September 2020, enforceable contractual balances of £5.5m (2019: £9.0m) were outstanding on non-POCI assets written off in the period. This excludes those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances are kept under review for operational purposes, but no amounts are recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the year ended 30 September 2020 and 30 September 2019 is set out below.

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9
New assets originated or purchased	10.2	-	-	-	10.2
Changes in loss allowance					
Transfer to Stage 1	0.9	(0.7)	(0.2)	-	-
Transfer to Stage 2	(1.2)	1.3	(0.1)	-	-
Transfer to Stage 3	(0.5)	(0.4)	0.9	-	-
Changes due to credit risk	6.8	11.9	20.5	0.4	39.6
Write offs	-	-	(9.9)	-	(9.9)
Assets derecognised	-	-	-	-	-
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8
Loss allowance at 1 October 2018	4.9	2.6	46.7	-	54.2
New assets originated or purchased	4.4	-	-	-	4.4
Changes in loss allowance					
Transfer to Stage 1	0.5	(0.5)	-	-	-
Transfer to Stage 2	(0.3)	0.4	(0.1)	-	-
Transfer to Stage 3	(0.5)	(0.4)	0.9	-	-
Changes due to credit risk	(2.9)	3.3	3.9	-	4.3
Write offs	-	-	(17.0)	-	(17.0)
Assets derecognised	(0.1)	(1.7)	(2.2)	-	(4.0)
Loss allowance at 30 September 2019	6.0	3.7	32.2	-	41.9

The principal factor generating the increase in the loss allowance in the period is the impact of the Covid-19 crisis, which has led to increased loss expectations across all of the Group's portfolios, primarily as a result of the forecast deterioration in key economic variables and their impact on the Group's customers. The broad availability of payment holidays has also been reflected, with floors applied for both payment holiday accounts and payment holiday extensions.

These increases in expected losses have also led to increased numbers of accounts having an SICR identified and therefore being transferred from Stage 1 to Stage 2. The transfers to Stage 2 in 2020 include £576.3m of balances with extended payment reliefs which were identified as having an SICR for this reason only.

Overall the impact of the PD floors and the transfer of additional accounts to the life-time ECL provisioning required by Stage 2 has increased the total provision by £19.8m from the £62.0m which would have been indicated had only the Group's standard SICR tests been used.

In the year ended 30 September 2019, the principal factors generating the reduction in the loss allowance were the derecognition of the PM12 assets, shown above as 'assets derecognised', a major account review exercise relating to unsecured legacy assets, resulting in the cessation of collection on a large number of accounts and a write off of £5.8m, and realisations on RoR cases where provisions of £7.3m were utilised.

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
New assets originated or purchased	2,071.4	-	-	-	2,071.4
Changes in staging					
Transfer to Stage 1	202.3	(200.1)	(2.2)	-	-
Transfer to Stage 2	(846.2)	849.2	(3.0)	-	-
Transfer to Stage 3	(42.6)	(20.5)	63.1	-	-
Redemptions and repayments	(1,488.3)	(54.1)	(42.0)	(78.1)	(1,662.5)
Goodwill adjustment	-	-	-	-	-
Assets derecognised	-	-	-	-	-
Write offs	-	-	(9.9)	-	(9.9)
Other changes	50.5	12.4	2.2	21.1	86.2
Balance at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
Loss allowance	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Carrying value	11,307.5	1,029.6	132.7	161.6	12,631.4
Balance at 1 October 2018	11,274.1	397.8	188.2	294.7	12,154.8
New assets originated or purchased	2,443.2	-	-	4.1	2,447.3
Changes in staging					
Transfer to Stage 1	100.8	(97.5)	(3.3)	-	-
Transfer to Stage 2	(240.0)	243.4	(3.4)	-	-
Transfer to Stage 3	(27.1)	(18.6)	45.7	-	-
Redemptions and repayments	(1,586.1)	(30.0)	(29.6)	(110.1)	(1,755.8)
Goodwill adjustment	-	-	-	(2.7)	(2.7)
Assets derecognised	(636.8)	(39.4)	(14.1)	(14.7)	(705.0)
Write offs	-	-	(17.0)	-	(17.0)
Other changes	54.5	2.8	1.4	47.7	106.4
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
Loss allowance	(6.0)	(3.7)	(32.2)	-	(41.9)
Carrying value	11,376.6	454.8	135.7	219.0	12,186.1

Other changes includes interest and similar charges.

(d) Impairments charged to income

The amounts charged to the profit and loss account in the period are analysed as follows.

	Mortgage Lending	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
30 September 2020				
Provided in period	25.8	22.7	1.3	49.8
Recovery of written off amounts	-	(1.0)	(0.5)	(1.5)
	25.8	21.7	0.8	48.3
Of which				
Loan accounts	25.8	9.5	0.8	36.1
Finance leases	-	12.2	-	12.2
	25.8	21.7	0.8	48.3
30 September 2019				
Provided in period	1.2	7.2	0.3	8.7
Recovery of written off amounts	(0.2)	-	(0.5)	(0.7)
	1.0	7.2	(0.2)	8.0
Of which				
Loan accounts	1.0	2.8	(0.2)	3.6
Finance leases	-	4.4	-	4.4
	1.0	7.2	(0.2)	8.0

(e) Economic impacts

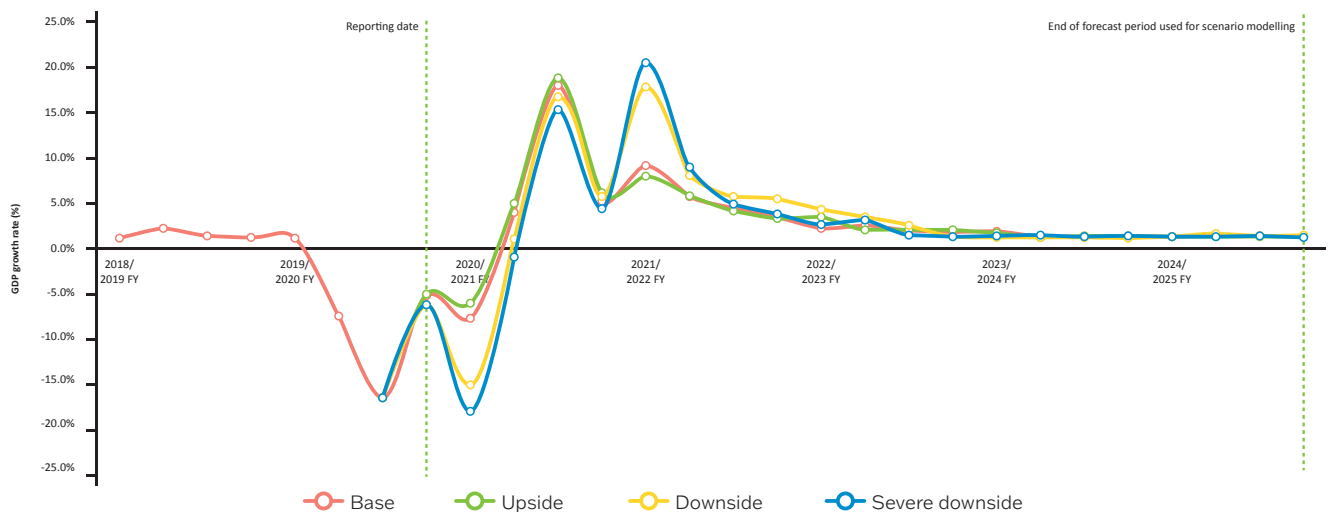
Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be consistent.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies.

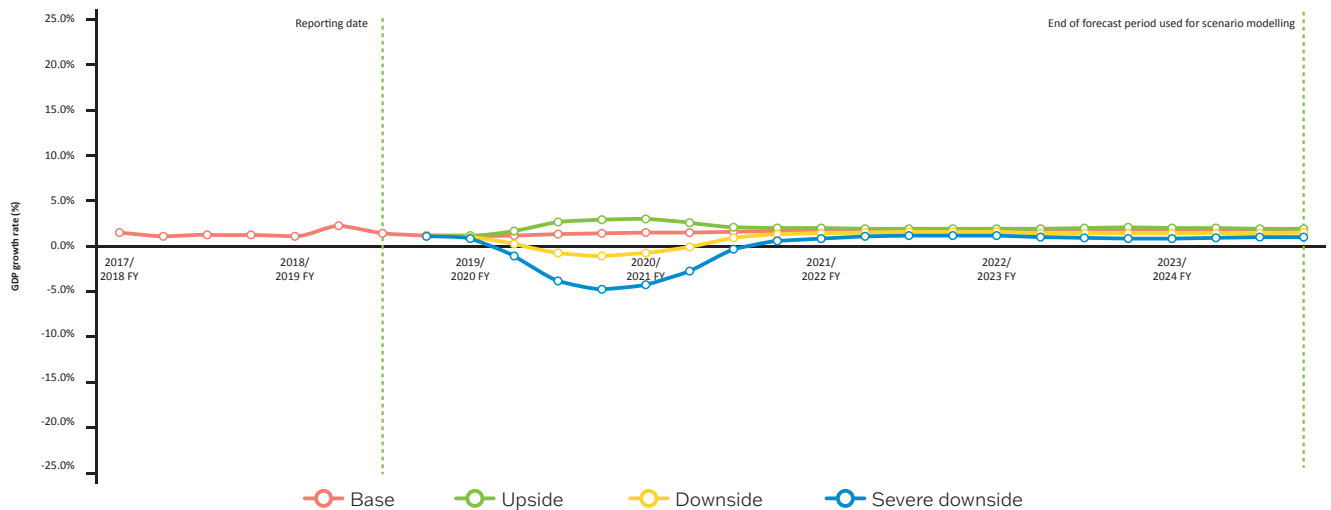
The four economic scenarios comprise a base case, which will normally carry the highest scenario weighting, an upside case, a downside and a severe downside, the latter typically being benchmarked to be at least as severe as scenarios provided by the Bank of England for stress testing purposes. For the 2020 year end, each of the Group's scenarios represents a differing level of impact of the pandemic on the economy and different timings of recovery. They have been reviewed against emerging economic data and updated external forecasts reflecting the most recent information available, including the impact of the UK's second lockdown. The approach utilises data and forecasts from both economic advisers and from public sources, such as Bank of England statements and projections.

The overall shape of the scenarios adopted, and the change in the forecasts year-on-year is illustrated by the forecasts of annual GDP growth rates set out in the charts below.

Historical and forecast GDP quarterly year-on-year growth rates - As at 30 September 2020



Historical and forecast GDP quarterly year-on-year growth rates - As at 30 September 2019



The fundamental rebasing of the Group's scenarios in the year, resulting from the impact of the Covid-19 pandemic, means that it is not useful to discuss detailed changes in the scenarios year-on-year.

The Group revised its weightings at the time of the half-year accounts. Whilst the base case represents the highest individually weighted scenario at 40%, the combined downside and severe downside cases carry a combined 50% weighting, reflecting the scale of uncertainty and potentially adverse economic impact from Covid-19.

It should be noted that 'Severe Downside' in the Covid-19 scenarios is based on a potential outcome and is less severe than that used at 30 September 2019 which was based on the PRA 'once in 200-year' stress test. Therefore, the 2020 scenario carries a higher probability.

The weightings attached to each scenario are set out below:

	2020	2019
Central Scenario	40%	40%
Upside Scenario	10%	20%
Downside Scenario	35%	35%
Severe Scenario	15%	5%
	100%	100%

The economic variables comprising each scenario, and their projected average rates of increase (or decrease) in each of the first five years of the forecast period are set out below.

30 September 2020

Gross Domestic Product ('GDP') (year-on-year change)

	2021	2022	2023	2024	2025
Central Scenario	4.9%	5.7%	2.2%	1.5%	1.4%
Upside Scenario	6.0%	5.4%	2.4%	1.5%	1.5%
Downside Scenario	2.1%	9.3%	2.9%	1.3%	1.5%
Severe Scenario	0.2%	9.5%	2.2%	1.4%	1.3%

House Price Index ('HPI') (year-on-year change)

	2021	2022	2023	2024	2025
Central Scenario	(0.8)%	0.3%	4.0%	4.0%	3.8%
Upside Scenario	1.3%	1.3%	3.0%	3.3%	3.8%
Downside Scenario	(3.5)%	(7.0)%	(0.1)%	3.8%	3.8%
Severe Scenario	(11.8)%	(13.8)%	(5.3)%	1.5%	3.8%

Bank Base Rate ('BBR') (rate)

	2021	2022	2023	2024	2025
Central Scenario	0.1%	0.1%	0.4%	0.8%	0.8%
Upside Scenario	0.1%	0.4%	0.7%	0.9%	1.0%
Downside Scenario	0.1%	0.1%	0.1%	0.3%	0.8%
Severe Scenario	0.0%	(0.2)%	0.1%	0.2%	0.6%

Consumer Price Inflation ('CPI') (rate)

	2021	2022	2023	2024	2025
Central Scenario	0.9%	1.7%	2.2%	2.1%	2.1%
Upside Scenario	1.2%	2.1%	2.1%	2.2%	2.1%
Downside Scenario	0.7%	1.3%	1.8%	2.1%	2.0%
Severe Scenario	(0.1)%	0.7%	1.5%	2.0%	2.0%

Unemployment (rate)

	2021	2022	2023	2024	2025
Central Scenario	7.1%	5.3%	5.0%	5.0%	4.4%
Upside Scenario	6.3%	4.8%	4.6%	4.5%	4.1%
Downside Scenario	8.2%	6.5%	5.7%	5.0%	4.8%
Severe Scenario	8.5%	7.8%	7.0%	6.3%	5.5%

Secured lending (annual change)

	2021	2022	2023	2024	2025
Central Scenario	3.6%	3.7%	3.8%	3.9%	3.9%
Upside Scenario	4.7%	4.5%	4.2%	4.1%	4.0%
Downside Scenario	1.8%	2.3%	3.2%	3.7%	3.8%
Severe Scenario	(0.9)%	0.2%	2.3%	3.4%	3.7%

Consumer credit (annual change)

	2021	2022	2023	2024	2025
Central Scenario	6.0%	6.1%	6.1%	6.3%	6.3%
Upside Scenario	8.7%	8.2%	7.3%	6.9%	6.7%
Downside Scenario	1.8%	2.8%	4.3%	5.4%	5.7%
Severe Scenario	(4.6)%	(2.3)%	1.6%	4.0%	4.8%

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Gross Domestic Product ('GDP') (year-on-year change)

	2020	2021	2022	2023	2024
Central Scenario	1.3%	1.7%	1.8%	1.5%	1.9%
Upside Scenario	2.2%	2.5%	2.0%	1.5%	2.1%
Downside Scenario	(0.1)%	0.4%	1.6%	1.3%	1.5%
Severe Scenario	(2.1)%	(1.6)%	1.2%	1.4%	1.0%

House Price Index ('HPI') (year-on-year change)

	2020	2021	2022	2023	2024
Central Scenario	1.3%	2.9%	4.0%	4.2%	4.3%
Upside Scenario	2.9%	7.4%	8.6%	4.6%	4.0%
Downside Scenario	(1.3)%	(4.4)%	(3.4)%	3.6%	4.8%
Severe Scenario	(5.2)%	(15.4)%	(14.4)%	2.7%	5.5%

Bank Base Rate ('BBR') (rate)

	2020	2021	2022	2023	2024
Central Scenario	0.8%	0.8%	0.8%	0.8%	0.8%
Upside Scenario	1.0%	1.5%	2.0%	2.4%	2.5%
Downside Scenario	0.5%	0.5%	0.5%	0.5%	0.5%
Severe Scenario	0.0%	0.0%	0.0%	0.0%	0.0%

Consumer Price Inflation ('CPI') (rate)

	2020	2021	2022	2023	2024
Central Scenario	2.1%	2.1%	2.1%	2.1%	2.1%
Upside Scenario	2.0%	1.5%	1.6%	2.0%	2.2%
Downside Scenario	2.3%	3.1%	2.9%	2.1%	2.1%
Severe Scenario	2.5%	4.6%	4.1%	2.2%	2.1%

Unemployment (rate)

	2020	2021	2022	2023	2024
Central Scenario	4.9%	4.0%	3.9%	3.9%	3.8%
Upside Scenario	3.6%	3.5%	3.5%	3.5%	3.5%
Downside Scenario	4.9%	6.1%	5.9%	5.6%	5.3%
Severe Scenario	6.4%	9.2%	8.8%	8.2%	7.5%

Secured lending (annual change)

	2020	2021	2022	2023	2024
Central Scenario	3.3%	3.6%	3.7%	3.8%	3.9%
Upside Scenario	3.6%	4.7%	4.5%	4.2%	4.0%
Downside Scenario	2.8%	1.8%	2.3%	3.2%	3.7%
Severe Scenario	1.9%	(0.9)%	0.2%	2.3%	3.4%

Consumer credit (annual change)

	2020	2021	2022	2023	2024
Central Scenario	6.0%	6.0%	6.1%	6.1%	6.3%
Upside Scenario	6.9%	8.7%	8.2%	7.3%	6.9%
Downside Scenario	4.8%	1.8%	2.8%	4.3%	5.4%
Severe Scenario	(2.9)%	(4.6)%	(2.3)%	1.6%	4.0%

After the end of the initial five year period, the final rate or rate of change (as appropriate) is assumed to continue into the future in each scenario.

To illustrate the levels of non-linearity in the various scenarios, the maximum and minimum quarterly levels for each variable over the five year period are set out below.

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	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	18.0	(7.6)	18.8	(5.9)	17.8	(15.1)	20.5	(17.9)
HPI	5.0	(4.0)	4.0	0.0	4.0	(10.0)	4.0	(20.0)
BBR	0.8	0.1	1.0	0.1	1.0	0.1	0.8	(0.4)
CPI	2.4	0.6	2.3	0.7	2.3	0.2	2.3	(0.3)
Unemployment	7.6	4.0	7.0	4.0	9.0	4.5	9.0	5.3
Secured lending	3.9	3.5	4.8	4.0	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

30 September 2019

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	1.9	1.2	3.1	1.2	1.6	(1.0)	1.3	(4.7)
HPI	4.3	0.7	9.7	0.9	4.9	(4.7)	5.7	(17.8)
BBR	0.8	0.8	2.5	0.8	0.5	0.5	0.0	0.0
CPI	2.2	2.0	2.2	1.4	3.2	2.0	4.9	2.0
Unemployment	4.1	3.8	3.9	3.5	6.1	4.2	9.2	4.5
Secured lending	3.9	3.2	4.8	3.3	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.2	6.0	1.5	5.9	(5.2)

The asymmetry in the models is demonstrated by comparing the calculated impairment provision with that which would have been produced using the Central scenario alone, 100% weighted.

	2020	2019
	£m	£m
Calculated provision	81.8	41.9
100% weighted central scenario	67.4	37.7
Effect of multiple economic scenarios	14.4	4.2

(f) Sensitivity

The calculation of impairment provision under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

Economic conditions

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provision which would be calculated if each of the economic scenarios were 100% weighted would be:

Scenarios	2020	
	Provision £m	Difference £m
Central	67.4	(14.4)
Upside	58.0	(23.8)
Downside	82.4	0.6
Severe downside	134.3	52.5

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging. However due to the significant impact of post model stage adjustments, the effect on the PD SICR test of 100% weighting has not been taken into account above.

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £53.3m would transfer from Stage 1 to Stage 2 (2019: £25.8m), and the total provision would increase by £1.6m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (2019: £0.6m).

Value of security

The principal assumptions impacting on loss given default are the estimated security values. If the rate of growth in house prices assumed by the model after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £5.9m.

At 30 September 2019, if the rate of growth in house prices assumed by the model were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £5.5m.

As the house price index is not predicted to increase consistently from 30 September 2020, the sensitivity calculation at 30 September 2019 cannot be repeated exactly.

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.8m (2019: £0.7m).

20. Derivative financial instruments and hedge accounting

Introduction

The Group uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 56 to 59) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

Hedge accounting is applied where appropriate, though some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, particularly where the hedged risk relates to an off balance sheet item. In other cases, hedge accounting has not been adopted either because natural accounting offsets are expected or because complying with the IAS 39 hedge accounting rules would be particularly onerous.

The Group's hedging arrangements can be analysed between:

- Fair value hedges of portfolio interest rate risk, which are used to manage the interest rate risk inherent in fixed rate lending and deposit taking.
- Cash flow hedges, which are used to manage the foreign exchange and interest rate risk inherent in its currency borrowings.

An economic hedge of interest rate risk in fixed rate lending will also address pipeline exposures, where future lending at a given fixed rate is anticipated. However, such arrangements do not qualify as hedges for accounting purposes.

In addition, the Group utilises currency derivatives to hedge its exposure on the small amount of its lending denominated in foreign currencies.

The analysis below splits derivatives between those accounted for within portfolio fair value hedges, or as cash flow hedges and those which, despite representing an economic hedge, are not accounted for as hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2020 or the preceding year.

	2020	2020	2019	2019
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Derivatives in hedge accounting relationships				
<i>Fair value hedges</i>				
Interest rate swaps				
Fixed to floating	-	(130.0)	0.2	(78.3)
Floating to fixed	14.4	-	7.6	(0.2)
	14.4	(130.0)	7.8	(78.5)
<i>Cash flow hedges</i>				
Cross-currency basis swaps				
Dollar-sterling	213.2	-	274.6	-
Euro-sterling	232.1	-	308.1	-
	445.3	-	582.7	-
Total derivatives in hedge accounting relationships	459.7	(130.0)	590.5	(78.5)
Other derivatives				
Interest rate swaps	3.4	(2.4)	1.9	(2.0)
Currency futures	0.2	-	-	-
Total recognised derivative assets/(liabilities)	463.3	(132.4)	592.4	(80.5)

The credit risk inherent in the derivative financial assets shown above is discussed in note 56.

(a) Fair value hedges

Background and hedging objectives

The Group's fair value hedges of portfolios of interest rate risk ('macro hedges') arise from its management of the interest rate risk inherent in its fixed rate lending and deposit taking activities. These activities would expose the Group to movement in market interest rates if not hedged.

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings, as in the Group's securitisation transactions, but may also arise where retail deposit funding is used. Where possible the Group takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing or duration risk and is controlled within limits under the Group's interest rate risk management process, described in note 58. In order to manage these exposures, they are hedged with financial derivatives and form part of the Group's portfolio hedging arrangements. Duration risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural interest rate risk management has been delegated by the Board to the Executive Risk Committee ('ERC') and by ERC to the Assets and Liabilities Committee ('ALCO'). A hedging strategy is developed for each fixed product considering behavioural characteristics, such as whether a customer is likely to prepay before contractual maturity. This is reviewed from time to time with any changes agreed with ALCO.

In order to manage potential exposure to changes in interest rates between the point at which fixed rate products are priced and the advance date, it may be necessary to undertake hedging of assets in the pipeline. Interest rate swaps used to hedge pipeline loan exposures, which are not yet recognised on the balance sheet, can cause unmatched fair value costs or credits to arise until both sides of the hedge can be recognised within the interest rate portfolio hedging arrangement, generally a few months after the inception of the derivative contract.

In managing interest rate exposure, Treasury may use interest rate swaps, forward rate agreements, swaptions or interest rate caps and floors. However, interest rate swaps are the most generally used instruments.

This policy creates two macro hedges:

- The 'loan hedge' matching fixed rate buy-to-let mortgage assets, or other fixed rate assets, with interest rate swaps to convert the interest receivable to a floating rate; and
- The 'deposit hedge' matching fixed rate deposits with interest rate swaps which operates in the opposite direction, converting the fixed rate interest payable to floating rate amounts.

The Group is in the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA and all new interest rate swap agreements since 1 February 2020 have referenced SONIA.

This means that each of these macro hedges can be divided into two sections, one referencing LIBOR and one SONIA. Through the year, as assets and deposits matured and were replaced by new business, the LIBOR-linked element of the hedges reduced, and the SONIA-linked element increased.

All new interest rate hedging arrangements for fixed rate assets or liabilities are executed with SONIA as a reference rate. In addition, hedging related to fixed rate assets funded in the most recent securitisation transactions, PM 26 and PM 27, where the funding rate is SONIA-linked, was also undertaken with reference to SONIA.

During the year the Group also began hedging interest rate risk on fixed rate CBILS and BBLS exposures using SONIA-linked basis guarantee swaps, which are included in the loan hedge.

There remains a back book of swaps referencing three-month LIBOR, which is currently running off as the instruments reach maturity. Certain of these swaps have a maturity after December 2021, when LIBOR is expected to become unavailable and the Group is closely following emerging market practice for the treatment of such contracts. The International Swaps and Derivative Association ('ISDA'), the trade organisation for derivatives, have released a protocol which incorporates fallback provisions to facilitate transition to SONIA when LIBOR ceases or if it is deemed unrepresentative by the FCA. The Group expects to adhere to transition in accordance with the protocol by December 2020.

The designation of the two macro hedges is updated, on a month by month basis, using software which compares the overall tenor, value and rate positions to match the expected fair value movement of the swaps with the expected interest rate risk related movement in the fair value of the relevant assets or liabilities over the designation period as closely as possible. The software applies regression analysis techniques to the potential impact of changes in expected interest rates over the designation period to maximise expected hedge effectiveness on a prospective basis. The value of the portfolio of loans or deposits selected is then designated, as a monetary amount of interest rate risk, as the hedged item, while the portfolio of swaps selected are designated as the hedging instruments.

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships.

At the end of each designation period the Group will assess the effectiveness of each hedge retrospectively, based on fair value movements (relating to interest rate risk components only) which have occurred in the period. Movements are compared to pre-determined test thresholds using regression techniques to determine whether the hedge was effective in the period.

Ineffectiveness

The Group has identified the following possible sources of hedge ineffectiveness in its portfolio hedges of interest rate risk:

- The maturity profile of the hedging instruments may not exactly match that of the hedged items, particularly where hedged items settle early.
- The use of derivatives as a hedge of interest rate risk additionally exposes the Group to the derivative counterparties' credit risk, which is not matched in the hedged item. This risk is minimised by transacting only with high quality counterparties and through collateralisation arrangements (as described in note 56).
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments.
- Difference in the timing of interest payments on the hedged items and settlements on the hedging instruments.

These sources of ineffectiveness are minimised by the portfolio matching process, which seeks to match the terms of the items as closely as possible.

In addition to the hedging ineffectiveness described above, group profit will also be affected by the fair value movements of interest rate swap agreements which were entered into as part of the Group's interest rate risk hedging strategy but failed to find a match in the hedging portfolio.

Hedging Instruments

The hedging portfolios at 30 September 2020 and 30 September 2019 consist of a large number of sterling denominated swaps. In addition, at 30 September 2020 there were a small number of balance guarantee swaps ('BGS') in place. Settlement on all swaps is generally quarterly (monthly for BGS) where:

- One payment is calculated based on a fixed rate of interest and the nominal value of the swap.
- An opposite payment is calculated based on the same nominal value but using a floating interest rate set at a fixed margin over a reference rate, LIBOR or SONIA.

On the BGS the nominal value of the swap is linked to the principal value of a pool of assets and reduces in line with redemptions and repayments until maturity. Other interest rate swaps have a fixed nominal value throughout their lives.

The Group pays fixed rate and receives floating when hedging exposures from fixed rate assets (in the loan hedge). Conversely, the Group pays floating rate and receives fixed rate when hedging fixed rate deposits, in the deposit hedge.

The principal terms of the hedging instruments are set out below, analysed between the two directions of the swap.

	2020		2019	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
Average fixed notional interest rate	0.42%	0.91%	0.83%	1.04%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	1,147.5	3,968.8	1,619.0	4,304.5
SONIA BGS	-	25.2	-	-
Other SONIA swaps	1,043.0	1,317.3	-	486.8
	2,190.5	5,311.3	1,619.0	4,791.3
Maturing				
Within one year	1,287.5	531.5	805.5	465.4
Between one and two years	669.0	1,012.1	449.5	595.2
Between two and five years	234.0	3,731.0	364.0	3,554.7
More than five years	-	36.7	-	176.0
	2,190.5	5,311.3	1,619.0	4,791.3
Fair value	14.3	(129.9)	7.5	(78.2)

The value included above for BGS are analysed by their contractual maturity dates although, due to the terms of the instruments, it is likely that the balance outstanding will reduce more quickly.

The increased levels of hedging shown above arise from the growth in both the loan and deposit books. The changes in fair value are a result of moves in market implied interest rates compared to the rates on the fixed legs of the swaps.

Accounting impacts

Movements affecting the portfolio fair value hedges during the year are set out below.

	2020		2019	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
	£m	£m	£m	£m
Hedging instruments				
<i>Interest rate swaps</i>				
Included in derivative financial assets	14.3	-	7.6	0.2
Included in derivative financial liabilities	-	(129.9)	(0.1)	(78.4)
	14.3	(129.9)	7.5	(78.2)
Notional principal value	2,190.5	5,311.3	1,619.0	4,791.3
Change in fair value used in calculating hedge ineffectiveness	6.6	(48.1)	7.9	(98.5)
	2020		2019	
	Deposit Hedge	Loan Hedge	Deposit Hedge	Loan Hedge
	£m	£m	£m	£m
Hedged items				
<i>Fixed rate deposits</i>				
Monetary amount of risk relating to Retail Deposits	2,083.9	-	1,473.7	-
<i>Fixed rate loans</i>				
Monetary amount of risk relating to Loans to Customers	-	5,353.4	-	4,834.8
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 16 and 28)*	(10.4)	109.7	(3.9)	64.2
Of which: amounts related to discontinued hedging relationships being amortised	-	(11.6)	-	(8.8)
Change in fair value used in recognising hedge ineffectiveness	(6.4)	48.2	(8.1)	92.2
Hedge ineffectiveness recognised				
Included in fair value (losses) / gains in the profit and loss account	0.2	0.1	(0.2)	(6.3)

* Under the IAS 39 rules relating to fair value hedge accounting for portfolios of interest rate risk, the change in the fair value of the hedged items attributable to the hedged risk is shown as 'fair value adjustments from portfolio hedging' next to the carrying value of the hedged assets or liabilities in the appropriate note.

(b) Cash flow hedging

Background and hedging objectives

The Group has entered into cross-currency basis swap agreements which form part of its securitisation arrangements, providing an economic hedge against financial risks inherent in the deal structures, as described below. Such relationships have been designated as cash flow hedges for accounting purposes.

In any securitisation where asset backed floating rate notes ('FRNs') are issued in currency (US dollars or euros), a currency and interest rate mismatch between assets and liabilities would exist, exposing the securitisation and the Group to both foreign exchange and interest basis risk.

This would preclude such a deal from attaining a AAA rating for its senior debt. To address that issue, in each deal a bespoke cross-currency basis swap was written, with the swap being an asset or liability of the relevant SPV company.

The effect of these swaps is to translate the required currency payments, both principal and interest to sterling payments, based on a fixed rate of exchange. They also translate the reference rate of interest on the notes from a dollar LIBOR or EURIBOR basis to a sterling LIBOR basis. This effectively eliminates the foreign exchange and interest rate basis risks with respect to these instruments.

In order to achieve a AAA rating for the deal, the swaps must themselves be capable of this level of rating. Therefore, the deal conditions specify that only high quality counterparties may be used, and that where there is deterioration in credit quality of the counterparty, collateral must be posted. The collateral requirement is supervised by the independent third-party rating agencies.

These arrangements will be affected by the withdrawal or amendment of IBOR rates (sterling LIBOR, US dollar LIBOR and EURIBOR). While sterling LIBOR is to be retired any changes to other rates may not be parallel or take place at the same time. The Group expects a common solution to be developed across securitisation issuers in conjunction with other market participants and expects this to be implemented in the coming financial year.

Hedging instruments

Under these swap agreements

- The Group will make quarterly payments of principal and floating rate interest in sterling and receive equivalent amounts of principal and floating rate interest, in currency (either US dollars or euros), translated at an exchange rate fixed on inception
- Settlement of both the cross-currency basis swaps and the notes to which they relate takes place on the same date. The Group makes a single payment in sterling to the swap provider who will make the corresponding swap payment in currency to the external principal paying agent. The principal paying agent will use these funds immediately to make the payments required on the currency notes
- The nominal amount of the swaps is adjusted automatically, quarter by quarter, such that it always amortises in line with the quarterly payments of principal made on the currency notes (a 'balance guarantee' feature)
- Floating rate interest on the sterling (pay) leg of the swaps is set with reference to three-month sterling LIBOR, with floating rate interest on the currency (receive) legs set by reference to equivalent currency rates
- The payment and repricing dates are the same (to the day) for the swaps as for their underlying notes
- The swaps must remain in place for as long as the notes are outstanding

The principal terms of the hedging instruments (the cross-currency basis swaps) are summarised below.

	2020		2019	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Average fixed exchange rate	2.0	1.5	2.0	1.5
Average margin over LIBOR on interest payable	0.23%	0.48%	0.24%	0.49%
Average margin over US dollar LIBOR / EURIBOR on interest receivable	0.19%	0.54%	0.19%	0.52%
Notional principal value (£m)	397.0	687.5	447.5	1,007.4
Fair value (£m)	213.2	232.1	274.6	308.1
Average remaining term (years)	20	21	21	22

Although the average remaining contractual term is as shown above, the link between the notional principal of the swaps and the balance outstanding on the notes means that the life may, in practice, be much shorter.

The absolute value of these swaps is relatively large as the majority of the instruments date from before the 2008 credit crisis, when a major dislocation in rates occurred, creating significant market value in the instruments. However, economically, this is offset by the corresponding increase in the carrying value of the currency denominated notes. Legacy assets, those with inception dates in 2008 or earlier, account for £445.3m of the cross-currency basis swap balance at 30 September 2020 (2019: £582.1m), with post-2010 assets representing £nil (2019: £0.6m).

The decrease in notional principal related to note repayments in the period, with no new currency-denominated notes issued in the year.

Sources of potential ineffectiveness

All cross-currency basis swap agreements have been designated as cash flow hedges in line with their economic effect and the critical terms, such as interest and exchange rates, pricing dates and principal balances of the designated hedging instruments exactly match those of the hedged currency denominated FRNs. This results in a critical terms match for IAS 39 purposes and hence no ineffectiveness could arise from sources other than credit risk.

In respect of credit risk, the hedging instruments may be partially collateralised, depending on the rating of the counterparties from time to time. Additional collateral is conditionally available, as described in note 56, under the terms of the instruments. This generates a small potential credit valuation adjustment associated with the derivative asset representing the credit risk of the receivable future cash flows that make up the derivative fair value. However, IAS 39 requires that Other Comprehensive Income ('OCI') is adjusted by the lower of the cumulative gain or loss on the derivative or the hedged item (as proxied by a hypothetical derivative). As the derivative bears credit risk of the counterparty (for the uncollateralised portion) it has a lower fair value than the hypothetical derivative. The result is that the full fair value of the derivative is taken to OCI as it is the lower of the two amounts and no ineffectiveness arises.

Accounting impacts

Movements affecting the cash flow hedge relationships in the year are set out below.

	2020		2019	
	Swap currency		Swap currency	
	USD £m	EUR £m	USD £m	EUR £m
Hedging Instruments				
<i>Cross-currency basis swaps</i>				
Included in derivative financial assets	213.2	232.1	274.6	308.1
Included in derivative financial liabilities	-	-	-	-
	213.2	232.1	274.6	308.1
Notional principal value	397.0	687.5	447.5	1,007.4
Change in fair value used in calculating hedge ineffectiveness	(29.5)	(42.6)	71.3	(21.2)
Hedged Items				
<i>Floating rate notes</i>				
Included in Asset Backed Loan Notes	397.0	687.5	447.5	1,007.4
Changes in fair value used in calculating hedge ineffectiveness	(29.5)	(42.6)	71.3	(21.2)
Cash flow hedging reserve before tax	0.7	2.3	0.8	2.8

The table below summarises the amounts which have affected total comprehensive income as a result of the cash flow hedges described above.

	2020 £m	2019 £m
Change of value in hedging instrument recognised in cash flow hedge reserve		
US dollar swaps	(29.5)	71.3
Euro swaps	(42.6)	(21.2)
	(72.1)	50.1
Amount reclassified from cash flow hedge reserve to profit, recognised as foreign exchange differences and interest on asset backed loan notes, both included within interest payable		
US dollar swaps	(29.0)	71.1
Euro swaps	(42.5)	(21.5)
	(71.5)	49.6
Net amount recognised in Other Comprehensive Income before tax	(0.6)	0.5

All amounts reclassified to profit in the financial year have been transferred because the hedged item has affected profit or loss. In the year ended 30 September 2019 amounts were additionally reclassified to profit on the derecognition of the PM12 FRNs (note 7).

(c) Derivatives not in a hedge accounting relationship

The Group's other derivatives comprise:

- Interest rate swaps which are economically part of the Group's portfolio hedging arrangements but failed to find a match in the hedge designation, including swaps hedging interest rate risk on the new lending pipeline
- Currency futures, economically hedging exposures on lending denominated in currency, where hedge accounting has not been adopted due to the size of the exposure

The principal terms of these derivatives are set out below.

Interest rate swaps

	2020		2019	
	Pay fixed	Pay floating	Pay fixed	Pay floating
Average fixed notional interest rate	0.28%	0.23%	0.75%	0.77%
Average notional margin over LIBOR	-	-	-	-
Average notional margin over SONIA	-	-	-	-
	£m	£m	£m	£m
Notional principal value				
LIBOR swaps	145.7	237.0	315.4	554.0
SONIA BGS	422.0	698.0	-	8.0
	567.7	935.0	315.4	562.0
Maturing				
Within one year	128.1	715.0	68.4	424.0
Between one and two years	60.6	47.0	43.5	95.0
Between two and five years	182.0	173.0	92.5	43.0
More than five years	197.0	-	111.0	-
	567.7	935.0	315.4	562.0
Fair value	3.4	(2.4)	1.9	(2.0)

Currency futures

	2020	2019
<i>US dollar futures</i>		
Average future exchange rate	1.27	1.22
	£m	£m
Notional principal value	14.1	5.7
Maturing		
Within one year	14.1	5.7
Between one and two years	-	-
Between two and five years	-	-
	14.1	5.7
Fair value	0.2	-

21. Sundry assets

(a) The Group

	<i>Note</i>	2020	2019	2018
		£m	£m	£m
Current assets				
Accrued interest income		0.1	0.4	0.6
Trade receivables		3.2	3.6	2.2
CSA assets		103.5	72.2	3.8
CRDs		15.1	11.4	6.2
Sovereign receivables		0.2	-	-
Other receivables		3.2	2.7	2.5
Sundry financial assets	65	125.3	90.3	15.3
Prepayments		2.7	2.1	2.6
Other tax		-	0.4	1.1
		128.0	92.8	19.0

Cash ratio deposits ('CRDs') are non-interest-bearing deposits lodged with the Bank of England, based on the value of the Bank's eligible liabilities. These are required to comply with regulatory rules.

Credit Support Annex ('CSA') assets are deposits placed with highly rated banks to act as security for the Group's derivative financial liabilities.

Neither of these balances is accessible by the Group at the balance sheet date. Therefore, they are included in sundry assets rather than cash balances.

Sovereign receivables includes amounts receivable from the UK Government under the CBILS and BBLS schemes.

CRDs, CSA assets, sovereign receivables and accrued interest are considered to be Stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the UK Government, Bank of England and major banks) have been assessed and are considered to be so low as to require no significant impairment provision.

(b) The Company

	2020	2019	2018
	£m	£m	£m
Current assets			
Amounts owed by Group companies	84.0	106.6	216.3
Accrued interest income	0.6	0.7	0.7
	84.6	107.3	217.0

The amounts owed to the Company by other Group entities are considered to be Stage 1 balances for IFRS 9 impairment purposes. The probability of default of the subsidiaries has been assessed in the context of the Group's overall funding and asset position, and is considered to be so low as to require no significant impairment provision.

22. Current tax assets / liabilities

Current tax in the Group and the Company represents UK corporation tax owed or recoverable.

23. Deferred tax

(a) The Group

The movements in the net deferred tax asset / (liability) are as follows:

	Note	2020 £m	2019 £m	2018 £m
Opening net asset / (liability)				
As previously reported		6.2	(5.6)	(4.8)
Change of accounting policy	61	-	5.0	-
Restated		6.2	(0.6)	(4.8)
Derecognition	7	-	1.8	-
Acquisitions		-	0.5	(0.3)
Income statement (charge)/credit	12	(1.1)	2.3	1.2
Credit to equity		1.1	2.2	(1.7)
Closing net asset / (liability)		6.2	6.2	(5.6)

The net deferred tax asset for which provision has been made is analysed as follows:

	2020 £m	2019 £m	2018 £m
Accelerated tax depreciation	2.9	2.3	4.1
Retirement benefit obligations	6.7	5.9	3.7
Temporary differences on loans to customers	(3.8)	(5.3)	(14.0)
Tax losses	1.3	0.4	0.2
Other timing differences	(0.9)	2.9	0.4
Net deferred tax asset / (liability)	6.2	6.2	(5.6)

As stated in note 12, legislation in the year has reversed the expected reduction in the standard rate of UK tax to 17.0% which had already been accounted for. This change has been reflected in the deferred tax balance. The temporary differences shown above have been provided at the rate prevailing when the Group anticipates these temporary differences to reverse. In the event that the temporary differences actually reverse in different periods a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Group's control (eg the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (eg the level of redemptions of finance leases).

If temporary differences reverse within Paragon Bank PLC in a period in which it is subject to the banking surcharge, then the impact of the reversal will be at an effective tax rate that includes the banking surcharge to some extent.

In addition to the temporary differences, the Group has tax losses of £2.3m (2019: £2.3m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

The movements in the net deferred tax liability are as follows:

	2020 £m	2019 £m	2018 £m
Opening net liability	1.6	1.8	1.8
Income statement charge / (credit)	0.2	(0.2)	-
Closing net liability	1.8	1.6	1.8

The net deferred tax liability for which provision has been made is analysed as follows:

	2020	2019	2018
	£m	£m	£m
Other timing differences	1.8	1.6	1.8
Net deferred tax liability	1.8	1.6	1.8

24. Property, plant and equipment

(a) The Group

	Leased assets	Land and buildings	Plant and machinery	Total
	£m	£m	£m	£m
Cost				
At 30 September 2018	46.4	22.8	10.7	79.9
Additions	11.6	-	1.1	12.7
Disposals	(5.3)	-	(1.2)	(6.5)
At 30 September 2019	52.7	22.8	10.6	86.1
Adoption of IFRS 16 (note 61)	-	6.0	1.0	7.0
Additions	12.9	0.7	1.5	15.1
Disposals	(7.5)	-	(0.6)	(8.1)
At 30 September 2020	58.1	29.5	12.5	100.1
Accumulated depreciation				
At 30 September 2018	11.0	3.6	8.5	23.1
Charge for the year	7.6	0.5	1.0	9.1
On disposals	(2.2)	-	(1.2)	(3.4)
At 30 September 2019	16.4	4.1	8.3	28.8
Charge for the year	8.3	1.8	1.7	11.8
On disposals	(6.1)	-	(0.5)	(6.6)
At 30 September 2020	18.6	5.9	9.5	34.0
Net book value				
At 30 September 2020	39.5	23.6	3.0	66.1
At 30 September 2019	36.3	18.7	2.3	57.3
At 30 September 2018	35.4	19.2	2.2	56.8

Land and buildings and plant and machinery shown above are used within the Group's business. Leased assets includes £27.0m in respect of assets leased under operating leases (2019: £25.6m) and £12.5m of assets available for hire (2019: £10.7m).

The carrying values of right of use of assets, in respect of leases where the Group is the lessee, included in property, plant and equipment are set out below.

	Land and buildings £m	Plant and machinery £m	Total £m
Cost			
At 30 September 2019	-	-	-
Adoption of IFRS 16 (note 61)	6.0	1.0	7.0
Additions	-	0.3	0.3
Disposals		(0.1)	(0.1)
At 30 September 2020	6.0	1.2	7.2
Accumulated depreciation			
At 30 September 2019	-	-	-
Charge for the year	1.4	0.6	2.0
On disposals	-	(0.1)	(0.1)
At 30 September 2020	1.4	0.5	1.9
Net book value			
At 30 September 2020	4.6	0.7	5.3
At 30 September 2019	-	-	-

During the year ended 30 September 2018, the Group entered into a transaction with the Paragon Pension Plan, effectively granting a first charge over its freehold head office building as security for its agreed contributions under the recovery plan. The carrying value of the assets subject to this charge was £17.7m (2019: £18.0m).

(b) The Company

The property, plant and equipment balance of the Company represents a right of use asset in respect of a building leased from a fellow Group entity. The carrying value of this asset is set out below.

	Land and buildings £m
Cost	
At 30 September 2019	-
Adoption of IFRS 16 (note 61)	18.8
Additions	-
Disposals	-
At 30 September 2020	18.8
Accumulated depreciation	
At 30 September 2019	-
Charge for the year	1.4
On disposals	-
At 30 September 2020	1.4
Net book value	
At 30 September 2020	17.4
At 30 September 2019	-

25. Intangible assets

	Goodwill (note 26)	Computer software	Other intangible assets	Total
	£m	£m	£m	£m
Cost				
At 30 September 2018	168.2	9.4	10.6	188.2
Acquisitions	2.2	-	-	2.2
Additions	-	2.0	-	2.0
At 30 September 2019	170.4	11.4	10.6	192.4
Acquisitions	-	-	-	-
Additions	-	1.0	-	1.0
At 30 September 2020	170.4	12.4	10.6	193.4
Accumulated amortisation and impairment				
At 30 September 2018	6.0	7.3	5.6	18.9
Amortisation charge for the year	-	1.7	0.7	2.4
At 30 September 2019	6.0	9.0	6.3	21.3
Amortisation charge for the year	-	1.2	0.8	2.0
At 30 September 2020	6.0	10.2	7.1	23.3
Net book value				
At 30 September 2020	164.4	2.2	3.5	170.1
At 30 September 2019	164.4	2.4	4.3	171.1
At 30 September 2018	162.2	2.1	5.0	169.3

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of businesses.

Movements in goodwill in the year ended 30 September 2019 relate to the finalisation of the acquisition accounting for Titlestone described in the accounts for that year.

26. Goodwill

The goodwill carried in the accounts is attributable to three cash generating units ('CGU's), which have not changed in the year. The balance is as analysed below:

	2020	2019
	£m	£m
CGU		
SME lending	113.0	113.0
Development finance	49.8	49.8
TBMC	1.6	1.6
	164.4	164.4

(a) SME lending

The goodwill carried in the accounts relating to the SME lending (formerly asset finance) CGU was recognised on acquisitions in the years ended 30 September 2016 and 30 September 2018.

An impairment review undertaken at 30 September 2020 indicated that no write down was required.

The recoverable amount of the SME lending CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five-year period. These forecasts reflect the potential ongoing impact of Covid-19 on the business, with overall average growth increased to include the recovery from the Covid-19 low point.

The key assumptions underlying the value in use calculation for the SME lending CGU are:

- Level of business activity, based on management expectations. The forecast assumes a compound annual growth rate ('CAGR') for new business over the five-year period of 19.7%, compared with 12.0% used in the calculation at 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.5% (2019: 1.9%) which does not exceed the long-term average growth rates for the markets in which the business is active

Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 15.0% (2019: 13.2%)

As an illustration of the sensitivity of this impairment test to movements in the key assumptions, the Group has calculated that a 10.0% reduction in profit levels coupled with a 100 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection.

In the testing carried out at 30 September 2019, a 24.0% reduction in profit levels coupled with a 370 basis point increase in the pre-tax discount rate would have that effect.

(b) Development finance

The goodwill carried in the accounts relating to the development finance CGU was first recognised on a business acquisition in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2020 indicated that no write down was required.

The recoverable amount of the development finance CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five-year period. These forecasts include the potential ongoing impact of Covid-19 on the business.

The key assumptions underlying the value in use calculation for the development finance cash generating unit are:

- Level of business activity, based on management expectations. The forecast assumes a CAGR for new commitments over the five-year period of 16.9%, compared with 18.3% used in the calculation at 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.5% (2019: 1.9%) which does not exceed the long-term average growth rate for the UK economy

Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 14.2% (2019: 13.2%)

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the development finance CGU to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2019.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC cash generating unit was recognised on an acquisition in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2020 which indicated no further impairment. The recoverable amount of the TBMC CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 4.41% (2018: 4.74%) and cash flows beyond the five year budget are extrapolated using a 1.6% (2019: 1.6%) growth rate, being the average long-term growth rate in the UK economy over a twenty year period.

The key assumptions underlying the value in use calculation for the TBMC business are:

- Level of business activity, based on management expectations. Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment
- Discount rate, which is based on market rates of interest plus a margin appropriate to the risk profile of the TBMC business as an investment.

The directors believe that no reasonably possible change in any of the key assumptions above would cause the recoverable value of the CGU to fall below its balance sheet carrying value. This was also the case at 30 September 2019.

27. Investment in subsidiary undertakings

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 30 September 2018	770.7	200.0	13.7	984.4
Investments in subsidiaries	-	-	-	-
Capital distributions	(130.0)	-	-	(130.0)
Loans advanced	-	100.0	5.1	105.1
Loans repaid	-	-	-	-
Provision movements	(0.2)	-	(18.6)	(18.8)
At 30 September 2019	640.5	300.0	0.2	940.7
Investments in subsidiaries	-	-	-	-
Capital distributions	(15.6)	-	-	(15.6)
Loans advanced	-	90.0	4.7	94.7
Loans repaid	-	-	-	-
Provision movements	14.7	-	(4.4)	10.3
At 30 September 2020	639.6	390.0	0.5	1,030.1

Investments in subsidiaries represent transactions between the Company and various of its subsidiaries.

During the years ended 30 September 2020 and 30 September 2019, the Group carried out capital reductions in various non-trading subsidiaries. Dividends were paid, or capital was distributed to the parent and the investments above were written off as a result of the reduction in these entities' net assets.

During the year ended 30 September 2020 the Company received £113.9m in dividend income from its subsidiaries (2019: £44.3m) and £18.2m of interest on loans to Group companies (2019: £15.1m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 66.

28. Retail deposits

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits, and notice and easy access accounts. The method of interest calculation on these deposits is analysed as follows:

	2020	2019	2018
	£m	£m	£m
Fixed rate	4,975.9	4,154.4	3,643.1
Variable rates	2,880.7	2,237.5	1,653.5
	7,856.6	6,391.9	5,296.6

The weighted average interest rate on retail deposits at 30 September 2020, analysed by charging method, was:

	2020	2019	2018
	%	%	%
Fixed rate	1.69	2.02	1.94
Variable rates	0.72	1.43	1.36
All deposits	1.34	1.81	1.76

The contractual maturity of these deposits is analysed below.

	2020	2019	2018
	£m	£m	£m
Amounts repayable			
In less than three months	565.0	466.6	256.8
In more than three months, but not more than one year	2,725.6	2,088.4	2,024.7
In more than one year, but not more than two years	1,541.6	1,158.0	1,010.6
In more than two years, but not more than five years	664.8	900.9	655.3
Total term deposits	5,497.0	4,613.9	3,947.4
Repayable on demand	2,359.6	1,778.0	1,349.2
	7,856.6	6,391.9	5,296.6
Fair value adjustments for portfolio hedging (note 20)	10.4	3.9	(4.2)
	7,867.0	6,395.8	5,292.4

29. Asset backed loan notes

The Group's asset backed loan notes ('Notes') are rated and publicly listed and are secured on portfolios comprising variable and fixed rate mortgages. The maturity date of the Notes matches the maturity date of the underlying assets. The Notes can be prepaid in part from time to time, but such prepayments are limited to the net capital received from borrowers in respect of the underlying assets. There is no requirement for the Group to make good any shortfall on the Notes out of general funds. It is likely that a substantial proportion of the Notes will be repaid within five years.

The Group also has an option to repay all of the Notes on any issue at an earlier date (the 'call date'), at their outstanding principal amount.

Interest is payable at a fixed margin above;

- The London Interbank Offered Rate ('LIBOR') on notes denominated in sterling, other than notes issued by Paragon Mortgages (No. 26) PLC and Paragon Mortgages (No. 27) PLC
- The compounded Sterling Overnight Interbank Average Rate ('SONIA') on notes denominated in sterling issued by Paragon Mortgages (No. 26) PLC and Paragon Mortgages (No. 27) PLC
- The Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros
- The London Interbank Offered Rate ('US dollar LIBOR') on notes denominated in US dollars

The IBOR rates, LIBOR, EURIBOR and US dollar LIBOR are intended to be withdrawn and replacement rates will be substituted for the note issues affected in line with market practice.

All payments in respect of the Notes are required to be made in the currency in which they are denominated.

The Group publishes detailed information on the performance of all of its note issues on the Bond Investor Reporting section of its website at www.paragonbankinggroup.co.uk. A more detailed description of the securitisation structure under which these Notes are issued is given in note 57.

On 30 April 2020, a Group company, Paragon Mortgages (No. 27) PLC, issued £735.8m of sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	1.1%	648.3
B	AA	Aa1	1.5%	41.9
C	A	Aa3	1.8%	22.8
D	BBB	Baa1	2.1%	22.8
				735.8

All of the above notes were retained by the Group.

Notes in issue at 30 September 2020 and 30 September 2019, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2020	2019	2020	2019
Sterling notes			£m	£m	%	%
Interest based on LIBOR						
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	-	95.2	-	0.38
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	-	155.7	-	0.52
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	221.1	237.7	0.15	0.15
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	416.4	443.7	0.27	0.27
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	390.0	423.8	0.23	0.23
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	108.5	117.7	0.30	0.30
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	-	34.5	-	1.84
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	-	45.7	-	2.85
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	379.4	423.6	0.72	0.72
First Flexible No. 6 PLC	01/12/35	01/03/08	-	47.7	-	1.27
Interest based on SONIA						
Paragon Mortgages (No. 26) PLC	15/05/45	15/08/24	231.3	364.3	1.05	1.05
Paragon Mortgages (No. 27) PLC†	15/04/47	15/10/25	-	-	-	-
US dollar notes			\$m	\$m	%	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	-	15.5	-	0.36
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	134.6	143.4	0.18	0.18
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	150.7	166.1	0.20	0.20
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	502.1	552.9	0.19	0.19
First Flexible No. 6 PLC	01/12/35	01/03/08	-	7.5	-	0.56
Euro notes			€m	€m	%	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	-	147.7	-	0.56
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	-	247.0	-	0.39
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	182.4	196.1	0.54	0.54
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	268.3	285.9	0.42	0.42
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	317.0	326.4	0.48	0.48
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	244.0	248.9	0.73	0.72
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	-	2.2	-	0.70
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	-	0.6	-	1.10
First Flexible No. 6 PLC	01/12/35	01/03/08	-	26.8	-	1.05

[†] All notes issued by Paragon Mortgages (No. 27) were retained by the Group (see note 57)

The details of the assets backing these securities are given in note 17.

During the year, the Group redeemed all of the outstanding notes of the following securitisations at par:

- Paragon Mortgages (No. 9) PLC on 18 February 2020
- Paragon Mortgages (No. 10) PLC on 15 September 2020
- Paragon Mortgages (No. 23) PLC on 15 October 2019
- Paragon Mortgages (No. 24) PLC on 15 April 2020
- First Flexible No. 6 PLC on 1 September 2020

The underlying assets were subsequently funded by other Group companies.

On 23 September 2020, notice was given of the Group's intention to redeem all of the outstanding notes of Paragon Mortgages (No. 11) PLC at par, and this took place on 15 October 2020, after the year end.

On 23 November 2020, after the end of the year, the Group gave notice of its intention to redeem all of the outstanding notes of Paragon Mortgages (No. 15) PLC at par. This was expected to take place on 15 December 2020.

On 11 November 2020, after the end of the year, a Group company, Paragon Mortgages (No. 28) PLC, issued £703.1m of rated sterling mortgage backed floating rate notes, analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	0.95%	623.8
B	AA	Aa1	1.35%	39.7
C	A	Aa3	1.65%	21.6
D	BBB-	Baa1	1.95%	18.0
				703.1

All of the above notes were retained by the Group.

On 26 June 2019, the Group disposed of its beneficial interest in the Paragon Mortgages (No. 12) PLC securitisation as described in note 7. At that point, the FRN liabilities were derecognised by the Group, although the notes remain in issue. The Group's continuing involvement in the transaction is described in note 46.

30. Bank borrowings

New first mortgage loans may be financed by a secured bank loan, referred to as a 'warehouse facility'. These facilities are drawn on the completion of a mortgage and repayment of the facilities is restricted to the principal cash received in respect of the funded mortgage. Loans originated in warehouse facilities are refinanced in the mortgage backed securitisation market when conditions are appropriate or through internal sales to access retail funding. More information on this process is given in note 57 and details of assets held within the warehouse facilities are given in note 17. Details of the Group's bank borrowings are set out below.

	2020			2019		
	Principal value	Maximum available facility	Carrying value	Principal value	Maximum available facility	Carrying value
	£m	£m	£m	£m	£m	£m
i) Paragon Second Funding	657.8	657.8	657.8	787.5	787.5	787.5
ii) Paragon Seventh Funding	-	400.0	-	-	200.0	-
	657.8	1,057.8	657.8	787.5	987.5	787.5

- i) The Paragon Second Funding warehouse was available for further drawings until 29 February 2008 at which point it converted automatically to a term loan and no further drawings were allowed. This loan is a sterling facility provided to Paragon Second Funding Limited by a consortium of banks and is secured on all the assets of Paragon Second Funding Limited, Paragon Car Finance (1) Limited and Paragon Personal Finance (1) Limited. Its final repayment date is 28 February 2050, but it is likely that substantial repayments will be made within the next five years. Interest on this loan is payable monthly in sterling at 0.675% above LIBOR (2019: 0.675% above LIBOR).
- ii) On 14 November 2018, a £200.0m warehouse funding facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all of the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. This was renewed for 12 months on 24 October 2019 and was increased to £400.0m and renewed for a further 18 months on 25 September 2020. Interest was payable at 0.95% over three month LIBOR up to 25 September 2020 and 1.05% over three month LIBOR thereafter. The renewal also included terms on which the reference rate would be transitioned to SONIA during the commitment period.

The weighted average margin above LIBOR on bank borrowings at 30 September 2020 was 0.675% (2019: 0.675%).

31. Retail bonds

On 11 February 2013 the Company inaugurated a £1,000.0m Euro Medium Term Note Programme under which it may issue retail bonds, or other notes, within a twelve-month period. The prospectus has been updated from time to time, most recently renewing the programme for a further twelve-month period on 15 July 2016, but may be further extended in the future.

The terms of issue for each tranche of notes are separately determined. These bonds are listed on the London Stock Exchange and have a fixed term, but are callable at the option of the Company. A summary of the retail bonds outstanding under this programme, shown with their principal values, is set out below.

Maturity date	Interest terms	Issue price	Currency	2020 £m	2019 £m
5 December 2020	6.000% p.a. fixed	par	GBP	60.0	60.0
30 January 2022	6.125% p.a. fixed	par	GBP	125.0	125.0
28 August 2024	6.000% p.a. fixed	par	GBP	112.5	112.5
				297.5	297.5

The notes are unsubordinated unsecured liabilities of the Company and the amount included in the accounts of the Group and the Company in respect of these bonds is £296.8m (2019: £296.5m), of which £60.0m falls due within one year (2019: £nil).

32. Corporate bonds

On 9 September 2016 the Company issued £150.0m of 7.25% Fixed Rate Reset Callable Subordinated Tier 2 Notes due 2026 at par to provide long-term capital for the Group. These bonds bear interest at a fixed rate of 7.25% per annum until 9 September 2021, after which interest will be payable at a fixed rate which is 6.731% over the sterling 5-year mid-market swap rate at that time. These bonds are unsecured and subordinated to any other creditors of the Company. At 30 September 2018 the Notes were rated BBB- by Fitch and, during the year, the Notes were downgraded to BB+ following the application of updated bank rating criteria.

The carrying value of these bonds in the accounts of the Group and the Company at 30 September 2020 was £149.8m (2019: £149.6m).

33. Central bank facilities

During the year, the Group has utilised facilities provided by the Bank of England including through its Sterling Monetary Framework. These facilities enable either funding or off-balance sheet liquidity to be provided to Paragon Bank on the security of designated pools of the Bank's first mortgage assets and / or for the retained Notes described in note 57, with the amount available based on the value of the security given, subject, where appropriate, to a haircut.

Drawings under the Indexed Long Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. While no drawings under the ILTR were outstanding at 30 September 2020, the scheme was regularly accessed during the year. At 30 September 2019 the average rate of interest on the Group's ILTR drawings was 0.90%.

Drawings under the original Term Funding Scheme ('TFS') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 9 months (2019: 22 months). As these drawings are provided at rates below those available commercially, by a government agency, they are accounted for under IAS 20. The TFS is no longer available for new drawings.

Drawings under the Term Funding Scheme for SMEs ('TFSME') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 46 months.

During the year, the Group also accessed the Contingent Term Repo Facility ('CTRF'), which was a temporary short-term facility for collateralised drawings introduced by the Bank of England in response to the Covid-19 pandemic.

Drawings under the FLS were used to provide off balance sheet liquidity and formed part of the Bank's HQLA. Fees were charged under the FLS at 0.25% of the market value of the liquidity drawn and the facility expired in June 2020.

The amounts drawn under these facilities are set out below.

	2020	2019
	£m	£m
TFSME	910.0	-
TFS	944.4	944.4
ILTR	-	50.0
On balance sheet funding	1,854.4	994.4
FLS	-	109.0
Total central bank facilities	1,854.4	1,103.4

TFS includes £700.0m falling due within one year (2019: £nil).

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes and eligible retained Notes can also be used to support this funding (note 57). The mortgage assets pledged in support of these drawings are set out in note 17.

The balances arising from the TFSME and TFS carried in the Group accounts are shown below.

	2020	2020	2019	2019
	£m	£m	£m	£m
TFSME at IAS 20 carrying value	874.1		-	
Deferred government assistance	35.9		-	
		910.0		-
TFS at IAS 20 carrying value	937.5		930.5	
Deferred government assistance	6.9		13.9	
		944.4		944.4
		1,854.4		944.4

34. Sundry liabilities

(a) The Group

	2020 £m	2019 £m	2018 £m
Current liabilities			
Accrued interest	29.2	37.4	27.5
Trade creditors	1.6	0.9	2.7
CSA liabilities (note 56)	-	-	10.3
Other accruals	29.5	29.7	29.7
Sundry financial liabilities at amortised cost	60.3	68.0	70.2
Contingent consideration (note 35)	3.2	2.2	-
Sundry financial liabilities	63.5	70.2	70.2
Lease payables (note 36)	1.5	-	-
Deferred income	1.0	1.3	0.9
Conduct (note 37)	-	-	-
Other taxation and social security	3.3	2.4	2.5
	69.3	73.9	73.6
Non-current liabilities			
Accrued interest	14.3	14.9	12.4
Other accruals	-	0.2	0.2
Sundry financial liabilities at amortised cost	14.3	15.1	12.6
Contingent consideration (note 35)	10.3	21.5	25.7
Sundry financial liabilities	24.6	36.6	38.3
Lease payables (note 36)	4.1	-	-
Deferred income	2.0	2.2	2.5
	30.7	38.8	40.8
Total sundry financial liabilities at amortised cost	74.6	83.1	82.8
Total sundry financial liabilities at fair value	13.5	23.7	25.7
Total other sundry liabilities	11.9	5.9	5.9
Total sundry liabilities	100.0	112.7	114.4

(b) The Company

	2020 £m	2019 £m	2018 £m
Current liabilities			
Amounts owed to Group companies	22.7	23.8	125.7
Accrued interest	2.9	3.6	2.8
Sundry financial assets at amortised cost	25.6	27.4	128.5
Lease payables (note 36)	1.2	-	-
	26.8	27.4	128.5
Non-current liabilities			
Lease payables (note 36)	16.3	-	-
Total sundry liabilities	43.1	27.4	128.5

35. Contingent consideration

The contingent consideration represents consideration payable in respect of corporate acquisitions which is dependent on the performance of the acquired businesses. Movements in the balance are set out below.

	2020	2019
	£m	£m
At 1 October 2019	23.7	25.7
Payments	(4.4)	(2.5)
Revaluation	(6.2)	-
Unwind of discounting (note 5)	0.4	0.5
At 30 September 2020 (note 34)	13.5	23.7

The write down is a result of the reconsideration of future business volumes following the impact of Covid-19.

36. Lease payables

The Group's lease liabilities arise under the leasing arrangements described in note 47. Related right of use assets are shown in note 24.

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Leasing liabilities falling due:				
In more than five years	0.6	-	11.0	-
In more than two but less than five years	2.4	-	4.0	-
In more than one year but less than two years	1.1	-	1.3	-
In more than one year (note 34)	4.1	-	16.3	-
In less than one year (note 34)	1.5	-	1.2	-
	5.6	-	17.5	-

37. Conduct

The Group, as a participant in the financial services industry is exposed to a high level of regulatory supervision, which could in the event of conduct failures expose it to financial liabilities. The Group maintains a strong compliance and conduct culture supervised by the second line compliance function, to mitigate the risk, although it is impossible to eliminate it entirely.

Over recent years, in common with other financial services firms, the Group has followed guidance issued by the FCA in respect of redress to customers in respect of the mis-selling of payment protection insurance ('PPI'), though the sums involved have not been material.

The regulatory environment continues to develop, through regulatory policies, legislative rules and court rulings, and while the Group's assessment is that it currently has no further potential liability for conduct issues, this is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

38. Called-up share capital

The share capital of the Company consists of a single class of £1 ordinary shares.

Movements in the issued share capital in the year were:

	2020 Number	2019 Number
Ordinary shares		
At 1 October 2019	261,573,351	281,596,936
Shares issued	204,621	1,606,849
Shares cancelled	-	(21,630,434)
At 30 September 2020	261,777,972	261,573,351

During the year, the Company issued 204,621 shares (2019: 1,606,849) to satisfy options granted under Sharesave schemes for a consideration of £585,315 (2019: £4,075,843).

On 31 July 2019, 21,630,434 shares held in treasury were cancelled by the Company.

39. Reserves

(a) The Group

	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Share premium account	68.7	68.3	65.8	65.8
Capital redemption reserve	50.3	50.3	28.7	28.7
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve (note 20)	2.5	3.0	3.3	3.3
Profit and loss account	880.7	835.9	868.3	890.7
	932.0	887.3	895.9	918.3

(b) The Company

	2020 IFRS 9 £m	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Share premium account	68.7	68.3	65.8	65.8
Capital redemption reserve	50.3	50.3	28.7	28.7
Merger reserve	(23.7)	(23.7)	(23.7)	(23.7)
Profit and loss account	319.1	256.3	390.0	390.0
	414.4	351.2	460.8	460.8

The merger reserve arose, due to the provisions of UK company law at the time, on a group restructuring on 12 May 1989 when the Company became the parent entity of the Group.

40. Own shares

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Treasury shares				
At 1 October 2019	23.0	91.8	23.0	91.8
Shares purchased	-	26.7	-	26.7
Shares cancelled	-	(95.5)	-	(95.5)
At 30 September 2020	23.0	23.0	23.0	23.0
ESOP shares				
At 1 October 2019	17.5	12.2	-	-
Shares purchased	5.2	7.6	-	-
Options exercised	(7.9)	(2.3)	-	-
At 30 September 2020	14.8	17.5	-	-
Balance at 30 September 2020	37.8	40.5	23.0	23.0
Balance at 1 October 2019	40.5	104.0	23.0	91.8

At 30 September 2020 the number of the Company's own shares held in treasury was 5,218,702 (2019: 5,218,702). These shares had a nominal value of £5,218,702 (2019: £5,218,702). These shares do not qualify for dividends.

The Employee Share Ownership Plan ('ESOP') shares are held in trust for the benefit of employees exercising their options under the Company's share option schemes and awards under the Paragon Performance Share Plan and Deferred Share Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

At 30 September 2020, the trust held 3,636,218 ordinary shares (2019: 3,912,516) with a nominal value of £3,636,218 (2019: £3,912,516) and a market value of £12,108,606 (2019: £18,873,977). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2020 (2019: all). The dividends on all of these shares have been waived (2019: all).

41. Equity dividend

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2020	2019	2020	2019
	Per share	Per share	£m	£m
<i>Equity dividends on ordinary shares</i>				
Final dividend for the previous year	14.2p	13.9p	35.9	35.9
Interim dividend for the current year	-	7.0p	-	18.1
	14.2p	20.9p	35.9	54.0

Amounts paid and proposed in respect of the year:

	2020	2019	2020	2019
	Per share	Per share	£m	£m
Interim dividend for the current year	-	7.0p	-	18.1
Proposed final dividend for the current year	14.4p	14.2p	36.4	35.8
	14.4p	21.2p	36.4	53.9

The proposed final dividend for the year ended 30 September 2020 will be paid on 26 February 2021, subject to approval at the Annual General Meeting, with a record date of 29 January 2021. The dividend will be recognised in the accounts when it is paid.

42. Net cash flow from operating activities

(a) The Group

	2020	2019
	£m	£m
Profit before tax	118.4	159.0
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	3.5	1.5
Profit on disposal of operating property, plant and equipment	-	-
Amortisation of intangible assets	2.0	2.4
Foreign exchange movement on borrowings	(136.8)	(124.8)
Other non-cash movements on borrowings	1.5	3.6
Impairment losses on loans to customers	48.3	8.0
Charge for share based remuneration	2.7	5.9
Gain on derecognition	-	(9.7)
Derecognition of cash flow hedge	-	(0.9)
Net (increase) / decrease in operating assets:		
Assets held for leasing	(3.2)	(0.9)
Loans to customers	(493.6)	(792.0)
Derivative financial instruments	129.1	169.7
Fair value of portfolio hedges	(45.5)	(88.3)
Other receivables	(35.6)	(73.8)
Net increase / (decrease) in operating liabilities:		
Retail deposits	1,464.7	1,095.3
Derivative financial instruments	51.9	75.8
Fair value of portfolio hedges	6.5	8.1
Other liabilities	(39.1)	(1.6)
Cash generated by operations	1,074.8	437.3
Income taxes (paid)	(46.1)	(39.4)
	1,028.7	397.9

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

(b) The Company

	2020	2019
	£m	£m
Profit before tax	93.7	6.5
Non-cash items included in profit and other adjustments:		
Depreciation on property, plant and equipment	1.4	-
Non-cash movements on borrowings	0.5	0.7
Impairment provision / (release) on investments in subsidiaries	5.3	148.8
Charge for share based remuneration	2.7	5.9
Net decrease in operating assets:		
Other receivables	22.7	109.7
Net (decrease) in operating liabilities:		
Other liabilities	(1.8)	(101.1)
Cash generated by operations	124.5	170.5
Income taxes received	5.3	0.4
	129.8	170.9

43. Net cash flow from investing activities

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Proceeds from sales of operating property, plant and equipment	0.1	-	-	-
Purchases of operating property, plant and equipment	(1.9)	(1.1)	-	-
Purchases of intangible assets	(1.0)	(2.0)	-	-
Movement in loans to subsidiary undertakings	-	-	(94.7)	(105.1)
Residual disposal (note 7)	-	11.4	-	-
Investment in subsidiary undertakings	-	-	-	-
Net cash (utilised) / generated by investing activities	(2.8)	8.3	(94.7)	(105.1)

44. Net cash flow from financing activities

	The Group		The Company	
	2020	2019	2020	2019
	£m	£m	£m	£m
Shares issued (note 38)	0.6	3.9	0.6	4.1
Dividends paid (note 41)	(35.9)	(54.0)	(35.9)	(54.0)
Issue of asset backed floating rate notes	-	362.5	-	-
Repayment of asset backed floating rate notes	(1,013.3)	(591.1)	-	-
Movement on central bank facilities	860.0	(30.0)	-	-
Movement on other bank facilities	(130.1)	(148.3)	-	-
Capital element of lease payments	(2.0)	-	(1.3)	-
Purchase of shares (note 40)	(5.2)	(34.3)	-	(26.7)
Sale of shares	0.2	-	-	-
Net cash (utilised) by financing activities	(325.7)	(491.3)	(36.6)	(76.6)

45. Reconciliation of net debt

(a) The Group

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Recognition/ Derecognition	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2020							
Asset backed loan notes	4,419.4	-	(1,013.3)	-	(136.8)	1.2	3,270.5
Bank borrowings	787.5	-	(130.1)	-	-	0.4	657.8
Corporate bonds	149.6	-	-	-	-	0.2	149.8
Retail bonds	296.5	-	-	-	-	0.3	296.8
Central bank borrowings	994.4	-	860.0	-	-	-	1,854.4
Lease liabilities	-	-	(2.0)	7.3	-	0.3	5.6
Bank overdrafts	1.0	-	(0.6)	-	-	-	0.4
Gross debt	6,648.4	-	(286.0)	7.3	(136.8)	2.4	6,235.3
Cash	(1,225.4)	-	(699.6)	-	-	-	(1,925.0)
Net debt	5,423.0	-	(985.6)	7.3	(136.8)	2.4	4,310.3
30 September 2019							
Asset backed loan notes	5,554.7	362.5	(591.1)	(784.1)	(124.8)	2.2	4,419.4
Bank borrowings	935.6	-	(148.3)	-	-	0.2	787.5
Corporate bonds	149.3	-	-	-	-	0.3	149.6
Retail bonds	296.1	-	-	-	-	0.4	296.5
Central bank borrowings	1,024.4	-	(30.0)	-	-	-	994.4
Lease liabilities	-	-	-	-	-	-	-
Bank overdrafts	1.1	-	(0.1)	-	-	-	1.0
Gross debt	7,961.2	362.5	(769.5)	(784.1)	(124.8)	3.1	6,648.4
Cash	(1,310.6)	(362.5)	447.7	-	-	-	(1,225.4)
Net debt	6,650.6	-	(321.8)	(784.1)	(124.8)	3.1	5,423.0

Non-cash movements arising from recognition in the year ended 30 September 2020 include include amounts recognised on transition to IFRS 16.

Non-cash movements arising from recognition/derecognition in the year ended 30 September 2019 include the derecognition of PM12 asset backed loan notes on the derecognition of that securitisation (note 7).

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the facilities concerned and the inception of new lease assets.

(b) The Company

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Recognition	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2020							
Corporate bonds	149.6	-	-	-	-	0.2	149.8
Retail bonds	296.5	-	-	-	-	0.3	296.8
Lease liabilities	-	-	(1.3)	18.8	-	-	17.5
Gross debt	446.1	-	(1.3)	18.8	-	0.5	464.1
Cash	(14.1)	-	1.5	-	-	-	(12.6)
Net debt	432.0	-	0.2	18.8	-	0.5	451.5
30 September 2019							
Corporate bonds	149.3	-	-	-	-	0.3	149.6
Retail bonds	296.1	-	-	-	-	0.4	296.5
Lease liabilities	-	-	-	-	-	-	-
Gross debt	445.4	-	-	-	-	0.7	446.1
Cash	(24.9)	-	10.8	-	-	-	(14.1)
Net debt	420.5	-	10.8	-	-	0.7	432.0

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds. Recognition includes amounts recognised on transition to IFRS 16.

46. Unconsolidated structured entities

Following the Group's disposal of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation (note 7) in June 2019, it ceased to consolidate the assets and liabilities of the entity. The external securitisation borrowings remain in place with their terms unchanged and the Group continues to act as administrator, for which it charges a fee. It has no other exposure to the profitability of the deal, no exposure to credit risk, other than on the recoverability of its quarterly fee, and no obligation to make further contribution to the entity.

Fee income from servicing arrangements of £1.9m is included in third party servicing fees (note 8) (2019: £0.5m) and £0.3m is included in other debtors in respect of unpaid fees at the year end (2019: £0.3m). Outstanding collection monies due to the structured entity of £0.4m are included in other creditors at 30 September 2020 (2019: £0.4m).

47. Leasing arrangements

(a) As Lessor

The Group, through its motor finance and asset finance businesses, leases assets under both finance and operating leases. In respect of certain of these assets, the Group also provides maintenance services to the lessee.

Accounting for these balances from 1 October 2019 is governed by IFRS 16, while in previous periods IAS 17 applied, however the change in standards has not had a significant impact on the amounts presented (note 61).

Disclosures in respect of these balances are set out in these financial statements as follows

Disclosure	Note
Investment in finance leases	18
Finance income on net investment in finance leases	4
Assets leased under operating leases	24
Operating lease income	6

The undisclosed future minimum lease payments receivable by the Group under operating lease arrangements may be analysed as follows:

	2020	2019
	£m	£m
Amounts falling due:		
Within one year	12.4	7.1
Within one to two years	6.8	6.7
Within two to three years	4.3	3.3
Within three to four years	2.9	1.8
Within four to five years	1.7	0.9
After more than five years	1.3	0.5
	29.4	20.3

(b) As Lessee

The Group's use of leases as a lessee relates to the rental of office buildings and company cars. Under IFRS 16 these have been accounted for as right of use assets and corresponding lease liabilities.

The average term of the current building leases from inception or acquisition is 9 years (2019: 7 years) with rents subject to review every five years, while the average term of the vehicle leases is 3 years (2019: 3 years).

The Company's use of leases as lessee is limited to the rental of an office building from a subsidiary entity. The lease term from inception is 15 years.

Disclosures relating to these leases are set out in these financial statements as follows.

Disclosure	Note
Depreciation on right of use assets	24
Interest expense on lease liabilities	5
Expense relating to short-term leases	8
Additions to right of use assets	24
Carrying amount of right of use assets	24
Maturity analysis of lease liabilities	57

There was no subleasing of any right of use asset and the total cash flows relating to leasing as a lessee were £2.2m.

Disclosures made in respect of IAS 17 requirements for 2019 are set out below.

	The Group	The Company
	2019	2019
	£m	£m
Minimum lease payments under operating leases recognised in operating expenses for the year		
Office buildings	1.9	-
Motor vehicles	0.9	-
Office equipment	0.1	-
	2.9	-

At 30 September 2019 the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fell due as follows:

	The Group	The Company
	2019	2019
	£m	£m
Amounts falling due:		
Within one year	3.2	-
Between two and five years	5.8	-
After more than five years	1.7	-
	10.7	-

48. Related party transactions

(a) The Group

During the year, certain of the non-executive directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. Deposits of £301,000 were outstanding at the year end (2019: none), and the maximum amount outstanding during the year was £500,000 (2019: £250,000).

Mr A K Fletcher, a non-executive director of the Company until 31 December 2018, is a director of Paragon Pension Plan Trustees Limited, which acts as the corporate trustee of the Plan. In respect of this appointment he was paid £4,000 in the year ended 30 September 2019 by Paragon Finance PLC, the sponsoring company of the Plan up to the date of his resignation as a director of the Company.

The Plan is a related party of the Group. Transactions with the Plan are described in note 53.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 51.

(b) The Company

During the year, the parent company entered into transactions with its subsidiaries, which are related parties. Management services were provided to the Company by one of its subsidiaries and the Company granted awards to employees of subsidiary undertakings under the share based payment arrangements described in note 52.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 27 and 66.

Outstanding current account balances with subsidiaries are shown in notes 21 and 34.

During the year the Company incurred interest costs of £1.0m in respect of borrowings from its subsidiaries (2019: £1.6m).

The Company leased an office building from a subsidiary entity (note 47). Finance charges recognised in respect of this lease were £0.5m.

49. Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions that are within the scope of CRD IV. The objective of the country-by-country reporting requirements is to provide increased transparency regarding the source of the financial institution's income and the locations of its operations.

Paragon Banking Group PLC is a UK registered entity. Details of its subsidiaries are given in note 66 and the activities of the Group are described in Section A2.1.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2020 were:

	United Kingdom £m
Year ended 30 September 2020	
Total operating income	295.1
Profit before tax	118.4
Corporation tax paid	46.1
Public subsidies received	-
Average number of full time equivalent employees	1,285
	United Kingdom £m
Year ended 30 September 2019	
Total operating income	307.3
Profit before tax	159.0
Corporation tax paid	39.4
Public subsidies received	-
Average number of full time equivalent employees	1,269

The Group's participation in Bank of England funding schemes is set out in note 33.

D2.2 Notes to the Accounts - Employment costs

For the year ended 30 September 2020

The notes set out below give information on the Group's employment costs, including the disclosures on share based payments and pension schemes required by accounting standards.

50. Employees

The average number of persons (including directors) employed by the Group during the year was 1,385 (2019: 1,365). The number of employees at the end of the year was 1,392 (2019: 1,368).

Costs incurred during the year in respect of these employees were:

	2020 £m	2020 £m	2019 £m	2019 £m
Share based remuneration	2.7		5.9	
Other wages and salaries	64.0		62.6	
Total wages and salaries		66.7		68.5
National Insurance on share based remuneration	(0.1)		1.0	
Other social security costs	8.0		7.7	
Total social security costs		7.9		8.7
Defined benefit pension cost	2.0		1.9	
Other pension costs	3.1		2.1	
Total pension costs		5.1		4.0
Total employment costs		79.7		81.2
Of which				
Included in operating expenses (note 9)		77.6		79.3
Included in maintenance costs (note 6)		2.1		1.9
		79.7		81.2

Details of the pension schemes operated by the Group are given in note 53.

The Company has no employees. Details of the directors' remuneration are given in note 51.

51. Key management remuneration

The remuneration of the directors, who are the key management personnel of the Group and the Company, is set out below in aggregate in accordance with IAS 24 – 'Related Party Transactions'. Further information about the remuneration of individual directors is provided in the Annual Report on Remuneration in Section B7.2.2.

	2020	2020	2019	2019
	£m	£m	£m	£m
Salaries and fees	1.9		1.8	
Cash amount of bonus	-		1.5	
Social security costs	0.5		0.5	
Short-term employee benefits		2.4		3.8
Post-employment benefits		0.3		0.5
IFRS 2 cost in respect of directors	0.7		2.1	
National Insurance thereon	(0.1)		0.4	
Share based payment		0.6		2.5
		3.3		6.8

Post-employment benefits shown above are shown as 'pension allowance' in Section B7.2.2. Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

The negative charge in respect of National Insurance accrued on share based payments in 2020 is principally a result of reduced vesting estimates.

Social security costs paid in respect of directors are required to be included in this note by IAS 24, but do not fall within the scope of the disclosures in the Directors' Remuneration Report.

52. Share based remuneration

During the year, the Group had various share based payment arrangements with employees. They are accounted for by the Group and the Company as shown below.

The effect of the share based payment arrangements on the Group's profit is shown in note 50.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B7.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2020 and at 30 September 2019 is set out below.

	2020	2019
	Number	Number
(a) Sharesave Plan	4,134,577	2,558,569
(b) Performance Share Plan	4,842,196	4,762,886
(c) Company Share Option Plan	444,771	730,816
(d) Deferred Bonus Plan	819,265	774,046
(e) Restricted Stock Units	265,672	134,827
	10,506,481	8,961,144

(a) Sharesave plan

The Group operates an All Employee Share Option ('Sharesave') plan. Grants under this scheme vest, in the normal course, after the completion of the appropriate service period and subject to a savings requirement.

A reconciliation of movements in the number and weighted average exercise price of Sharesave options over £1 ordinary shares during the year ended 30 September 2020 and the year ended 30 September 2019 is shown below.

	2020 Number	2020 Weighted average exercise price p	2019 Number	2019 Weighted average exercise price p
Options outstanding				
At 1 October 2019	2,558,569	338.06	3,265,788	281.60
Granted in the year	2,748,494	278.56	1,147,016	360.16
Exercised or surrendered in the year	(940,709)	348.35	(1,606,849)	253.65
Lapsed during the year	(231,777)	351.68	(247,386)	361.53
At 30 September 2020	4,134,577	295.40	2,558,569	338.06
Options exercisable	345,756	341.85	119,846	249.44

The weighted average remaining contractual life of options outstanding at 30 September 2020 was 36.8 months (2019: 26.1 months). The weighted average market price at exercise for share options exercised in the year was 441.06p (2019: 400.88p).

Options are outstanding under the Sharesave plans to purchase ordinary shares as follows:

Grant date	Period exercisable	Exercise price	Number 2020	Number 2019
11/06/2015	01/08/2020 to 01/02/2021	345.68p	8,242	9,977
20/06/2016	01/08/2019 to 01/02/2020	249.44p	-	119,846
20/06/2016	01/08/2021 to 01/02/2022	249.44p	432,210	439,425
28/07/2017	01/09/2020 to 01/03/2021	341.76p	337,514	493,841
28/07/2017	01/09/2022 to 01/03/2023	341.76p	22,726	44,667
31/07/2018	01/09/2021 to 01/03/2022	408.80p	169,359	278,873
31/07/2018	01/09/2023 to 01/03/2024	408.80p	21,124	38,581
30/07/2019	01/09/2022 to 01/03/2023	360.16p	411,334	1,049,338
30/07/2019	01/09/2024 to 01/03/2025	360.16p	6,574	84,021
27/07/2020	01/09/2023 to 01/03/2024	278.56p	2,187,502	-
27/07/2020	01/09/2025 to 01/03/2026	278.56p	537,992	-
			4,134,577	2,558,569

An option holder has the legal right to a payment holiday of up to twelve months without forfeiting their rights. In such cases the exercise period would be deferred for an equivalent period of time and therefore options might be exercised later than the date shown above.

In the event of the death or redundancy of the employee options may be exercised early and the exercise period may also start or end later than stated above (options may be exercised up to twelve months after the decease of the holder).

The fair value of options granted is determined using a trinomial model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2020 and the year ended 30 September 2019, are shown below.

Grant date	27/07/20	27/07/20	30/07/19	30/07/19
Number of awards granted	2,210,502	537,992	1,058,831	88,185
Market price at date of grant	343.2p	343.2p	422.0p	422.0p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	0.62	0.55	0.51	0.53
Inputs to valuation model				
Expected volatility	34.24%	32.98%	22.58%	26.44%
Expected life at grant date (years)	3.45	5.45	3.48	5.47
Risk-free interest rate	(0.13)%	(0.11)%	0.36%	0.40%
Expected annual dividend yield	4.34%	4.34%	4.95%	4.95%
Expected annual departures	5.00%	5.00%	5.00%	5.00%

The expected volatility of the share price used in determining the fair value for the three-year schemes is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date. The five-year schemes use share price data for the preceding five years.

(b) Paragon Performance Share Plan ('PSP')

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and normally vest in the third financial year after the date of grant, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group.

Awards vest on the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied. For employees, other than the executive directors, awards may be exercised from the vesting date to the day before the tenth anniversary of the grant date. Executive directors' awards made in 2020 are exercisable from the time of the Group's fifth results announcement after the date of the grant to the day before the tenth anniversary of the grant date. Where performance conditions are not met in full, awards lapse at this point. Awards will also lapse on cessation of employment, other than in 'good leaver' circumstances. Clawback provisions apply to awards granted under the PSP as detailed in the remuneration policy.

The conditional entitlements outstanding under this scheme at 30 September 2020 and 30 September 2019 were:

Grant date	Period exercisable	Number	Number
		2020	2019
04/01/2010	04/01/2013 to 03/01/2020 [†]	-	18,702
17/12/2010	17/12/2013 to 16/12/2020 [†]	9,925	12,424
21/12/2011	21/12/2014 to 20/12/2021 [†]	5,093	15,335
28/02/2013	28/02/2016 to 27/02/2023 [†]	5,443	6,981
10/12/2013	10/12/2016 to 09/12/2023 [†]	6,210	76,614
18/12/2014	18/12/2017 to 17/12/2024 [†]	6,277	233,550
22/12/2015	22/12/2018 to 21/12/2025 [†]	16,887	411,800
01/12/2016	01/12/2019 to 30/11/2026 [‡]	462,076	1,339,409
08/12/2017	08/12/2020 to 07/12/2027 [‡]	1,155,740	1,161,803
14/12/2018	14/12/2018 to 13/12/2028 [‡]	1,479,563	1,486,268
06/07/2020	07/12/2022* to 05/07/2030 [‡]	1,185,790	-
06/07/2020	07/12/2024* to 05/07/2030 [‡]	509,192	-
		4,842,196	4,762,866

* Estimated date

[†] These awards, which were conditional on the achievement of performance-based criteria, vested before the start of the financial year. Any reduction in entitlements resulting from the application of those criteria is reflected in the numbers above.

[‡] These awards are (or were) subject to performance criteria, assessed over a period of three financial years, starting with the year of grant.

- 50% to a Total Shareholder Return ('TSR') test based on a ranking of the Company's TSR against those of a comparator group of UK listed financial services companies, determined at the date of grant. This tranche vests in full for upper quartile performance, 25% vests for median performance and vesting between those points is determined on a straight line basis

- 25% to an EPS test. This tranche vests in full if EPS increases by at least 7% more than the retail price index ('RPI') over the test period, 25% vests if this increase is at least 3% more than the RPI and vesting between those points is determined on a straight line basis
- 25% to a risk test. The risk test is based on an internal scorecard of the Group's performance against its principal risk metrics

At the point of exercise, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below, evaluated at that point, is equal to the gain from the gross PSP vesting.

ψ These awards are subject to performance criteria, similar to those described at ⁸ above, except that:

- The EPS condition is measured against an absolute target. Full vesting occurs if EPS for the third year of the test period is at least 68p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis

φ These awards are subject to performance criteria, similar to those described at ⁸ above, except that:

- The TSR condition related to 25% of the grant, not 50%
- The EPS condition is measured against an absolute target. Full vesting occurs if EPS for the third year of the test period is at least 67p, 25% vesting if EPS in this year is 60p and vesting between those points on a straight line basis
- The risk condition comprises two components. 50% of the risk element is based on an assessment by the Chief Risk Officer of the six key measures of the Group's risk appetite: regulatory breaches; customer service performance; conduct; operational risk incidents; capital and liquidity; and credit losses. The remaining 50% is based on a strategic risk assessment reflecting the management of risk as it impacts on the delivery of the Group's medium term strategy
- 12.5% of the grant is determined based on a customer service test assessed by the Chair of the Risk and Compliance Committee. The customer service test is based on the performance of the Group against its most significant customer service metrics including insight feedback on key product lines and complaint levels. 50% of this tranche will vest for on-target performance
- 12.5% of the grant is determined based on a people test. The people test is based on the performance of the Group against its most significant employment metrics including employee engagement, voluntary attrition and gender diversity levels. 50% of this tranche will vest for on-target performance
- Due to the volatility of the share price at the time of grant, the Remuneration Committee may adjust the vesting levels at the vesting date if it believes that the use of this share price has created a potential windfall gain
- No CSOP grants were made in conjunction with this award, therefore no adjustment on vesting will take place

For each of the risk, customer and people tests set out above, the Remuneration Committee will determine the extent to which this condition has been met, between 0% and 100%, and vesting for the relevant tranche will occur at that level, subject to a 25% threshold, below which no awards in the tranche will vest.

On exercise, holders of awards granted in February 2013 and thereafter receive a payment equivalent to the dividends accruing on the vested shares during the vesting period.

The fair value of awards granted under the PSP is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2020 and the year ended 30 September 2019 are shown below:

Grant date	06/07/20	14/12/18
Number of awards granted	1,694,982	1,493,230
Market price at date of grant	360.60p	401.00p
Contractual life (years)	2.4	3.0
Fair value per share at date of grant	301.32p	307.32p
Inputs to valuation model		
Expected volatility	33.93%	28.86%
Expected life (years)	2.4	3.0
Risk-free interest rate	(0.06)%	1.20%

For all of the above grants no departures are expected. The expected volatility is based on the annualised standard deviation of daily changes in price over the three years preceding the grant date.

The effect of the CSOPs is not allowed for in the IFRS 2 market values of the 2016, 2017 and 2018 grants.

(c) Company Share Option Plan ('CSOP')

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each member of staff may be granted up to a maximum total value of £30,000 of tax benefitted options. No new CSOP awards were made in the year ended 30 September 2020.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2020 and the year ended 30 September 2019 is shown below.

	2020 Number	2020 Weighted average exercise price p	2019 Number	2019 Weighted average exercise price p
Options outstanding				
At 1 October 2019	730,816	398.19	549,061	399.16
Granted in the year	-	-	191,543	396.04
Exercised or surrendered in the year	(218,008)	361.88	-	-
Lapsed during the year	(68,037)	372.15	(9,788)	410.72
At 30 September 2020	444,771	419.97	730,816	398.19
Options exercisable	93,974	361.88	-	-

The weighted average remaining contractual life of options outstanding at 30 September 2020 was 89.5 months (2019: 96.5 months). The weighted average market prices at exercise for share options exercised in the year was 365.62p.

The conditional entitlements outstanding under this scheme at 30 September 2020 and 30 September 2019 were:

Grant date	Period exercisable	Exercise price	Number 2020	Number 2019
01/12/2016	01/12/2019 to 30/11/2026 ^β	361.88p	93,974	370,445
08/12/2017	08/12/2020 to 07/12/2027 ^β	477.76p	169,502	174,049
14/12/2018	14/12/2021 to 13/12/2028 ^β	396.04p	181,295	186,322
			444,771	730,816

^β 66.7% of these awards are (or were) subject to a TSR test and 33.3% are subject to an EPS test. These tests operate in the same manner and with the same conditions as those for the PSP grant of the same date.

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated on exercise so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place.

No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

(d) Deferred Bonus awards

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2020 and 30 September 2019 were:

Grant date	Period exercisable	Number 2020	Number 2019
10/12/2013	10/12/2016 to 09/12/2023	55,302	55,302
18/12/2014	18/12/2017 to 17/12/2024	52,888	79,853
22/12/2015	22/12/2018 to 21/12/2025	60,042	96,559
01/12/2016	01/12/2019 to 30/11/2026	105,318	105,318
08/12/2017	08/12/2020 to 07/12/2027	102,516	102,516
14/12/2018	14/12/2021 to 13/12/2028	334,498	334,498
12/12/2019	12/12/2022 to 11/12/2029	108,701	-
		819,265	774,046

The Deferred Bonus shares can be exercised from the third anniversary of the award date until the day before the tenth anniversary of the date of grant.

The Deferred Bonus shares granted in December 2016 and thereafter accrue dividends only over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2020 and the year ended 30 September 2019 are shown below.

Grant date	12/12/19	14/12/18
Number of awards granted	108,701	334,498
Market price at date of grant	489.20p	401.00p
Fair value per share at date of grant	489.20p	401.00p

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. For RSU awards to vest, the grantee's personal performance must be satisfactory during the financial year preceding the vesting date. In addition, a risk based performance condition, assessed against the Group's risk management metrics and, additionally from 2020, against its strategic management of risk for the medium term, considered over the vesting period, must also be met. The level to which this condition is met will be determined by the Remuneration Committee and vesting levels scaled back as appropriate.

The conditional entitlements outstanding under this scheme at 30 September 2020 and 30 September 2019 were:

Grant date	Period exercisable	Number 2020	Number 2019
01/12/2016	01/12/2019 to 30/11/2026	-	60,115
08/12/2017	08/12/2020 to 07/12/2027	22,672	22,672
14/12/2018	14/12/2021 to 13/12/2028	52,040	52,040
06/07/2020	06/12/2022* to 05/07/2030	190,960	-
		265,672	134,827

* Estimated date

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2020 and the year ended 30 September 2019 are shown below.

Grant date	06/07/20	14/12/18
Number of awards granted	190,690	52,040
Market price at date of grant	360.60p	401.00p
Contractual life (years)	2.4	3.0
Fair value per share at date of grant	360.60p	401.00p

For all of these grants no departures are expected.

53. Retirement benefit obligations

(a) Defined benefit plan - description

The Group operates a funded defined benefit pension scheme in the UK (the 'Plan'). The Plan assets are held in a separate fund, administered by a corporate trustee, to meet long-term pension liabilities to past and present employees. The Trustee of the Plan is required by law to act in the best interests of the Plan's beneficiaries and is responsible for the investment policy adopted in respect of the Plan's assets. The appointment of directors to the Trustee is determined by the Plan's trust documentation. The Group has a policy that one third of all directors of the Trustee should be nominated by active and pensioner members of the Plan.

Employees who are members of the Plan are entitled to receive a pension of 1/60 of their final basic annual salary for every year of eligible service (to a maximum of 2/3). Dependants of members of the Plan are eligible for a dependant's pension and the payment of a lump sum in the event of death in service.

The principal actuarial risks to which the Plan is exposed are:

- **Investment risk** – The present value of the defined benefit liabilities is calculated using a discount rate set by reference to high quality corporate bond yields. If plan assets underperform corporate bonds, this will increase the deficit. The strategic allocation of assets under the Plan is currently weighted towards equity assets and diversified growth funds as its liability profile is relatively immature, and it is expected that these asset classes will, over the long-term, outperform gilts and corporate bonds. In consultation with the Company, the Trustee keeps the allocation of the Plan's investments under review to manage this risk on a long-term basis.
- **Interest risk** – A fall in corporate bond yields would reduce the discount rate used in valuing the Plan liabilities and increase the value of the Plan liabilities. The Plan assets would also be expected to increase, to the extent that bond assets are held, but this would not be expected to fully match the increase in liabilities, given the weighting towards equity assets and diversified growth funds noted above.
- **Inflation risk** – Pensions in payment are increased annually in line with the Retail Price Index ('RPI') or the Consumer Price Index ('CPI') for Guaranteed Minimum Pensions built up since 1988. Pensions built up since 5 April 2006 are capped at 2.5% and pensions built up before 6 April 2006 are capped at 5%. For employees who have left the Company but have deferred pensions, these also revalue over the period to retirement predominantly in line with RPI. Therefore, an increase in inflation would also increase the value of the pension liabilities. The Plan assets would also be expected to increase, to the extent that they are linked to inflation, but this may not fully match the increase in liabilities.
- **Longevity risk** – The value of the Plan deficit is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would increase the deficit in the Plan.
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on a premium over the expected rate of inflation. Should the salaries of plan members increase at a higher rate, then the deficit will be higher.

The risks relating to death in service payments are insured with an external insurance company.

As a result of the Plan having been closed to new entrants since February 2002, the service cost as a percentage of pensionable salaries is expected to increase as the average age of active members rises over time. However, the membership is expected to reduce so that the service cost in monetary terms will gradually reduce.

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2019, by Aon Hewitt, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with section 224 of the Pensions Act 2004, the level of assets which would be required to buy insurance policies for benefits earned to the valuation date, was £203.6m, with a shortfall against the assets of £85.0m (2016: £118.4m). The deficit on the Technical Basis, the basis agreed by the Trustee as being appropriate to meet member benefits, assuming the plan continues as a going concern, was £18.2m (2016: £18.0m). This valuation was agreed with the Trustee during the period and forms the basis of the IAS 19 valuation.

Following the agreement of the 2019 actuarial valuation in the period, the Trustee put in place a revised recovery plan. On current forecasts the Trustee's recovery plan would to meet the statutory funding objective by 31 July 2025. The revised recovery plan continues to include a Pension Funding Partnership ('PFP') arrangement effectively granting the Plan a first charge over the Group's head office building as security for payments under the plan (note 24). No amount is included in the Plan assets in respect of the building, which remains within the Group's Property, Plant and Equipment balance (note 24) but this arrangement provides the Plan with additional security in a stress event.

(b) Defined benefit plan – financial impact

For accounting purposes, the valuation at 31 March 2019 was updated to 30 September 2020 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

The major categories of assets in the Plan at 30 September 2020, 30 September 2019 and 30 September 2018 and their fair values were:

	2020	2019	2018
	£m	£m	£m
Cash and cash equivalents	28.6	7.1	0.6
Equity instruments	60.7	60.7	61.8
Debt instruments	34.9	34.2	28.4
Real estate funds	10.3	10.8	10.7
Total fair value of Plan assets	134.5	112.8	101.5
Present value of Plan liabilities	(154.9)	(147.3)	(121.0)
(Deficit) in the Plan	(20.4)	(34.5)	(19.5)

At 30 September 2020 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets.

During October 2018, the High Court made a ruling in the Lloyds Banking Group Pension Scheme GMP ('Guaranteed Minimum Pension') equalisation case, which effectively directs defined benefit pension schemes to change their rules to equalise the benefits of male and female members for the effects of GMPs for employees who were, at one time, contracted out of state schemes. The Court did not specify a single method which schemes should employ and hence the impact of this on the Plan will not be certain until the Trustee has determined which method should be adopted and detailed calculations have been performed to evaluate the impact, as the impact on members will vary from person to person.

The estimated effect of this ruling was accounted for in the accounts of the Group for the year ended 30 September 2019 as a 'past service cost'. However, this estimate is based on one permissible method, method C2, and therefore the actual amount may vary due to the method which the Trustee chooses to apply, which is yet to be finalised, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts' requirements as further cases are determined.

The movement in the fair value of the Plan assets during the year was as follows:

	2020	2019
	£m	£m
At 1 October 2019	112.8	101.5
Interest on Plan assets	2.3	3.0
Cash flows		
Contributions by the Group	24.5	4.6
Contributions by Plan members	0.2	0.2
Benefits paid	(2.9)	(2.4)
Administration expenses paid	(0.6)	(0.7)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	(1.8)	6.6
At 30 September 2020	134.5	112.8

Contributions by the Group in the year ended 30 September 2020 included a one-off £20.0m payment made as part of the new recovery plan agreed between the Group and the Trustee in the year.

The actual return on Plan assets in the year ended 30 September 2020 was £0.5m (2019: £9.6m).

The movement in the present value of the Plan liabilities during the year was as follows:

	2020	2019
	£m	£m
At 1 October 2019	147.3	121.0
Current service cost	2.0	1.6
Past service cost	-	0.3
Funding cost	2.7	3.5
Cash flows		
Contributions by Plan members	0.2	0.2
Benefits paid	(2.9)	(2.4)
Remeasurement loss / (gain)		
Arising from demographic assumptions	1.2	(1.4)
Arising from financial assumptions	6.0	24.5
Arising from experience adjustments	(1.6)	-
At 30 September 2020	154.9	147.3

The liabilities of the Plan are measured by discounting the best estimate of future cash flows to be paid out by the Plan using the Projected Unit method. This amount is reflected in the liability in the balance sheet. The Projected Unit method is an accrued benefits valuation method in which the Plan liabilities are calculated based on service up until the valuation date allowing for future salary growth until the date of retirement, withdrawal or death, as appropriate. The future service rate is then calculated as the contribution rate required to fund the service accruing over the next year again allowing for future salary growth. The major weighted average assumptions used by the actuary were (in nominal terms):

	30 September 2020	30 September 2019	30 September 2018
In determining net pension cost for the year			
Discount rate	1.85%	2.95%	2.70%
Rate of compensation increase	3.20%	3.60%	3.60%
Rate of price inflation	2.70%	3.10%	3.10%
Rate of increase of pensions	2.65%	2.95%	2.90%
In determining benefit obligations			
Discount rate	1.75%	1.85%	2.95%
Rate of compensation increase	2.95%	3.20%	3.60%
Rate of price inflation	2.95%	2.70%	3.10%
Rate of increase of pensions	2.85%	2.65%	2.95%
Further life expectancy at age 60			
Male member aged 60	28	28	28
Female member aged 60	29	29	29
Male member aged 40	30	30	30
Female member aged 40	31	31	31

The amounts charged in the consolidated income statement in respect of the Plan are:

	Note	2020 £m	2019 £m
Current service cost		2.0	1.6
Past service cost		-	0.3
Total service cost	50	2.0	1.9
Administration expenses		0.6	0.7
Included within operating expenses		2.6	2.6
Funding cost of Plan liabilities		2.7	3.5
Interest on Plan assets		(2.3)	(3.0)
Net interest expense	5	0.4	0.5
Components of defined benefit costs recognised in profit or loss		3.0	3.1

The amounts recognised in the consolidated statement of comprehensive income in respect of the Plan are:

	2020 £m	2019 £m
Return on Plan assets (excluding amounts included in interest)	(1.8)	6.6
Actuarial gains/(losses)		
Arising from demographic assumptions	(1.2)	1.4
Arising from financial assumptions	(6.0)	(24.5)
Arising from experience adjustments	1.6	-
Total actuarial (loss)	(7.4)	(16.5)
Tax thereon	2.1	2.4
Net actuarial (loss)	(5.3)	(14.1)

Of the remeasurement movements reflected above:

- The return on plan assets represents worse than expected investment performance
- The change in demographic assumptions reflects the adoption of new mortality assumptions, using the most recent version of the tables adopted by the Trustee in the triennial valuation, which predict marginally higher life expectancy among members than the previous versions reversing the trend of recent years
- The change in financial assumptions reflects principally the impact of market-implied inflation expectations on discount rates, where reduced gilt and bond yields in the year have led to a lower rate
- The inflation assumptions used over the year have changed to reflect the latest information, including market pricing and the UK Government's RPI consultation, and the extent to which the Plan's assets hedge inflation
- the experience adjustments arise on the adoption of the 2019 Plan valuation as the basis of the IAS 19 valuation in the year

(c) Defined benefit plan – future cash flows

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2020, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

Assumption	Increase in assumption	Impact on scheme liabilities
Discount rate	0.1% p.a.	(2.1)%
Rate of inflation*	0.1% p.a.	2.1%
Rate of salary growth	0.1% p.a.	0.3%
Rates of mortality	1 year of life expectancy	3.0%

* maintaining a 0.0% assumption for real salary growth

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years.

In conjunction with the Trustee, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan. There have been no changes in the processes by which the Plan manages its risks from previous periods.

The current target asset allocations for the year ending 30 September 2021 are 60% growth assets (primarily equities), 30% bonds and 10% real estate.

The rate of employee contributions to the Plan is 5.0% of pensionable salaries. Following the finalisation of the March 2019 valuation, the agreed rate of employer contributions increased to 43.8% from 32.0% with effect from 1 July 2020. Additional contributions of £2.5m per annum for deficit reduction, including amounts payable under the PFP, and £0.4m per annum in respect of costs, each payable monthly, were also agreed. An additional contribution of £20.0m was made by the Group in June 2020.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2021 is £4.4m.

The average durations of the benefit obligations in the Plan at the year end are shown in the table below:

	2020 Years	2019 Years
Category of member		
Active members	24	25
Deferred pensioners	23	24
Current pensioners	15	16
All members	22	24

(d) Defined contribution arrangements

The Group sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Group successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme. During the year the Group increased its contribution to the scheme for those employees making the maximum 6% contribution to 10% of salary from 6%, generating an increase in the amounts being saved by employees.

The Group also sponsors a number of other defined contribution pension plans relating to acquired entities and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2020, which represent the total cost charged against income, were £3.1m (2019: £2.1m) (note 50).

D2.3 Notes to the Accounts - Capital and financial risk

For the year ended 30 September 2020

The notes below describe the processes and measurements which the Group and the Company use to manage their capital position and their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not subject to audit. Where this is the case, the relevant disclosures are marked as such.

54. Capital management

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The Group's response to the Covid-19 situation has been planned and executed with the protection of its capital base and its long-term viability as key strategic priorities.

The Group sets its target amount of capital in proportion to risk, availability, regulatory requirements and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

(a) Dividend policy

The Company is committed to a long-term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value. In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans.

The distributable reserves of the Company comprise its profit and loss account balance (note 39) and, other than the regulatory requirement to retain an appropriate level of capital in Paragon Bank PLC, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

At the time of approving the half yearly report, the Board considered the exceptional level of uncertainty in the UK and global economy, together with the public statements of government and regulatory bodies and emerging market practice and concluded that, while the capital position and liquidity position of the Company remained strong, it would not be advisable to declare an interim dividend for the year.

The appropriate level of dividend for the full-year was considered in light of economic and regulatory developments in the second half of the year. In particular the levels of provision in the Group's loan portfolios and the potential for further provision under stress were considered by the Board, along with the capital requirements of the Group both under the base case medium term forecast and under stress, discounting the effects of the current temporary reduction in regulatory buffers in response to Covid-19. On the basis of the analysis the Board concluded that a dividend payment for the year of around 40% of earnings, in line with policy, could be made.

The dividend cover for the year, which is subject to approval at the forthcoming AGM is set out below.

	<i>Note</i>	2020	2019
		£m	£m
Earnings per share (p)	14	36.0	49.4
Proposed dividend per share in respect of the year (p)	41	14.4	21.2
Dividend cover (times)		2.50	2.33

For the purposes of dividend policy, the Group defines dividend cover based on basic earnings per share, adjusted where considered appropriate, and dividend per share. This is the most common measure used by financial analysts.

The most recent policy review, in November 2020, also confirmed the existing dividend policy would continue to apply for future periods, subject to the impact of any future events, and the Board will consider the appropriateness and scale of any interim dividend in the context of the Group's results and the operating and economic environment at the time.

(b) Return on tangible equity ('RoTE')

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

It effectively reflects a return on equity as if all intangible assets are eliminated immediately against reserves. As this is similar to the approach used for the capital of financial institutions it is widely used in the sector.

The Group's consolidated RoTE for the year ended 30 September 2020 is derived as follows:

	<i>Note</i>	2020	2019
		£m	£m
Profit for the year after tax		91.3	127.4
Amortisation of intangible assets	25	2.0	2.4
Adjusted profit		93.3	129.8
Divided by			
Opening equity		1,108.4	1,073.5
Opening intangible assets	25	(171.1)	(169.3)
Opening tangible equity		937.3	904.2
Closing equity		1,156.0	1,108.4
Closing intangible assets	25	(170.1)	(171.1)
Closing tangible equity		985.9	937.3
Average tangible equity		961.6	920.7
Return on Tangible Equity		9.7%	14.1%

This table is not subject to audit

(c) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue an individual capital requirement setting an amount of regulatory capital, which the Group is required to hold in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This comprises variable elements based on its total risk exposure and also fixed elements. This requirement is set in accordance with the international Basel III rules, issued by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR').

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

The Group has elected to take advantage of the IFRS 9 transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors applying to transition adjustments will allow for a 95% add back to CET1 capital and Risk Weighted Assets ('RWA') in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year.

As part of the regulatory response to Covid-19, Article 473a was revised to extend the transitional arrangements for Stage 1 and Stage 2 impairment provisions created in the financial year ended 30 September 2020 and the financial year ending 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before the current period. In order to increase institutions lending capacity in the short-term, the EU has determined that these additional provisions should be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

These responses also allow, under paragraph 7a of the Article, the impact of transitional adjustments to be weighted at 100% in calculating RWA. The Group has taken advantage of this derogation and hence the IFRS 9 adjustment to RWA is equal to the adjustment to capital at 30 September 2020.

Where these reliefs are taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

The tables below demonstrate that at 30 September 2020 the Group's regulatory capital of £1,141.2m (2019: £1,072.0m) exceeded the amounts required by the regulator, including £749.6m (2019: £742.9m) in respect of Pillar 1 and Pillar 2a capital (unaudited), which is comprised of fixed and variable elements.

The total regulatory capital at 30 September 2020 on the fully loaded basis of £1,098.9m was in excess of the Pillar 1 and 2a requirement of £745.3m (2019: £741.8m) on the same basis (amounts not subject to audit).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer of 2.5% of risk weighted assets (at 30 September 2020) (2019: 2.5%) and a Counter-Cyclical Buffer ('CCyB'), currently 0.0% of risk weighted assets (2019: 1.0%). The reduction in the CCyB in the year was a response to the Covid-19 pandemic and the long-term rate in a standard risk environment is expected to be 2.0%. Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2020 is set out below.

	Note	Regulatory basis		Fully loaded basis	
		2020 £m	2019 £m	2020 £m	2019 £m
Total equity		1,156.0	1,108.4	1,156.0	1,108.4
<i>Deductions</i>					
Proposed final dividend	41	(36.4)	(35.8)	(36.4)	(35.8)
IFRS 9 transitional relief	*	42.3	21.2	-	-
Intangible assets	25	(170.1)	(171.1)	(170.1)	(171.1)
Prudent valuation adjustments	5	(0.6)	(0.7)	(0.6)	(0.7)
Common Equity Tier 1 ('CET1') capital		991.2	922.0	948.9	900.8
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		991.2	922.0	948.9	900.8
Corporate bond	32	150.0	150.0	150.0	150.0
Total Tier 2 capital		150.0	150.0	150.0	150.0
Total regulatory capital ('TRC')		1,141.2	1,072.0	1,098.9	1,050.8

* Firms are permitted to phase in the impact of IFRS 9 transition over a five-year period.

⁹ For capital purposes, assets and liabilities held at fair value, such as the Group's derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the 'Simplified Approach' set out in the CRR.

The total risk exposure amount calculated under the CRD IV framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	Regulatory basis		Fully loaded basis	
	2020	2019	2020	2019
	£m	£m	£m	£m
<i>Credit risk</i>				
Balance sheet assets	6,171.7	5,997.2	6,171.7	5,997.2
Off balance sheet	104.1	85.5	104.1	85.5
IFRS 9 transitional relief	42.3	10.5	-	-
Total credit risk	6,318.1	6,093.2	6,275.8	6,082.7
Operational risk	544.3	516.6	544.3	516.6
Market risk	-	-	-	-
Other	85.7	114.0	85.7	114.0
Total risk exposure amount ('TRE')	6,948.1	6,723.8	6,905.8	6,713.3
Solvency ratios				
	%	%	%	%
CET1	14.3	13.7	13.7	13.4
TRC	16.4	15.9	15.9	15.7

This table is not subject to audit

The CRD IV risk weightings for credit risk exposures are currently calculated using the Standardised Approach. The Basic Indicator Approach is used for operational risk.

The table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as shown. The PRA has proposed a minimum UK leverage ratio of 3.25% for UK firms.

	Note	2020	2019
		£m	£m
Total balance sheet assets		15,505.5	14,395.5
Less: Derivative assets	20	(463.3)	(592.4)
Central bank deposits	15	(1,637.1)	(816.4)
CRDs	21	(15.1)	(11.4)
Accrued interest on sovereign exposures		-	(0.2)
On-balance sheet items		13,390.0	12,975.1
Less: Intangible assets	25	(170.1)	(171.1)
Total on balance sheet exposures		13,219.9	12,804.0
Derivative assets	20	463.3	592.4
Potential future exposure on derivatives		92.3	120.0
Total derivative exposures		555.6	712.4
Post offer pipeline at gross notional amount		949.1	903.4
Adjustment to convert to credit equivalent amounts		(773.8)	(739.2)
Off balance sheet items		175.3	164.2
Tier 1 capital		991.2	922.0
Total leverage exposure before IFRS 9 relief		13,950.8	13,680.6
IFRS 9 relief		42.3	25.8
Total leverage exposure		13,993.1	13,706.4
UK leverage ratio		7.1%	6.7%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	2020	2019
	£m	£m
Fully loaded Tier 1 capital	948.9	900.8
Total leverage exposure before IFRS 9 relief	13,950.8	13,680.6
Fully loaded UK leverage exposure	6.8%	6.6%

This table is not subject to audit

The UK leverage ratio is prescribed by the PRA and differs from the leverage ratio defined by Basel and the CRR due to the exclusion of central bank balances from exposures.

The regulatory capital disclosures in these financial statements relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the year.

55. Financial risk management

The principal risks arising from the Group's exposure to financial instruments are credit risk, liquidity risk and market risk (particularly, interest rate risk and currency risk). These risks are discussed in notes 56 to 59 respectively.

The Board has a Risk and Compliance Committee, consisting of the Chair of the Board and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. Executive responsibility for the oversight and operation of the Group's risk management framework is delegated to the Executive Risk Committee ('ERC'). ERC discharges its duties through a number of sub-committees and escalates issues of concern to the Risk and Compliance Committee where appropriate.

The Credit Committee and ALCO are sub-committees of the ERC which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees.

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 56 to 59 is materially similar to that existing throughout the year.

56. Credit risk

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

		The Group		The Company	
	Note	2020	2019	2020	2019
		£m	£m	£m	£m
Financial assets at amortised cost					
Loans to customers	16	12,631.4	12,186.1	-	-
Trade receivables	21	3.2	3.6	-	-
Amounts owed by Group companies	21	-	-	84.0	106.6
Cash	15	1,925.0	1,225.4	12.6	14.1
CSA assets	21	103.5	72.2	-	-
CRDs	21	15.1	11.4	-	-
Accrued interest income	21	0.1	0.4	0.6	0.7
		14,678.3	13,499.1	97.2	121.4
Financial assets at fair value					
Derivative financial assets	20	463.3	592.4	-	-
Maximum exposure to credit risk		15,141.6	14,091.5	97.2	121.4

While this maximum exposure represents the potential loss which might have to be accounted for by the Group, the terms on which a significant proportion of the Group's loan assets are funded, described under Liquidity Risk in note 57, limit the amount of principal repayments on the Group's securitised and warehouse borrowings in cases of capital losses on assets, considerably reducing the effective shareholder value at risk.

All financial assets at amortised cost are subject to the requirements of IFRS 9 relating to impairment.

Further information on the Group's exposure to credit risk by asset type, including the credit quality of assets and any potential concentrations of credit risk, is set out below for:

- Loans to customers
- Cash balances (including CSA assets, CRDs and accrued interest)
- Trade receivables
- Derivative financial assets

Loans to customers

The Group's credit risk is primarily attributable to its loans to customers and its business objectives rely on maintaining a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

Primary responsibility for the management of credit risk relating to lending activities across the Group lies with the Credit Committee. The Credit Committee is made up of senior employees, drawn from financial and risk functions independent of the underwriting process. It is chaired by the Credit Risk Director. Its key responsibilities include setting and reviewing credit policy, controlling applicant quality, tracking account performance against targets, agreeing product criteria and lending guidelines and monitoring performance and trends.

The Group's underwriting philosophy is based on a combination of sophisticated individual credit assessment and the automated efficiencies of a scored decision making process. Information on each applicant is combined with data taken from a credit reference bureau to provide a complete credit picture of the applicant and the borrowing requested. Key information is validated through a combination of documentation and statistical data which collectively provides evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement. In assessing credit risk, even where the Group would have security on a proposed loan, an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend.

In considering whether to acquire pools of loan assets, the Group will undertake a due diligence exercise on the underlying loan accounts. Such assets are generally not fully performing and are offered at a discount to their current balance. The Group's procedures may include inspection of original loan documents, verification of security and the examination of the credit status of borrowers. Current and historic cash flow data will also be examined. The objective of the exercise is to establish, to a level of confidence similar to that provided by the underwriting process, that the assets will generate sufficient cash flows to recover the Group's investment and generate an appropriate return without exposing the Group to material operational or conduct risks.

This section sets out information relevant to assessing the credit risk inherent in the Group's loans to customers balances. It is set out in the following subsections:

- Types of lending and related security
- Overall credit grading
- Credit characteristics of particular portfolios
- Arrears performance
- Acquired assets

Types of lending

The Group's balance sheet loan assets at 30 September 2020 are analysed as follows:

	2020 £m	2020 %	2019 £m	2019 %
Buy-to-let mortgages	10,583.8	83.8%	10,101.9	82.9%
Owner-occupied mortgages	53.1	0.4%	70.6	0.6%
Total first charge residential mortgages	10,636.9	84.2%	10,172.5	83.5%
Second charge mortgage loans	354.5	2.8%	389.2	3.2%
Loans secured on residential property	10,991.4	87.0%	10,561.7	86.7%
Development finance	609.0	4.8%	506.5	4.1%
Loans secured on property	11,600.4	91.8%	11,068.2	90.8%
Asset finance loans	452.0	3.6%	472.9	3.9%
Motor finance loans	272.4	2.2%	318.9	2.6%
Aircraft mortgages	26.0	0.2%	19.3	0.2%
Structured lending	94.9	0.7%	88.1	0.7%
Invoice finance	13.5	0.1%	18.5	0.1%
Total secured loans	12,459.2	98.6%	11,985.9	98.3%
Professions finance	22.3	0.2%	46.2	0.4%
CBILS and BBLS	25.2	0.2%	-	-
Other unsecured commercial loans	15.0	0.1%	19.3	0.2%
Unsecured consumer loans	109.7	0.9%	134.7	1.1%
Total loans to customers	12,631.4	100.0%	12,186.1	100.0%

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

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

Professions finance are generally short-term unsecured loans made to firms of lawyers and accountants for working capital purposes.

Loans made under the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') have the benefit of a guarantee underwritten by the UK Government.

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

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's loans to customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	2020 £m	2019 £m
Buy-to-let mortgages	154.3	149.7
Development finance	240.0	212.7
Structured lending	72.7	78.8
Asset finance	-	-
	467.0	441.2

The threshold of £10.0m is used internally for monitoring large exposures.

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2020 is set out below. The analysed amount represents gross carrying amount.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2020					
Very low risk	8,771.2	453.3	20.8	45.9	9,291.2
Low risk	1,229.2	120.9	10.7	21.7	1,382.5
Moderate risk	742.2	184.7	12.1	32.8	971.8
High risk	285.2	143.9	50.7	32.0	511.8
Very high risk	48.3	67.9	49.9	22.9	189.0
Not graded	253.6	74.7	31.9	6.7	366.9
Total gross carrying amount	11,329.7	1,045.4	176.1	162.0	12,713.2
Impairment	(22.2)	(15.8)	(43.4)	(0.4)	(81.8)
Total loans to customers	11,307.5	1,029.6	132.7	161.6	12,631.4
30 September 2019					
Very low risk	8,693.9	92.8	26.5	49.4	8,862.6
Low risk	1,267.2	77.5	6.7	26.5	1,377.9
Moderate risk	781.9	75.0	9.3	45.2	911.4
High risk	353.2	153.0	67.9	48.5	622.6
Very high risk	86.0	47.0	44.0	38.7	215.7
Not graded	200.4	13.2	13.5	10.7	237.8
Total gross carrying amount	11,382.6	458.5	167.9	219.0	12,228.0
Impairment	(6.0)	(3.7)	(32.2)	-	(41.9)
Total loans to customers	11,376.6	454.8	135.7	219.0	12,186.1

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to Stage 3 cases reported in note 19, other than those shown as 'realisations'.

Examples of these cases include fully up-to-date receiver of rent cases, customers who may be up to date on accounts with other lenders and accounts where the default on the Group's loan has yet to impact on external credit score.

A small proportion of the loan book (2020: 2.9%, 2019: 1.9%) is classed as 'not graded' above. This rating relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion. This disclosure is expected to be developed further in future.

Credit characteristics by portfolio

Loans secured on residential property

First mortgage loans have a contractual term of up to thirty years and second charge mortgage loans up to twenty five years. In all cases the borrower is entitled to settle the loan at any point and in most cases early settlement does take place. All borrowers on these accounts are required to make monthly payments.

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on residential property by value at 30 September 2020 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	First charge mortgages		Second charge mortgages	
	2020	2019	2020	2019
	%	%	%	%
Loan to value ratio				
Less than 70%	59.9	54.3	74.5	66.5
70% to 80%	35.9	36.2	16.7	18.5
80% to 90%	2.3	7.2	5.2	8.9
90% to 100%	0.4	0.6	1.2	2.7
Over 100%	1.5	1.7	2.4	3.4
	100.0	100.0	100.0	100.0
Average LTV ratio	65.7	67.3	62.2	65.7
<i>Of which:</i>				
Buy-to-let	65.8	67.4		
Owner-occupied	49.2	53.2		

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 5.0% in the year ended 30 September 2020 (2019: 0.2%).

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First charge		Second charge	
	2020	2019	2020	2019
	%	%	%	%
East Anglia	3.2	3.2	3.3	3.3
East Midlands	5.4	5.3	6.1	6.3
Greater London	18.7	18.9	8.2	7.8
North	3.2	3.3	3.9	4.2
North West	10.4	10.1	7.4	8.0
South East	31.6	31.9	39.5	37.7
South West	8.7	8.9	8.0	7.9
West Midlands	5.4	5.1	7.3	7.6
Yorkshire and Humberside	8.4	8.6	5.9	6.2
Total England	95.0	95.3	89.6	89.0
Northern Ireland	0.1	0.1	1.7	1.9
Scotland	1.7	1.4	5.2	5.6
Wales	3.2	3.2	3.5	3.5
	100.0	100.0	100.0	100.0

Development finance

Development finance loans have an average term of 21 months (2019: 20 months). Settlement of principal and accrued interest takes place once the development is sold or refinanced following its completion and the customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and/or property together with other charges and warranties related to the build.

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

	2020 By value %	2020 By number %	2019 By value %	2019 By number %
LTGDV				
50% or less	7.6	4.8	8.5	3.4
50% to 60%	22.4	13.2	18.2	15.5
60% to 65%	34.0	41.0	31.6	39.1
65% to 70%	31.3	36.1	32.3	32.4
70% to 75%	2.8	4.0	6.8	8.2
Over 75%	1.9	0.9	2.6	1.4
	100.0	100.0	100.0	100.0

The average LTGDV cover at the year end was 63.1% (2019: 64.8%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports. The Covid-19 pandemic had yet to have a significant impact on expected valuations by the year end.

At 30 September 2020, the development finance portfolio comprised 229 accounts (2019: 207) with a total carrying value of £609.0m (2019: £506.5m). Of these accounts only 7 were included in Stage 2 at 30 September 2020 (2019: 6), with 1 account classified as Stage 3 (2019: none). In addition, 1 account acquired in the Titlestone purchase had been classified as POCI (2019: 3). An allowance for these losses was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	2020 %	2019 %
East Anglia	5.1	3.1
East Midlands	5.5	2.9
Greater London	8.2	12.1
North	1.8	1.0
North West	0.4	0.1
South East	58.8	56.8
South West	14.0	13.9
West Midlands	4.0	7.2
Yorkshire and Humberside	1.1	1.5
Total England	98.9	98.6
Northern Ireland	-	-
Scotland	1.1	1.4
Wales	-	-
	100.0	100.0

Asset finance and Motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IFRS 16 (2019: IAS 17). The average contractual life of the asset finance loans was 52 months (2019: 56 months) while that of the motor finance loans was 60 months (2019: 57 months), but it is likely that a significant proportion of customers will choose to settle their obligations early.

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending by gross carrying value is set out below.

	2020	2019
	%	%
Commercial vehicles	32.0	30.3
Construction plant	33.7	34.8
Technology	6.9	7.8
Manufacturing	6.7	6.1
Print and paper	3.7	4.8
Refuse disposal vehicles	4.8	5.2
Other vehicles	3.6	3.0
Agriculture	2.9	2.7
Other	5.7	5.3
	100.0	100.0

Motor finance loans are secured over cars, motorhomes and light commercial vehicles and represent exposure to consumers and small businesses.

Structured lending

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

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

	2020	2019
Number of transactions	8	8
Total facilities (£m)	139.0	135.0
Carrying value (£m)	94.9	88.1

The maximum advance under these facilities was 80% of the underlying assets.

These accounts do not have a requirement to make regular payments, operating on a revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 30 September 2020, 4 of these facilities were identified as Stage 2 (2019: none) with the remainder in Stage 1.

CBILS and BBLS

Loans under these schemes, which were launched in the year as a response to the impact of Covid-19 on UK SMEs, have the benefit of guarantees underwritten by the UK Government.

The Group offers term loans and asset finance loans under the CBIL scheme. Interest and fees are paid by the UK Government for the first twelve months and the government guarantee caps the lender's losses at up to 80% of the outstanding balance.

Loans under the BBL scheme are six year term loans at a standard 2.5% per annum interest rate. The UK Government pays the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group's outstanding CBILS and BBLS loans at 30 September 2020 were:

	2020	2019
	£m	£m
CBILS		
Term loans	20.6	-
Asset finance	1.0	-
Total CBILS	21.6	-
BBLS	3.6	-
	25.2	-

At 30 September 2020, all of these accounts were considered to be performing accounts.

Unsecured consumer loans

Almost all of the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. Collections on purchased accounts remain in excess of those implicit in the purchase prices.

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2020 and 30 September 2019, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2020 %	2019 %
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.15	0.18
Buy-to-let accounts excluding receiver of rent cases	0.10	0.07
Owner-occupied accounts	3.72	2.44
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.52	0.42
Buy-to-let accounts excluding receiver of rent cases	0.50	0.37
Owner-occupied accounts	0.90	0.81
All mortgages	0.82	0.73
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	14.77	14.08
Post-2010 originations	0.62	0.38
Legacy cases (Pre-2010 originations)	21.17	19.85
Purchased assets	17.85	16.05
FLA data for secured loans	8.40	8.70
Motor finance loans		
Accounts more than 2 months in arrears		
All accounts	4.58	5.25
Originated cases	1.76	1.27
Purchased assets	13.10	12.13
FLA data for point of sale hire purchase	*	2.70
Asset finance loans		
Accounts more than 2 months in arrears	1.75	0.43
FLA data for business lease / hire purchase loans	1.70	1.10

* Not published

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2019 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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

It should be noted that, where customers have been allowed to defer payments as part of Covid 19 reliefs, these deferrals are not included in arrears measures above.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased Idem Capital assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans incorporate purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price. However, this will lead to higher than average reported arrears.

Acquired assets

Almost all of the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. No additional loans to customers treated as POCI were acquired in the year ended 30 September 2020. The total amount of undiscounted ECL at initial recognition on POCI loans to customers initially recognised during the year ended 30 September 2019 was minimal due to the level of purchases.

Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

In the debt purchase industry, Estimated Remaining Collections ('ERCs') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (which will be treated as POCI under IFRS 9), but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERC values for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	2020	2019	2018
	£m	£m	£m
All purchased consumer assets			
Carrying value	235.3	291.1	364.2
84 month ERC	277.8	342.3	434.9
120 month ERC	313.7	387.5	489.6
POCI assets only			
Carrying value	139.8	168.3	204.4
84 month ERC	176.9	214.1	269.9
120 month ERC	203.7	246.0	306.2

Amounts shown above are disclosed as loans to customers (note 16). They include first mortgages, second charge mortgage loans and unsecured consumer loans.

Cash balances

The credit risk inherent in the cash positions of the Group and the Company is controlled by ALCO, which determines with which institutions deposits may be placed with.

For cash deposits within the Group's securitisation structures, the scheme documents will set out criteria for allowable investments, including rating thresholds, which are monitored by the external trustees of each transaction.

The Group's cash balances are held in sterling at the Bank of England and at highly rated banks in current and call accounts. Cash is also invested in UK government securities and as short fixed term money market deposits. The Group has a Wholesale Credit Risk Policy including limits on large exposures to mitigate any concentration risk in respect of its investments.

The carrying value of the Group's and the Company's cash balances analysed by their long-term credit rating as determined by Fitch is set out below.

	2020 £m	2019 £m
The Group		
Cash with central banks rated:		
AA	-	816.4
AA-	1,637.1	-
	1,637.1	816.4
Cash with retail banks rated:		
AA-	112.0	230.5
A+	175.9	173.5
A-	-	5.0
	287.9	409.0
Total exposure	1,925.0	1,225.4
The Company		
Cash with retail banks rated:		
A+	12.6	9.1
A-	-	5.0
	12.6	14.1

The reduction in the rating on central bank deposits is a result of the downgrade of the UK's sovereign rating in the year.

CRDs share the central bank rating noted above while CSA assets, placed with retail banks, have similar ratings to those shown above.

Credit risk on all of these balances, and any interest accrued thereon, is considered to be minimal. These balances are considered as Stage 1 for IFRS 9 impairment purposes with a probability of default such that any provision required would be immaterial.

Trade debtors

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

Financial assets at fair value

The Group's financial assets held at fair value comprise solely derivative financial instruments used for hedging purposes (note 20).

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Such counterparties are typically highly rated banks and, for all derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally.

Where a derivative counterparty to the Group's cross-currency basis swaps fails to meet the required criteria, they are obliged under the terms of the instruments to provide a cash collateral deposit. These cash collateral deposits are held in escrow and not recognised as assets of the Group so do not form part of the Group's cash position.

The Group uses the International Swaps and Derivatives Association ('ISDA') Master Agreement for documenting certain derivative activity. For certain counterparties a Credit Support Annex ('CSA') has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to such counterparties by the Group is shown in note 21, while collateral pledged to the Group is shown in note 34.

Since June 2019, the Group has been centrally clearing eligible derivatives with a Central Clearing Counterparty ('CCP') which removes credit risk between bilateral counterparties and ensures timely settlement and / or porting of derivative contracts in the event of the failure of a counterparty.

The Group's exposure to credit risk in respect of the counterparties to its derivative financial assets, analysed by their long-term credit rating as determined by Fitch is set out below.

	2020	2019
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	-	7.3
AA-	97.8	155.6
A+	364.2	388.8
A	1.3	5.5
A-	-	35.2
Gross exposure (note 20)	463.3	592.4
Collateral amounts posted		
Cross-currency basis swap arrangements	-	64.1
CSA collateral amounts (note 34)	-	-
Total collateral	-	64.1
Net exposure	463.3	528.3

57. Liquidity risk

Liquidity risk is the risk that the Group might be unable meet its liabilities as they fall due.

The Group's principal source of liquidity risk is from its retail deposit funding. Deposit balances raised are typically used to support lending activities where maturity is over a longer period than that of the deposits. This maturity transformation exposes the Group to liquidity risk.

Further liquidity risk arises:

- In the medium term from the Group's corporate and retail bonds which are used to support its general operations and from its participation in central bank funding schemes;
- From the Group's derivatives portfolio which gives rise to liquidity risk due to the collateral requirements to cover adverse changes in valuation; and
- From the Group's participation in the SPVs where sufficient funding must be available.

Liquidity is also required to provide capital support for new loans and working capital for the Group.

Where assets are funded by non-recourse arrangements, through the securitisation process, liquidity risk is effectively eliminated.

As an authorised deposit taker, the liquidity position of Paragon Bank PLC, the Group's banking subsidiary, is also managed on a stand-alone basis.

Set out below is a summary of the contractual cash flows expected to arise from the Group's financial and leasing liabilities, based on the earliest date at which repayment can be demanded.

	Amounts payable				Total
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	
	£m	£m	£m	£m	£m
30 September 2020					
Retail deposits	5,740.0	1,608.2	704.5	-	8,052.7
Borrowings	792.9	398.7	1,079.0	161.5	2,431.5
Total non-derivative liabilities	6,532.9	2,066.3	1,783.5	161.5	10,484.2
Derivative liabilities	5.1	5.2	1.8	-	12.1
	6,538.0	2,071.5	1,785.3	161.5	10,496.3
30 September 2019					
Retail deposits	4,418.0	1,210.1	982.4	-	6,610.5
Borrowings	89.9	794.6	551.8	171.8	1,608.1
Total non-derivative liabilities	4,507.9	2,004.7	1,534.2	171.8	8,218.6
Derivative liabilities	(0.1)	2.9	1.8	-	4.6
	4,507.8	2,007.6	1,536.0	171.8	8,223.2

Non-recourse balances are payable only to the extent that funds are available, as described further below, and do not expose the Group to any material liquidity risk. They are therefore not included in the table above.

As the amounts set out above include all expected future cash flows, including principal and interest, they will not agree to amortised cost or fair value amounts reported in the balance sheet.

Further information on the liquidity exposure arising from the Group's retail deposits, securitisation and other borrowings is set out below.

The liquidity exposures of the Company arise only from its borrowings, and are set out below.

The overall responsibility for the management of liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for board approval. ALCO monitors liquidity risk metrics within limits set by the Board or regulators and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

The Group's and the Bank's liquidity position is managed on a day to day basis by the treasury function, under the supervision of ALCO.

Retail deposits

The Group's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, 97.3% (2019: 97.8%), are protected by the Financial Services Compensation Scheme ('FSCS') which mitigates against the possibility of a retail run.

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

	2020	2019
	£m	£m
Payable on demand	2,363.8	1,783.9
Payable in less than three months	598.3	482.7
Payable in less than one year but more than three months	2,777.9	2,151.4
Payable in less than one year or on demand	5,740.0	4,418.0
Payable in one to two years	1,608.2	1,210.1
Payable in two to five years	704.5	982.4
	8,052.7	6,610.5

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

At 30 September 2020 the liquidity buffer comprised the following on and off balance sheet assets. All of these assets are held within the Bank and are readily realisable.

	Note	2020	2019
		£m	£m
Balances with central banks		1,386.9	646.4
Total on balance sheet liquidity		1,386.9	646.4
FLS drawings	33	-	109.0
Long/ short repo transaction		150.0	-
		1,536.9	755.4

Balances with central banks above exclude group cash balances placed on deposit at the Bank of England through Paragon Bank.

Paragon Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA') relative to its short-term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement, is set through regulation for all regulated financial institutions. As at 30 September 2020, the Bank's LCR was comfortably above the required minimum regulatory standard. The Bank also monitors its Net Stable Funding Ratio ('NSFR') which measures the stability of the funding profile in relation to the composition of its assets and off balance sheet activities.

Liquidity is not regulated at Group level.

Borrowings

Set out below is the contractual maturity profile of the Group's and the Company's borrowings at 30 September 2020 and 30 September 2019 based on their carrying values. These are analysed between non-recourse (securitisation) and other funding, with the liquidity position arising principally from the other funding.

The Group

	Financial liabilities falling due:				Total
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	
	£m	£m	£m	£m	£m
30 September 2020					
Secured bank borrowings	-	-	-	657.8	657.8
Asset backed loan notes	-	-	-	3,207.5	3,207.5
Total non-recourse funding	-	-	-	3,928.3	3,928.3
Bank overdrafts	0.4	-	-	-	0.4
Retail bonds	60.0	124.8	112.0	-	296.8
Corporate bond	-	-	-	149.8	149.8
Central bank facilities	700.0	244.4	910.0	-	1,854.4
Lease liabilities	1.5	1.1	2.4	0.6	5.6
	761.9	370.3	1,024.4	4,078.7	6,235.3
30 September 2019					
Secured bank borrowings	-	-	-	787.5	787.5
Asset backed loan notes	-	-	-	4,419.4	4,419.4
Total non-recourse funding	-	-	-	5,206.9	5,206.9
Bank overdrafts	1.0	-	-	-	1.0
Retail bonds	-	59.9	236.6	-	296.5
Corporate bond	-	-	-	149.6	149.6
Central bank facilities	50.0	700.0	244.4	-	994.4
Lease liabilities	-	-	-	-	-
	51.0	759.9	481.0	5,356.5	6,648.4

The Company

	Financial liabilities falling due:				Total
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	
	£m	£m	£m	£m	£m
30 September 2020					
Retail bonds	60.0	124.8	112.0	-	296.8
Corporate bond	-	-	-	149.8	149.8
Lease liabilities	1.2	1.3	4.0	11.0	17.5
	61.2	126.1	116.0	160.8	464.1
30 September 2019					
Retail bonds	-	59.9	236.6	-	296.5
Corporate Bond	-	-	-	149.6	149.6
Lease liabilities	-	-	-	-	-
	-	59.9	236.6	149.6	446.1

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are described and set out on the following pages.

Non-recourse funding

The Group has historically used securitisation as a principal source of funding, but currently only accesses this market on a strategic basis. In a securitisation an SPV company within the Group will issue asset backed loan notes ('Notes') secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 29 and the assets backing the Notes are shown in note 17.

In each case the Group provides funding to the SPV at inception, subordinated to the Notes, which means that the primary credit risk on the pool assets is retained within the Group. The Group receives the residual income generated by the assets. These factors mean that the risks and rewards of ownership of the assets remain with the Group, and hence the loans remain on the Group's balance sheet.

Cash received from time to time in each SPV is held until the next interest payment date when, following payment of principal, interest and the associated costs of the SPV, the remaining balances become available to the Group. Cash balances are also held within each SPV to provide credit enhancement for the particular securitisation, allowing interest and principal payments to be made even if some of the loans default.

To provide further credit enhancement in certain SPVs, specific economic trigger events exist which cause additional cash to be retained in the SPV rather than being transferred to the Group. While the Group can, if it chooses, contribute additional cash to cover these requirements, it is under no obligation to do so. No such events occurred in the year ended 30 September 2020 or the year ended 30 September 2019. Whether any such events in any of the Group's other SPVs arise in the future will depend on the performance of the general economy and its impact on mortgage and loan arrears in each SPV. However, if all of the remaining trigger events occurred, a total of £25.0m of additional cash would be retained in the SPV companies (2019: £55.8m). The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 15 as 'securitisation cash'.

Newly originated mortgage loans may be initially funded by a revolving loan facility or 'warehouse' from the point of their origination until their inclusion in a securitisation transaction or other refinancing. A warehouse may also be used to hold acquired loans or to refinance Group loans on a short-term basis. A warehouse company functions in a similar way to an SPV, except that funds are drawn down as advances are made or loans are sold in, repaid when loans are securitised or refinanced by an internal asset sale and may subsequently be redrawn up to the end of a commitment period. The Group's Paragon Second Funding facility was initiated as a warehouse, but is no longer available for new drawings.

Repayment of the principal amount of the facilities is not required unless amounts are realised from the secured assets either through repayment, securitisation or asset sales, even after the end of the period. There is no further recourse to other assets of the Group in respect of either interest or principal on the borrowings. The Group has increased its available warehouse facilities in the period.

As with the SPVs, the Group provides subordinated funding to active warehouse companies and restricted cash balances are held within them. Contributions to the subordinated funding are made each time a drawing on the facility concerned is made. These amounts provide credit enhancement to the warehouse and cover certain fees. This funding is repaid when assets are securitised or refinanced by an internal asset sale. There were no active warehouse companies at 30 September 2020 or 30 September 2019, but undrawn facilities of £400.0m were available at the year end (2019: £200.0m).

Further details of the warehouse facilities are given in note 30 and details of the loan assets within the warehouses are given in note 17.

The final repayment date for all of the securitisation borrowings and the Paragon Second Funding warehouse borrowing is more than five years from the balance sheet date, the earliest falling due in 2039 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2020 under the SPV and warehouse arrangements, allowing for the effect of the cross-currency basis swaps, described under currency risk (note 59), which are net settled with the loan payments, was £3,489.1m (2019: £4,706.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £4,423.0m (2019: £6,276.6m). As the principal will, as discussed above, reduce as customers repay or redeem their accounts, the cash flow will be far less than this amount in practice.

Corporate debt

In February 2013, the Company initiated a Euro Medium Term Note issuance programme, with a maximum issuance of £1,000.0m. The Company had the ability to issue further notes under the programme and has issued three fixed rate bonds for a total of £297.5m, with interest rates ranging from 6.000% to 6.125% and maturities ranging from December 2020 to August 2024, the most recent issue of £112.5m being made in August 2015. This programme offers the Group opportunities to raise further working capital if needed.

The Group also issued £150.0 of tier 2 debt in September 2016 with an optional call date in September 2021 and a final maturity of September 2026.

The Group's ability to issue debt is supported by its credit rating issued by Fitch which was increased to BBB from BBB- in the year ended 30 September 2018 and confirmed in March 2019. Fitch's published outlook for the rating was, however, revised to negative in March 2020, due to the agency's expectation of weaker UK growth in 2020 as a result of Covid-19, in common with the ratings of other UK banks.

Of the Group's corporate and retail bond issuance, £60.0m falls due for payment in the next twelve months.

Central bank facilities

The Group has accessed term facilities under the central bank schemes described in note 33. The Group has prepositioned further assets with the Bank of England which can be used to release more funds for liquidity or other purposes. At 30 September 2020 the amount of drawings available in respect of prepositioned assets was £684.0m (2019: £1,095.0m).

Additional Liquidity

The Group holds certain of its own listed, externally rated, asset backed securities which may be used as security to access credit facilities, including those offered by the Bank of England. The principal value of these notes is analysed by credit grade and utilisation status below.

	2020			2019		
	Utilised £m	Available £m	Total £m	Utilised £m	Available £m	Total £m
Rating						
AAA	367.8	643.6	1,011.4	57.5	341.2	398.7
AA+ / AA / AA-	3.4	64.2	67.6	1.2	24.6	25.8
A+ / A / A-	3.6	51.8	55.4	2.5	30.1	32.6
BBB+ / BBB / BBB-	3.4	64.2	67.6	18.5	43.4	61.9
	378.2	823.8	1,202.0	79.7	439.3	519.0

As these notes are held internally, they are not included in balance sheet liabilities. Mortgage assets backing these securities remain on the Group's balance sheet and are included in amounts pledged as collateral in note 17.

Utilised notes includes those which the Group is obliged to hold under regulations governing securitisation issuance.

The available AAA notes would give access to £502.5m (2019: £276.0m) if used to secure drawings on Bank of England facilities.

Additional notes issued after the year end (note 29) provide access to further liquidity.

During the year, the Group entered in to a back-to-back long / short repo transaction with a UK bank. This provides £150.0m of liquidity, utilising £178.5m of the loan notes shown above, but does not appear on the Group's balance sheet.

Contractual cash flows

The total undiscounted amounts, inclusive of estimated interest, which would be payable in respect of the non-securitisation borrowings of the Group and the Company, should those balances remain outstanding until the contracted repayment date, or the earliest date on which repayment can be required, are set out below.

	Contingent consideration	Corporate bonds	Retail bonds	Central bank facilities	Lease liabilities	Total
	£m	£m	£m		£m	£m
a) The Group						
30 September 2020						
Payable in:						
Less than one year	3.2	10.9	75.3	701.9	1.6	792.9
One to two years	5.0	10.9	135.6	245.4	1.2	398.1
Two to five years	5.8	32.6	126.0	912.0	2.6	1,079.0
Over five years	-	160.9	-	-	0.6	161.5
	14.0	215.3	336.9	1,859.3	6.0	2,431.5

30 September 2019

Payable in:						
Less than one year	5.7	10.9	18.0	55.3	-	89.9
One to two years	6.2	10.9	75.3	702.2	-	794.6
Two to five years	12.7	32.6	261.6	244.9	-	551.8
Over five years	-	171.8	-	-	-	171.8
	24.6	226.2	354.9	1,002.4	-	1,608.1

	Corporate bonds	Retail bonds	Lease liabilities	Total
	£m	£m	£m	£m
a) The Company				
30 September 2020				
Payable in:				
Less than one year	10.9	75.3	1.7	87.9
One to two years	10.9	135.6	1.7	148.2
Two to five years	32.6	126.0	5.0	163.6
Over five years	160.9	-	12.0	172.9
	215.3	336.9	20.4	572.6

30 September 2019

Payable in:				
Less than one year	10.9	18.0	-	28.9
One to two years	10.9	75.3	-	86.2
Two to five years	32.6	261.6	-	294.2
Over five years	171.8	-	-	171.8
	226.2	354.9	-	581.1

Amounts payable in respect of the 'other accruals' and 'trade creditors' shown in note 34 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2020 disclosed in note 34.

The cash flows which are expected to arise from derivative contracts in place at the year end, estimating future floating rate payments and receipts on the basis of the yield curve at the balance sheet date are as follows:

	2020	2019
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	5.1	(0.1)
Payable in one to two years	5.2	2.9
Payable in two to five years	1.8	1.8
Payable in over five years	-	-
	12.1	4.6
On derivative assets		
Payable in less than one year	(38.1)	(14.0)
Payable in one to two years	(43.4)	(20.8)
Payable in two to five years	(45.7)	(42.0)
Payable in over five years	(0.1)	(0.5)
	(127.3)	(77.3)
	(115.2)	(72.7)

58. Interest rate risk

Interest rate risk is the current or prospective risk to capital or earnings arising from adverse movements in interest rates. The Group's exposure to this risk is a natural consequence of its lending, deposit taking and other borrowing activities, as some of its financial assets and liabilities bear interest at rates which float with various market rates while others are fixed, either for a term or for their whole lives. Such risk is referred to as Interest Rate Risk in the Banking Book ('IRRBB'). The Group does not seek to generate income from taking interest rate risk and aims to minimise exposures that occur as a natural consequence of carrying out its normal business activities.

The principal market-set interest rate used by the Group has historically been LIBOR, which has been used to set rates for certain loan assets and borrowings. However, the Group has continued to move towards the use of alternative reference rates during the year, with new wholesale debt and interest rate swaps referencing SONIA in response to the expected withdrawal of LIBOR from late 2021. This process is expected to continue in the new financial year.

The Group's risk management framework for IRRBB continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks measuring, managing, monitoring and controlling such risks. The Group will continue to develop these processes as interpretation of these standards becomes clearer as they become more widely implemented.

IRRBB is managed through board approved risk appetite limits and policies. The Group seeks to match the structure of assets and liabilities naturally where possible or by using appropriate financial instruments, such as interest rate swaps. Day to day management of interest rate risk is the responsibility of the Group's Treasury function, with control and oversight provided by ALCO.

IRRBB exposures

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

- Duration or re-pricing risk. The risk created when interest rates on assets, liabilities and off-balance sheet items reprice at different times causing them to move by different amounts
- Basis risk. The risk arising where assets and liabilities re-price with reference to different reference interest rates, for example rates set by the Group and market rates, such as Bank of England base rate, SONIA and LIBOR. Relative changes in the difference between the reference rates over time may impact earnings
- Optionality or prepayment risk. The risk that settlement of asset and liability balances at different times from those forecast due to economic conditions or customer behaviour may create a mismatch in future periods

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

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

- Economic Value ('EV') – a range of parallel and non-parallel interest rate stresses are applied to assess the change in market value from assets, liabilities and off balance sheet items re-pricing at different times
- Net Interest Income ('NII') - impact on earnings from a range of interest rate stresses

Interest rate benchmarks such as LIBOR have been subject to increasing global regulatory scrutiny. In July 2017 the FCA announced that it was its intention that by the end of 2021 it would no longer compel banks to make submissions to the LIBOR setting process. As a result of this, LIBOR is expected to be discontinued. The Bank of England's Working Group on Sterling Risk-Free Interest Rates has recommended SONIA as its replacement. However, there remains significant uncertainty as to how the transition from LIBOR and other Interbank Offered Rates to alternative benchmarks will be managed across the banking industry.

LIBOR is used in setting interest rates on significant amounts of the Group's loan assets and borrowings and an internal working group exists to identify the impact on the business and ensure an orderly transition from LIBOR to other reference rates across all classes of financial instrument.

The current balances of the Group's loans to customers where the interest rate or the reversionary interest rate is set by reference to IBOR are set out below.

	2020	2019
	£m	£m
First mortgages	3,750.0	4,079.0
Development finance facilities	234.6	101.6
Second charge mortgages	61.4	-
Structured lending	94.9	88.1
Aviation mortgages	24.1	17.2
	4,165.0	4,285.9

The second charge mortgages shown above were moved to LIBOR as a temporary measure following the withdrawal of the Finance House Base Rate in the year.

All structured lending agreements include fallback language to manage the transition from LIBOR.

Borrowings where interest rates are based on LIBOR and other IBOR rates are shown in notes 29 and 30. Derivative financial assets and liabilities where cash flows are based on IBOR rates are shown in note 20, where the Group's transition planning activities are also discussed.

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 20.

Interest rate sensitivity

To provide a broad indication of the Group's exposure to interest rate movements, the notional impact of a 1.0% change in UK interest rates on the equity of the Group at 30 September 2020, and the notional annualised impact of such a change on the operating profit of the Group, based on the year end balance sheet have been calculated.

As a simplification this calculation assumes that all relevant UK interest rates move by the same amount in parallel and that all repricing takes place at the balance sheet date.

On this basis, a 1.0% increase in UK interest rates would reduce the Group's equity at 30 September 2020 by £0.9m (2019: £1.1m) and increase profit before tax by £19.8m (2019: increase by £10.1m).

This calculation allows only for the direct effects of any change in UK interest rates. In practice, such a change might have wider economic consequences which would themselves potentially affect the Group's business and results.

Although certain of the Group's borrowings have interest rates dependent on US Dollar and Euro LIBOR rates, the effect of the cross-currency basis swaps is such that the Group's results have no material exposure to movements in these rates. The effects of independent 1.0% increases in US dollar or euro interest rates would be to increase the Group's equity by £0.3m (2019: £0.4m) and £0.9m (2019: £1.1m) respectively, however, in reality these movements would be mitigated by movements in UK interest rates and exchange rates.

It should be noted that these sensitivities are illustrative only, and much simplified from those used to manage IRRBB in practice.

The Company

All the borrowings of the Company have fixed interest rates. Its assets and liabilities with other group companies bear interest at floating rates based on LIBOR which reset within three months of the balance sheet date; all other balances in the Company balance sheet are non-interest bearing. The interest charging rates on the Company's financial assets and liabilities with other group entities will be transitioned away from LIBOR as part of the overall group project.

59. Currency risk

The Group has little appetite for material amounts of exposure to foreign currency movements and applies a hedging strategy for any material open positions through the use of spot or forward contracts or derivatives.

All of the Group's significant assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in US dollars and euros, which are described in note 29. Although IFRS 9 requires that they be accounted for as currency liabilities and valued at their spot rates, a condition of the issue of these notes was that bespoke interest rate and currency swaps ('cross-currency basis swaps') were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR-linked floating rate sterling borrowing eliminating currency risk for these exposures. The amount of this effective borrowing, ie the amount of the currency borrowing translated at the exchange rate on inception, is referred to as the 'equivalent sterling principal'.

The equivalent sterling principal amounts of notes in issue under the arrangements described above, and their carrying values at 30 September 2020 and 30 September 2019 are set out below:

	2020 Equivalent sterling principal £m	2020 Carrying value £m	2019 Equivalent sterling principal £m	2019 Carrying value £m
US dollar notes	397.0	609.6	447.5	721.6
Euro notes	687.5	917.8	1,007.4	1,314.1
	1,084.5	1,527.4	1,454.9	2,035.7

The asset finance business has a limited amount of lending denominated in US dollars and may contract to purchase assets for leasing in currency. These balances are hedged by the purchase of currency derivatives and/or appropriate currency balances.

As a result of these arrangements the Group has no material exposure to foreign currency risk, and no sensitivity analysis is presented for currency risk.

The Group's use of financial derivatives to manage currency risk is described further in note 20.

None of the assets or liabilities of the Company are denominated in foreign currencies.

D2.4 Notes to the Accounts - Basis of preparation

For the year ended 30 September 2020

The notes set out below describe the accounting basis on which the Group and the Company prepare their accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared required by legislation and accounting standards.

60. Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU. In the financial years reported upon this means that, in the Group's circumstances, the financial statements accord also with International Financial Reporting Standards as approved by the International Accounting Standards Board.

The particular accounting policies adopted have been set out in note 62 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in notes 63 and 64 respectively.

The Group has historically chosen to present an additional comparative balance sheet. The Group adopted IFRS 9 in its 2019 financial statements and, as required by that standard, did not restate its 2018 comparative information. In the financial statements for the year ended 30 September 2019, the Group presented an IFRS 9 transition date balance sheet as at the first day of that financial year, 1 October 2018. In the current year, as the Group presents three years of balance sheet information it has continued to present the IFRS 9 transition date balance sheet as an additional comparative.

Adoption of new and revised reporting standards

In the preparation of these financial statements, the following accounting standards are being applied for the first time.

- IFRS 16 – 'Leases'
- 2019 amendments to IAS 39 – 'Interest Rate Benchmark Reform' and consequential amendments to IFRS 7

The effect on the Group's and the Company's accounting of the adoption of these standards is discussed in note 61.

Impact of UK departure from the EU

Under the International Accounting Standards and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, despite the UK's exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Group until its first financial year commencing after the conclusion of the UK's Transition Period, currently expected to end on 31 December 2020.

Therefore, while EU endorsed IFRS applies to these financial statements and will apply to the financial statements for the year ending 30 September 2021, those for the year ending 30 September 2022 will instead be prepared under 'UK-adopted international accounting standards'. It is anticipated that 'UK-adopted international accounting standards' will be equivalent to IFRS as adopted by the EU at the point of transition and that there would be no amendments required in the Group's accounting as a result of that change.

Comparability of information

IFRS 16 does not require that the balance sheet information at 30 September 2018 and 30 September 2019 and the profit and loss information for the years ended on these dates is restated on the adoption of the Standard. The information presented for those periods in these financial statements is derived in accordance with IAS 17 - 'Leases' ('IAS 17'), and therefore may not be directly comparable with the balance sheet at 30 September 2020 and the profit and loss account for the year then ended which are prepared under IFRS 16.

Similarly, on the introduction of IFRS 9 in the year ended 30 September 2019, restatement of the position at 30 September 2018 was not required, with transition effectively taking place on 1 October 2018. In order to aid users of the accounts additional comparative balance sheet amounts at 1 October 2018, immediately following transition, have been provided where relevant. These are marked as 2018 IFRS 9. There were no significant impacts from the introduction of IFRS 9 in the Company's accounting.

Standards not yet adopted

In August 2020 the IASB issued a further amendment to IAS 39 'Interest Rate Benchmark Reform – Phase 2'. This amendment sets out accounting requirements for the treatment of IBOR-linked financial assets and liabilities under the amortised cost method and IBOR related hedge accounting when a firm replaces the IBOR linkage in the underlying instruments with a replacement benchmark. It is therefore potentially applicable to the Group's LIBOR-linked loan assets and those FRN liabilities where interest is charged on the basis of LIBOR or other IBOR rates (note 29). It also affects the Group's LIBOR (and other IBOR) referenced derivative assets and liabilities (note 20) and the hedging relationships which they form part of.

The intention of the standard is that, where the transition is effectively a like for like replacement, no windfall gain or loss should occur on transition, and hedging relationships should be able to continue.

This amendment is effective from the Group's financial year ending 30 September 2022 but will be available for early adoption once endorsed by the EU. The Group expects to implement the provisions of the amendment when it transitions its IBOR linked assets and liabilities, subject to appropriate endorsement. The impact of the amendment will depend upon the IBOR-related assets liabilities and hedging relationships at the point at which transition occurs.

Other standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

61. Changes in accounting standards

a) IFRS 16 – 'Leases'

The Group is required to adopt IFRS 16, which replaces IAS 17, the standard currently governing the accounting for operating and finance leases, in preparing its financial statements for the year ended 30 September 2020. It has transitioned to the new standard with effect from 1 October 2019, in accordance with the transitional provisions set out in the standard, using the modified retrospective approach. The standard addresses accounting by lessees and lessors which are considered separately below.

Lessor accounting

The provisions for lessor accounting under IFRS 16 are little changed from those in IAS 17 and so the accounting for the Group's finance lease receivables, shown in note 18 is not materially changed.

Lessee accounting

Accounting by lessees is changed significantly under IFRS 16, with a right of use asset recognised on the balance sheet for all leases, representing the economic benefit of controlling the underlying asset over the term of the lease. This includes leases previously treated as operating leases and not recognised on the balance sheet under IAS 17. The right of use asset on initial recognition is based on the discounted value of future minimum lease payments. It is recognised within fixed assets and depreciated over the term of the lease.

A corresponding liability arises representing the present value of future lease commitments and this is recognised within other liabilities. This balance is reduced over the life of the lease by lease payments made and the unwinding of the initial discount is recognised in interest expense.

Under IAS 17, the Group disclosed arrangements to lease office buildings, equipment and motor vehicles as operating leases and these have been restated in accordance with IFRS 16. Additionally, the Group has undertaken an exercise to identify potential lease agreements arising from service contracts. No such arrangements were identified. The Group had no involvement as a lessee in finance leases, as defined by IAS 17.

The Group has made use of practical expedients within IFRS 16 when performing its transition accounting. These include the right to exclude contracts that have not previously been classified as leases before the implementation date, and the ability to exclude leases of low value and those with a short-term.

At transition, on 1 October 2019, the Group recognised a right of use asset of £7.0m and a corresponding liability of £7.3m, in accordance with the provisions of IFRS 16 paragraph C5(b), referred to as the modified retrospective approach. Under this approach, there is no impact on equity on transition.

The difference between the asset and liability on recognition represents amounts prepaid or accrued in respect of lease rentals in the Group's balance sheet at 30 September 2019.

The leasing activities of the Company are limited to the lease of an office building from a subsidiary entity. At transition the Company recognised a right of use asset of £18.8m and a corresponding liability of £18.8m in accordance with the modified approach. There was no impact on the Company's equity at transition.

The discount rate used to derive the right of use asset was 2.5% based on a 5-year corporate bond yield, while the minimum lease payments used were materially similar to those disclosed as operating lease commitments at 30 September 2019 in note 51 to the annual accounts for the year then ended, except that irrecoverable VAT was excluded.

There was no immediate tax impact from transition and the Group's regulatory capital is unaffected. Under IFRS 16, the amount charged to profit and loss represents depreciation on the ROU asset and a finance charge on the liability instead of rents or similar charges. While this is a change of classification, the overall effect on profit is insignificant. There is no impact on reported cash flows, nor on earnings per share.

IFRS 16 does not require the restatement of comparative information and therefore all balance sheets and results for periods on or before 30 September 2019 are presented in accordance with IAS 17.

b) IAS 39 amendments 'Interest Rate Benchmark Reform'

This amendment was issued by the IASB to address the impact of uncertainties arising from IBOR reform (including the withdrawal of LIBOR) on hedge accounting. The Standard excludes the effect of such uncertainties from the evaluation of hedging relationships for accounting purposes and allows the continuation of IBOR-based hedging relationships despite these uncertainties, all other things being equal.

This amendment is applicable for periods beginning on or after 1 January 2020, but early application is permitted. The Group has elected to early apply this amendment retrospectively in these financial statements. As the amendment allows the continuation of existing arrangements, its adoption has no impact on reported amounts.

c) Accounting changes at 1 October 2018

The accounting changes affecting equity at 1 October 2018 relate to the adoption of IFRS 9 – 'Financial Instruments' and IFRS 15 – 'Revenue' and are described in detail in note 62 to the accounts for the year ended 30 September 2019.

62. Accounting policies

The particular policies applied by the Group in preparing these financial statements in accordance with the EU endorsed IFRS regime are described below.

As comparative financial information relating to the year ended 30 September 2019 and earlier periods has not been restated for IFRS 16, as permitted by that standard, the accounting policies applied differ to those used in the accounts for the year ended 30 September 2020. Where this is significant both policies are shown.

(a) Accounting convention

The financial statements have been prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

(b) Basis of consolidation

The consolidated financial statements deal with the accounts of the Company and its subsidiaries made up to 30 September 2020. Subsidiaries comprise all those entities over which the Group has control, as defined by IFRS 10 – 'Consolidated Financial Statements'.

In addition to legal subsidiaries, where the Company owns shares in the entity, directly or indirectly, in accordance with IFRS 10, companies owned by charitable trusts into which loans originated by group companies were sold as part of its warehouse and securitisation funding arrangements, where the Group enjoys the benefits of ownership and which, therefore, it is considered to control, are treated as subsidiaries.

Similarly, trusts set up to hold shares in conjunction with the Group's employee share ownership arrangements are also treated as subsidiaries.

A full list of the Group's subsidiaries is set out in note 66, together with further information on the basis on which they are considered to be controlled by the Company. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

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

Particular focus is given to the Group's financial forecasts to ensure the adequacy of resources available for the Group to meet its business objectives on both a short-term and strategic basis.

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.

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

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.

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

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – 'Business Combinations' to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Cash and cash equivalents

Balances shown as cash and cash equivalents in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

(f) Leases

Year ended 30 September 2020 under IFRS 16

For leases where the group is the lessee a right of use asset is recognised in property, plant and equipment on the inception of the lease based on the discounted value of the minimum lease payments at inception. A lease liability of the same amount is recognised at inception, with the unwinding of the discount included in the interest payable.

Leases where the Group is lessor are accounted for as operating or finance leases in accordance with IFRS 16 – 'Leases'. A finance lease is one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Finance lease receivables are accounted for as loans to customers, with impairment provisions determined in accordance with IFRS 9.

Rental income and costs on operating leases are charged or credited to the profit and loss account on a straight-line basis over the lease term. The associated assets are included within property, plant and equipment.

Year ended 30 September 2019 under IAS 17

Leases are accounted for as operating or finance leases in accordance with IAS 17 – 'Leases'. A finance lease is deemed to be one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Rental income and costs under operating leases are credited or charged to the profit and loss account on a straight line basis over the period of the leases.

(g) Loans to customers

Loans to customers includes assets accounted for as financial assets and finance leases. The Group assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Group has concluded that its business model for its customer loan assets is of the type defined as 'Held to collect' by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest ('SPPI'). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procurement fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the EIR method. The loan balances are then reduced where necessary by an impairment provision.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

(h) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is governed by IFRS 16 – 'Leases' and accounted for on the actuarial basis.

(i) Impairment of loans to customers

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IFRS 16, are reduced by an impairment provision based on their expected credit loss ('ECL'), determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

With the exception of POCI financial assets (which are discussed separately below), all assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as 'Stage 1' accounts, assets which have experienced an SICR but are not credit impaired are referred to as 'Stage 2' accounts, while credit impaired assets are referred to as 'Stage 3' accounts.

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, ie the total ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring; or
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, ie the total ECL that results from any future default events, weighted by the probability of those events occurring.

In establishing an ECL allowance, the Group assesses its probability of default, loss given default and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long-term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver and a tenant is in place, arrears may be reduced or cleared. Properties in receivership are eventually either returned to their landlord owners or sold.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCL. For these assets, the Group recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

(j) Amounts owed by or to group companies

In the accounts of the Company, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – 'Financial Instruments: Presentation' they are classified as assets or liabilities at amortised cost, as defined by IFRS 9.

(k) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation.

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. Vehicles held for short-term hire are depreciated in equal annual instalments to their estimated residual value over their expected useful life. This depreciation is deducted in arriving at net lease income and is shown in note 6.

The assets' residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Freehold premises	Short leasehold premises	Computer hardware	Furniture, fixtures and office equipment	Company motor vehicles
2% per annum	over the term of the lease	25% per annum	15% per annum	25% per annum

Depreciation on right of use assets recognised in accordance with IFRS 16 is provided on a straight line basis over the term of the lease.

(l) Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – 'Business Combinations'. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(m) Investments in subsidiaries

The Company's investments in subsidiary undertakings are valued at cost less provision for impairment.

(n) Own shares

Shares in Paragon Banking Group PLC held in treasury or by the trustee of the Group's employee share ownership plan are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

(o) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(p) Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the income statement as interest payable over the term of the borrowing on an EIR basis.

(q) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – 'Accounting for Government Grants and Disclosure of Government Assistance', the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

(r) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(s) Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Group has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Group documents the relationship between the hedging instruments and the hedged items at inception, as well as its risk management strategy and objectives for undertaking the transaction. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets or retail deposit liabilities) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

(t) Taxation

The charge for taxation represents the expected UK corporation tax (including the Bank Corporation Tax Surcharge where applicable) and other income taxes arising from the Group's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

The Group will hold a provision for any uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

Tax relating to items taken directly to equity is also taken directly to equity.

(u) Deferred taxation

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

(v) Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the income statement. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(w) Revenue

The revenue of the Group comprises interest receivable and similar charges, operating lease income and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(x) Other income

Other income, which is accounted for in accordance with IFRS 15, includes:

- Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed
- Fees charged to third parties for account administration services, which are credited as those services are performed
- Commissions receivable on the sale of insurances, as agent of the third-party insurer, which are taken to profit at the point at which the Group becomes unconditionally entitled to the income
- Maintenance income charged as part of the Group's contract hire arrangements which is recognised as the services are provided. Costs of these services are deducted in other income
- Broker fees receivable on the arrangement of loans funded by third parties, on an agency basis, which are taken to profit at the point of completion of the related loan

(y) Share based payments

In accordance with IFRS 2 – 'Share-based Payments', the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

(z) Dividends

In accordance with IAS 10 – ‘Events after the balance sheet date’, dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders’ funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

(aa) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – ‘The Effects of Changes in Foreign Exchange Rates’. The functional currency of the Company and all of the other entities in the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(bb) Segmental reporting

The accounting policies of the segments are the same as those described above for the Group as a whole. Interest payable by each segment includes directly attributable funding and the allocated cost of retail deposit funds utilised. Costs attributed to each segment represent the direct costs incurred by the segment operations.

63. Critical accounting judgements

The most significant judgements which the directors have made in the application of the accounting policies set out in note 62 relate to:

(a) Significant Increase in Credit Risk (‘SICR’)

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk (‘SICR’). The directors’ assessment is based primarily on changes in the calculated probability of default, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have an SICR, for account types where days overdue is an appropriate measure.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

In determining whether an account has an SICR in the Covid-19 environment the granting of Covid-19 reliefs, including payment holidays and similar arrangements, may mean that an SICR may exist without this being reflected in either arrears performance or credit bureau data. The Group has accepted the advice of UK regulatory bodies that the grant of Covid-19 relief does not, of itself, indicate an SICR, but has carefully considered internal credit and customer data to determine whether there might be any accounts with SICR not otherwise identified by the process.

Where accounts have received secondary periods of relief beyond the initial three month period, this has generally been considered to be strongly indicative of underlying problems and such accounts have been identified as having an SICR. Furthermore, adjustments to correct probabilities of default in models will also have a consequent result of identifying more SICRs.

More information on the definition of SICR adopted is given in note 19.

(b) Definition of default

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define ‘default’ for this purpose. The Group’s definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Group’s definition of default adopted is given in note 19.

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how the it intends to generate cash and profit from the assets; and
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit and loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all of the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Group has classified its customer loan assets as carried at amortised cost.

64. Critical accounting estimates

Certain of the balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are:

(a) Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (eg keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

All of this information may be impacted by Covid-19, its economic effect on customers and the forms of the reliefs given to ameliorate that impact. These may both change the underlying data and impact on the derivation of metrics normally used to monitor credit performance.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2020 have been derived specifically in light of the Covid-19 situation, modelling a variety of possible outcomes. It should be noted, however, that there is currently little agreement between economists on the longer term prospects for the UK and there is unlikely to be so until the country's path out of lockdown becomes clearer.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

In addition to uncertainty created by the economic scenarios, the Group recognises that the present situation lies outside the range of situations considered when it originally derived its IFRS 9 approach to impairment. It therefore considered, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

The position after considering all these matters is set out in note 19, together with further information on the Group's approach and sensitivity analysis. The Covid-19 economic scenarios described above and their impact on the overall provision are also set out in that note.

(b) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. These estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

In the case of purchased loan accounts, the assessment of future cash flows is significantly complicated by the uncertain impacts of Covid-19. The likely future cash flows have been assessed by the management on the basis of available performance data and customer contacts. The amount of income recognised to date at 30 September 2020 has been revised to allow for reduced future collections based on these assessments.

No evidence has so far been identified which would require the adjustment of EIR income for other products as a result of Covid-19.

To illustrate the potential variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £11.2m (2019: £7.2m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £10.3m (2019: £6.0m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £7.3m (2019: £4.2m)
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £9.4m (2019: £12.5m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the CGU, based on management forecasts and other assumptions described in note 26, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the CGU is able to achieve in practice. The impact of Covid-19 means that there is a greater risk of inaccuracy in compiling these forecasts. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 26.

(d) Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions relating to inflation, long-term return on investments and mortality. These are listed in note 53. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

Information on the sensitivity of the valuation to the various assumptions is given in note 53.

65. Financial assets and financial liabilities

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used and defines three levels:

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the year ended 30 September 2020 or the year ended 30 September 2019 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 35).

The Group has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

(a) Assets and liabilities carried at fair value

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	2020 £m	2019 £m
Financial assets			
Derivative financial assets	20	463.3	592.4
		463.3	592.4
Financial liabilities			
Derivative financial liabilities	20	132.4	80.5
Contingent consideration	35	13.5	23.7
		145.9	104.2

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9.

The Company has no financial assets or liabilities carried at fair value.

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate.

The principal inputs to these valuation models are LIBOR and SONIA benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and US dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. However, variability in this input does not have a significant impact on the valuation, compared to other inputs.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 20.

Contingent consideration

The value of the contingent consideration balances shown in note 35 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in the respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill and any other new business flows which are or might be attributable to the acquisition agreement, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

(b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	2020 Carrying amount £m	2020 Fair value £m	2019 Carrying amount £m	2019 Fair value £m
The Group					
Financial assets					
Cash	15	1,925.0	1,925.0	1,225.4	1,225.4
Loans to customers	16	12,631.4	12,856.1	12,186.1	12,370.1
Sundry financial assets	21	125.3	125.3	90.3	90.3
		14,681.7	14,906.4	13,501.8	13,685.8
Financial liabilities					
Short-term bank borrowings		0.4	0.4	1.0	1.0
Asset backed loan notes		3,270.5	3,270.5	4,419.4	4,419.4
Secured bank borrowings		657.8	657.8	787.5	787.5
Retail deposits	28	7,856.6	7,900.6	6,391.9	6,408.9
Corporate and retail bonds		446.6	455.7	446.1	474.9
Other financial liabilities	34	74.6	74.6	83.1	83.1
		12,306.5	12,359.6	12,129.0	12,174.8

	Note	2020 Carrying amount £m	2020 Fair value £m	2019 Carrying amount £m	2019 Fair value £m
The Company					
Financial assets					
Cash	15	12.6	12.6	14.1	14.1
Loans to group companies	21	84.0	84.0	106.6	106.6
Sundry financial assets	21	0.6	0.6	0.7	0.7
		97.2	97.2	121.4	121.4
Financial liabilities					
Corporate and retail bonds		446.6	455.7	446.1	474.9
Amounts owed to group companies	34	22.7	22.7	23.8	23.8
Other financial liabilities	34	2.9	2.9	3.6	3.6
		472.2	481.3	473.5	502.3

The fair values of retail deposits and corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market based, they are considered to be level 2 measurements.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

66. Details of subsidiary undertakings

Subsidiary undertakings of the Group at 30 September 2020, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that:

- for the shareholdings marked * the Company holds only 74% of the share capital

In these cases, the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked § which have additional preference share capital held within the Group.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Mortgages (No. 9) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 10) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 11) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 12) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 13) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 14) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 15) PLC	100% *	Residential mortgages
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100%	Non-trading
First Flexible (No. 7) PLC	100% *	Non-trading
Herbert (1) PLC	100%	Non-trading
Herbert (2) PLC	100%	Non-trading
Herbert (4) PLC	100%	Non-trading
Herbert (5) PLC	100%	Non-trading
Herbert (6) PLC	100%	Non-trading
Herbert (7) PLC	100%	Non-trading
Herbert (8) PLC	100%	Non-trading
Herbert (9) PLC	100%	Non-trading
Herbert (10) PLC	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Fourth Funding Limited	100%	Non-trading
Paragon Loan Finance (No. 1) Limited	100% §	Non-trading
Paragon Loan Finance (No. 2) Limited	100% §	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Pension Investments GP Limited	100%	Non-trading
Paragon Pension Plan Trustees Limited	100%	Non-trading
Paragon Personal Finance (1) Limited	100%	Non-trading
Paragon Secured Finance (No. 1) PLC	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading
Paragon Loan Finance (No. 3) Limited	100%	Non-trading

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Townend Farm (Easington) Management Company Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading
Direct and indirect subsidiaries of Paragon Bank PLC		
Paragon Finance PLC	100%	Residential mortgages and asset administration
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
First Flexible No. 6 PLC	100% §	Residential mortgages
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Asset Finance Limited	100%	Holding company and portfolio administration
Paragon Business Finance PLC	100%	Asset finance
Paragon Commercial Finance Limited	80%	Asset finance
Paragon Development Finance Limited	96.39%	Development Finance
Paragon Development Finance Services Limited	100%	Development Finance
Paragon Technology Finance Limited	100%	Asset finance
Premier Asset Finance Limited	100%	Asset finance broker
PBAF Acquisitions Limited	100%	Residential mortgages and loan finance
Specialist Fleet Services Limited	100%	Asset finance and contract hire
City Business Finance Limited	100%	Non-trading
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading
Direct and indirect subsidiaries of Idem Capital Holdings Limited		
Moorgate Loan Servicing Limited	100%	Asset administration
Idem (No. 3) Limited	100%	Asset investment
Idem Capital Securities Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Other indirect subsidiary undertakings		
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Buy to Let Direct Limited	100%	Non-trading
Moorgate Asset Administration Limited	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading

The financial year end of all of the Group's subsidiary companies is 30 September. They are all registered in England and Wales and operate in the UK except Paragon Pension Investments GP Limited, which is registered in Scotland and operates in the UK.

20% of the equity of Paragon Commercial Finance Limited is subject to a call option agreed as part of the acquisition of the company by PAF. No material minority interest attaches to this holding. 3.61% of the nominal value of the share capital of Paragon Development Finance Limited relates to shares subjects to put and call options issued pursuant to long-term incentive plans. No material minority interest attaches to this holding.

As part of the Group's financing arrangements certain mortgage and consumer loans originated by Paragon Mortgages (2010) Limited and Mortgage Trust Limited or acquired by Idem Capital Securities Limited have been sold to special purpose entity companies, which had raised non-recourse finance to fund these purchases. The shares of these companies are ultimately beneficially owned through independent trusts, but they are considered to be controlled by the Group, as defined by IFRS 10, due to the Group's exposures to the variable returns from the assets of each entity and its ability to direct their activities, within the constraints imposed by the lending documents. Hence, they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2020 comprise:

Company	Principal activity
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 23) Holdings Limited	Holding company
Paragon Mortgages (No. 23) PLC	Residential mortgages
Paragon Mortgages (No. 24) Holdings Limited	Holding company
Paragon Mortgages (No. 24) PLC	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Paragon Mortgages (No. 26) Holdings Limited	Holding company
Paragon Mortgages (No. 26) PLC	Residential mortgages
Paragon Mortgages (No. 27) Holdings Limited	Holding company
Paragon Mortgages (No. 27) PLC	Residential mortgages
Paragon Mortgages (No. 28) Holdings Limited	Holding company
Paragon Mortgages (No. 28) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 PLC	Non-trading
First Flexible No. 5 PLC	Non-trading
Paragon Fifth Funding Limited	Non-trading
Paragon Sixth Funding Limited	Non-trading
Paragon Mortgages (No. 18) Holdings Limited	Non-trading
Paragon Mortgages (No. 18) PLC	Non-trading
Paragon Mortgages (No. 19) Holdings Limited	Non-trading
Paragon Mortgages (No. 19) PLC	Non-trading
Paragon Mortgages (No. 20) Holdings Limited	Non-trading
Paragon Mortgages (No. 20) PLC	Non-trading
Paragon Mortgages (No. 21) Holdings Limited	Non-trading
Paragon Mortgages (No. 21) PLC	Non-trading
Paragon Mortgages (No. 22) Holdings Limited	Non-trading
Paragon Mortgages (No. 22) PLC	Non-trading

All of these companies are registered and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The Group accounts include the results of two Jersey companies, which are ultimately beneficially owned by a charitable trust, but are considered to be controlled by the Group, using the definition contained in IFRS 10 - 'Consolidated Financial Statements'. These companies, Idem Jersey (No. 1) Limited and Idem Jersey (No. 2) Limited are registered in the Bailiwick of Jersey and operate in the UK.

The share capital of Idem Jersey (No. 1) Limited is divided into A shares and B shares. All of the 600 B shares are held by Group companies, 100 by the parent company and 500 by other Group companies.

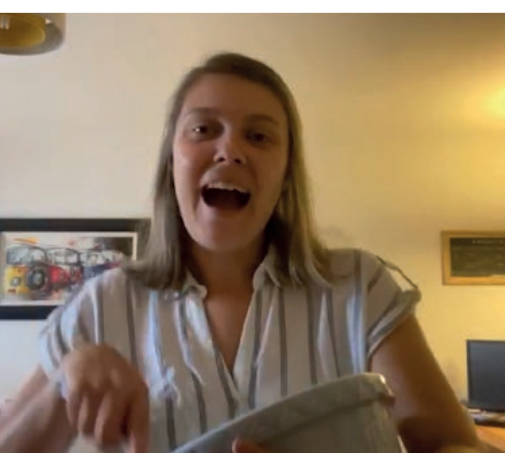
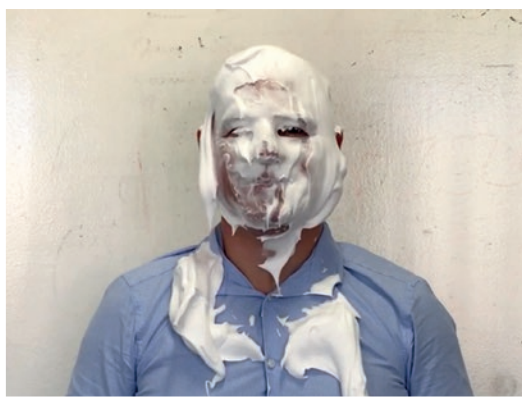
The Paragon Pension Partnership LP is a limited partnership established under Scots law, in which control is vested in members which are Group companies. It is therefore considered to be a subsidiary entity. The outside member is the Group's Pension Plan and the Plan's rights to income from the partnership are set out in the partnership agreement. Therefore, no minority interest arises. The partnership is registered in Scotland and operates in the UK.

The registered office of each of the entities listed in this note is the same as that of the Company (note 1), except that:

- The registered office of The Business Mortgage Company Limited, Buy to Let Direct Limited, TBMC Group Limited, and The Business Mortgage Company Services Limited is Greenmeadow House, 2 Village Way, Greenmeadow Springs Business Park, Cardiff, CF15 7NE
- The registered office of State Security Limited is Burlington House, Botleigh Grange Office Campus, Grange Drive, Hedge End, Southampton, SO30 2AF
- The registered office of the Scottish entities is Citypoint, 65 Haymarket Terrace, Edinburgh, EH12 5HD
- The registered office of the Jersey companies is IFC 5, St Helier, Jersey, JE1 1ST

All of the entities listed above are included in the consolidated accounts of the Group.

Homeloans (No. 7) LLP and Homeloans (No. 8) LLP are limited liability partnerships, established under English law, in which all of the members are Group companies. They are currently in liquidation. Both are registered in England and Wales and operate in the UK.



WE ARE MACMILLAN. CANCER SUPPORT

Our chosen charity of the year for 2020 was Macmillan Cancer Support and employees set themselves an ambitious target to raise £30,000 through a variety of fundraising activities

E. Appendices to the Annual Report

Additional financial information supporting amounts shown in the Strategic Report (Section A), but not forming part of the statutory accounts

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E1. Appendices to the Annual Report

For the year ended 30 September 2020

A. Underlying results

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Group's control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	2020	2019
	£m	£m
Profit on ordinary activities before tax	118.4	159.0
Less: Gain on disposal of financial assets	-	(9.7)
Add back: Fair value adjustments	1.6	15.1
Underlying profit	120.0	164.4

Underlying basic earnings per share, calculated on the basis of underlying profit, charged at the overall effective tax rate, is derived as follows.

	2020	2019
	£m	£m
Underlying profit	120.0	164.4
Tax at effective rate (note 12)	(27.5)	(32.7)
Underlying earnings	92.5	131.7
Basic weighted average number of shares (note 14)	253.6	257.6
Underlying earnings per share	36.5p	51.1p

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	2020	2019
	£m	£m
Underlying earnings	92.5	131.7
Amortisation of intangible assets (note 9)	2.0	2.4
Adjusted underlying earnings	94.5	134.1
Average tangible equity (note 54(b))	961.6	920.7
Underlying RoTE	9.8%	14.6%

B. Income statement ratios

Net interest margin ('NIM') and cost of risk (impairment charge as a percentage of average loan balance) for the Group are calculated as follows:

Year ended 30 September 2020

	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total
		£m	£m	£m	£m
Opening loans to customers	16	10,344.1	1,452.1	389.9	12,186.1
Closing loans to customers	16	10,819.5	1,514.8	297.1	12,631.4
Average loans to customers		10,581.8	1,483.4	343.5	12,408.7
Net interest		190.0	82.1	26.1	278.1
NIM		1.80%	5.53%	7.60%	2.24%
Impairment provision	19	25.8	21.7	0.8	48.3
Cost of risk		0.24%	1.46%	0.23%	0.39%

Year ended 30 September 2019

	<i>Note</i>	Mortgage Lending	Commercial Lending	Idem Capital	Total
		£m	£m	£m	£m
Opening loans to customers	16	10,449.5	1,131.3	519.8	12,100.6
Closing loans to customers	16	10,344.1	1,452.1	389.9	12,186.1
Average loans to customers		10,396.8	1,291.8	454.8	12,143.4
Net interest		177.8	65.0	54.3	278.4
NIM		1.71%	5.03%	11.94%	2.29%
Impairment provision	19	1.0	7.2	(0.2)	8.0
Cost of risk		0.01%	0.56%	(0.04)%	0.07%

Not all interest is allocated to segments (note 2).

C. Cost:income ratio

Cost:income ratio is derived as follows:

	<i>Note</i>	2020 £m	2019 £m
Cost – operating expenses	9	126.8	125.2
Total operating income		295.1	307.3
Cost / Income		43.0%	40.7%

Underlying cost:income ratio is derived as follows:

	2020 £m	2019 £m
Cost – as above	126.8	125.2
Adjusted cost	126.8	125.2
Income – as above	295.1	307.3
Gain on disposal of financial asset	-	(9.7)
Adjusted income	295.1	297.6
Underlying cost:income ratio	43.0%	42.1%

D. Net asset value

	<i>Note</i>	2020	2019
Total equity (£m)		1,156.0	1,108.4
Outstanding issued shares (m)	38	261.8	261.6
Treasury shares (m)	40	(5.2)	(5.2)
Shares held by ESOP schemes (m)	40	(3.6)	(3.9)
		253.0	252.5
Net asset value per £1 ordinary share		£4.57	£4.39
Tangible equity (£m)	54	985.9	937.3
Tangible net asset value per £1 ordinary share		£3.90	£3.71