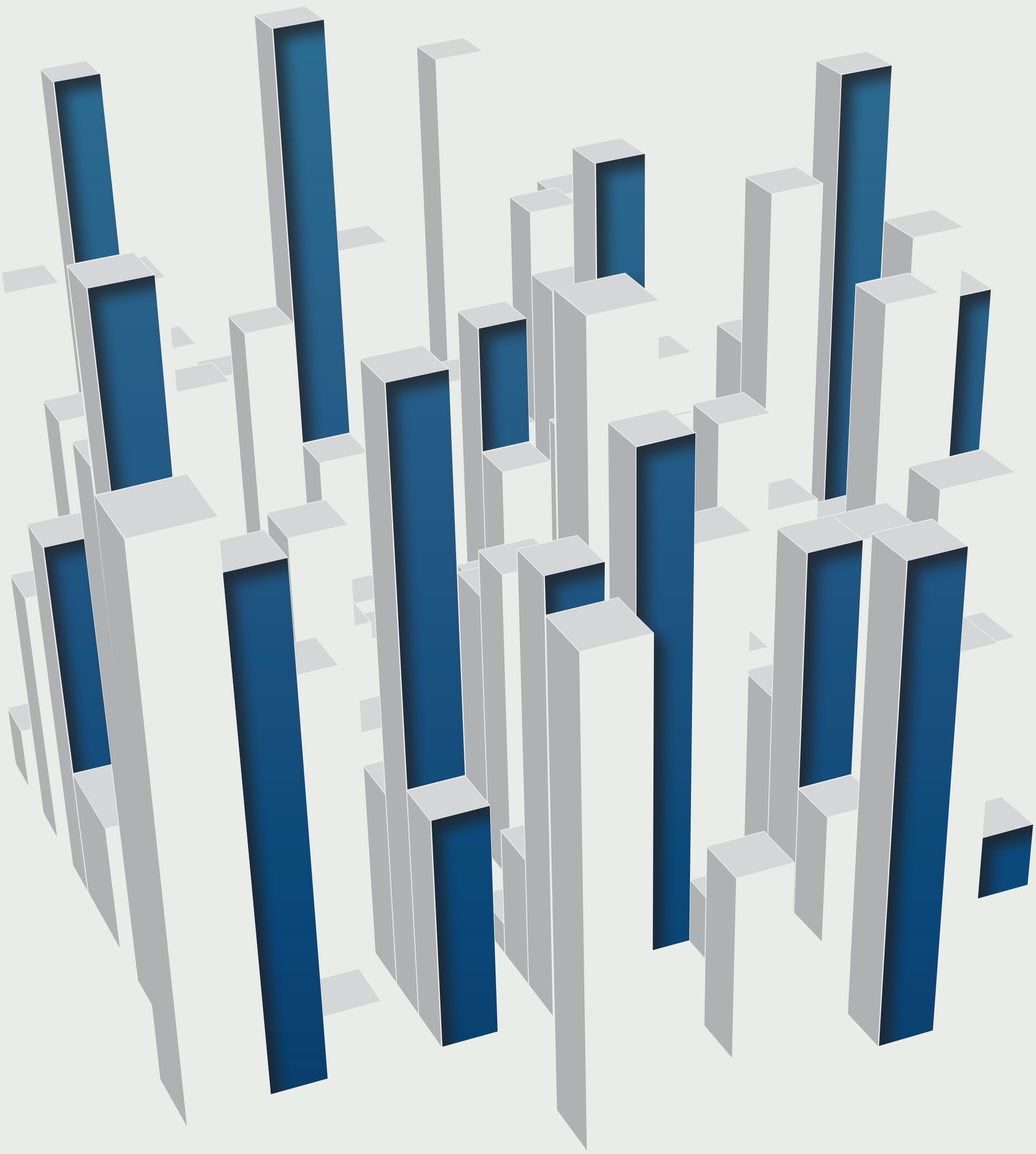


The Paragon Group of Companies PLC

Pillar III Disclosures

30 September 2016

paragon

CONTENTS

1.	Introduction	Page 3
2.	Governance	Page 9
3.	Risk Management	Page 14
4.	Capital Resources	Page 31
5.	Credit Risk	Page 38
6.	Asset Encumbrance	Page 50
7.	Counterparty Credit Risk	Page 54
8.	Interest Rate Risk	Page 56
9.	Securitisation	Page 58
10.	Remuneration Policies and Practices	Page 59
11.	Glossary	Page 60
	Appendices	
A.	Own Funds Disclosures	Page 61
B.	Leverage Ratio Disclosures	Page 69

1. INTRODUCTION

This section sets out

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

The Group

The Paragon Group of Companies PLC ('the Company') controls a group of companies ('the Group') which form three principal trading business operations:

- Paragon Mortgages, which includes its wholesale funded originated loan assets, as well as its legacy portfolios
- Idem Capital, its loan portfolio investment and third party servicing business; and
- Paragon Bank, the Group's banking subsidiary, which operates through Paragon Bank PLC and accepts savings deposits from customers and invests them in buy-to-let mortgages, consumer loans and in asset finance loans to SME (small and medium sized enterprise) customers

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

During the year the Group entered the SME asset finance market with the acquisition of several entities operating in that market.

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

The Group's other divisions are subject to various forms of conduct regulation, principally by the FCA, but are not subject to PRA regulation. The Group as a whole is the subject of consolidated supervision by the PRA by reason of the Company being the parent company of the Bank. The PRA sets requirements for the consolidated group in respect of capital adequacy, but not in respect of liquidity.

Disclosure Framework

The Basel III regulatory framework, which governs the amount of capital that banks and building societies are required to hold in order to protect their members, depositors and shareholders, was finalised in December 2010 by the Basel Committee on Banking Supervision ('BCBS'). The aim of Basel III is to make regulatory capital requirements more risk sensitive and representative of risk management controls and procedures in place within firms. The Group seeks to ensure that it protects stakeholders by holding sufficient capital at all times.

Basel III is implemented in the European Union ('EU') through the Capital Requirements Directive IV ('CRD IV'). The CRD IV text was formally published in the Official Journal of the EU in June 2013 and became effective from 1 January 2014. It is made up of the Capital Requirements Regulation ('CRR'), which is directly applicable to firms across the EU, together with the Capital Requirements Directive ('CRD'), which must be implemented through national law. CRD IV also makes changes to rules on corporate governance including remuneration and introduces standardised EU regulatory reporting, referred to as Common Reporting Standards ('COREP') and Financial Reporting Standards ('FINREP').

The PRA, as prudential regulator of the Company, is the body responsible for implementing CRD IV in the UK. The Company has been operating under the Basel III regime since the authorisation of its banking subsidiary, Paragon Bank PLC ('the Bank') in February 2014. It has adopted the Standardised Approach ('SA') for credit risk and the Basic Indicator Approach ('BIA') for operational risk.

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

Pillar I

This covers the minimum capital requirements of Basel III. The calculation is based on a risk based approach. It focuses on credit, operational and market risk in determining the Group's Minimum Capital Requirement ('MCR').

Pillar II

This requires that the Group conducts an Internal Capital Adequacy Assessment Process ('ICAAP') which is subject to review by the PRA under the Supervisory Review and Evaluation Process ('SREP').

In the ICAAP the Company's Board undertakes an assessment of the key risks facing the Company's business against which capital has not been provided under Pillar I to determine whether additional regulatory capital should be held, based on the identified risks and the risk management processes in place. A firm's Individual Capital Guidance ('ICG') is set by the PRA based on the ICAAP.

Pillar III

Pillar III complements Pillars I and II and aims to encourage market discipline by setting out disclosure requirements which should allow market participants to assess key pieces of information on a firm's capital, risk exposures, risk management processes and remuneration. These are set out in Part 8 of the CRR ('Part 8') as supplemented by secondary EU legislation and guidance issued by appropriate bodies.

Pillar III Disclosure Policy

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

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

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

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

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

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

The Company's Pillar III regulatory capital disclosure policies were approved by the Board of Directors in January 2014 and confirmed in January 2017 on the approval of this document.

Scope and Basis of Disclosure

This Pillar III disclosure has been drawn up in conjunction with the Annual Report and Accounts of the Group for the year ended 30 September 2016 ('the Group Accounts'). In accordance with Article 434 of the CRR, where a disclosure required by Part 8 is made in the Group Accounts it need not be repeated in this document.

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

The Group consolidation for regulatory purposes is the same as that used for statutory purposes and hence all subsidiary undertakings within the Group have been consolidated in the Pillar III disclosures. The names of all of these entities, and the basis on which they are considered to be subsidiaries of the Group are set out in note 67 to the Group Accounts.

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

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

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

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

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

Development in Disclosures

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

This Pillar III report presents similar disclosures to those published in 2015, except that additional disclosure templates mandated by the EU are set out in the appendices to this document. These cover:

- Own funds requirements disclosures (EU Commission Implementing Regulation 1423/2013)
- Leverage ratio disclosures (EU Commission Implementing Regulation 2016/200)

The significant amounts included in these templates were already included in the document. Further background information has been provided to users in a number of areas.

It should be noted that this is the first Pillar III disclosure including two acquired businesses:

- Five Arrows Leasing Group Limited, now Paragon Bank Asset Finance Limited ('PBAF') acquired on 3 November 2015; and
- Premier Asset Finance Limited acquired on 30 September 2016

Further information on these acquisitions is given in notes 8, 9 and 10 to the Group Accounts.

The assets of both of these businesses, most significantly PBAF, are included in the disclosures presented.

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

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

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

Approval

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

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

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

The Group prepared its second formal ICAAP document following the authorisation of the Bank as at 31 March 2016. It was prepared under the direction of the Group Finance Director and the executive management of the Group, with appropriate input and challenge from other areas of the business. The ICAAP was reviewed and challenged by the Group's executive and was formally approved by the Board in July 2016. Throughout the ICAAP's preparation, the Board was kept up-to-date with its progress and key findings, and the directors have received regulatory training sessions to ensure that they are able to provide the appropriate level of challenge.

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

The Group's regulator carried out a Supervisory Review and Evaluation Process ('SREP') based on the ICAAP submitted in 2016, the conclusion of which was that the actual level of the Group's capital is significantly in excess of the minimum requirements. A SREP of an updated ICAAP is expected to be carried out shortly after its completion.

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

In particular, they considered whether;

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

The directors were able to satisfy themselves on these matters and the Pillar III disclosures were therefore approved for publication by the Board of Directors of The Paragon Group of Companies PLC in January 2017.

2. GOVERNANCE

This section sets out

- The Group's approach to corporate governance
- Details of the governance framework operated by the Company
- Details of the separate governance framework operated by the authorised entity, Paragon Bank PLC

The Group

Good corporate governance is essential to the ethos of the Group. The Board is responsible for overall Group strategy and for the delivery of that strategy within a strong corporate governance and corporate responsibility framework.

Paragon Bank's governance and risk management framework was established as part of its start-up processes and reflects a similar governance structure to that of the Company. This structure is discussed in more detail below.

The Group's culture has a central role in the way the organisation operates. This culture is firmly reflected in the commitment of the Board of Directors to the principles of corporate governance contained in the Code issued by the FRC in September 2014 and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2016 the Company complied with the principles and provisions of the Code.

The new edition of the Code, published by the FRC in April 2016, will apply to the Company with effect from its year ending 30 September 2017. The Board has reviewed the new requirements and concluded that the Company is well placed to comply with the revised provisions.

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

Leadership

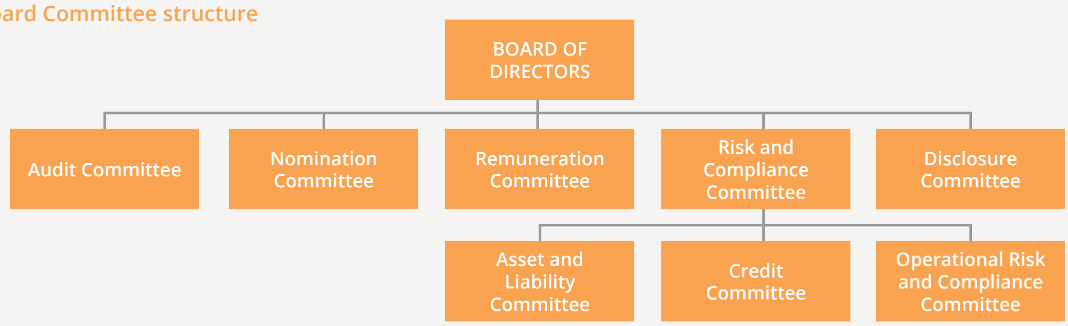
The Board of Directors is responsible for overall Group strategy, for approving major agreements, transactions and other financing matters and for monitoring the progress of the Group against budget. All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings and there is a formal schedule of matters reserved for decision by the Board, which includes material asset acquisitions and disposals, granting and varying authority levels of the Chairman and the executive directors, determination and approval of the Group's objectives, strategy and annual budget, investment decisions, corporate governance policies and financial and dividend policies.

During the year the Board of Directors consisted of the Chairman, Robert Dench, three executive directors, Nigel Terrington, Richard Woodman and John Heron and four non-executive directors, Alan Fletcher, Peter Hartill, Fiona Clutterbuck and Hugo Tudor. All the directors bring to the Company a broad and valuable range of experience and further details of this together with additional biographical information are set out in section B2 of the Group Accounts.

The division of responsibilities between the Chairman and Chief Executive is clearly established, set out in writing and agreed by the Board. There is a strong non-executive representation on the Board, including the Senior Independent Director, Fiona Clutterbuck. This provides effective balance and challenge.

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

Board Committee structure



Board Committees

- The Audit Committee, which during the year consisted of Peter Hartill (who chairs the Committee), Fiona Clutterbuck, Alan Fletcher and Hugo Tudor, all of whom were independent non-executive directors. The Committee meets at least three times a year
- The Nomination Committee, which during the year consisted of Robert Dench (who chairs the Committee), Nigel Terrington and all of the non-executive directors, ensuring that a majority of the Committee's members are independent non-executive directors. The Committee meets at least twice a year
- The Remuneration Committee, which during the year consisted of Alan Fletcher (who chairs the Committee), Fiona Clutterbuck, Peter Hartill and Hugo Tudor, all of whom were independent non-executive directors, and the Chairman of the Company, Robert Dench. The Committee meets at least three times a year
- The Risk and Compliance Committee, which during the year consisted of Fiona Clutterbuck (who chairs the Committee), Peter Hartill, Alan Fletcher and Hugo Tudor, all of whom were independent non-executive directors and the Chairman of the Company, Robert Dench. The Committee meets at least four times a year

In addition to the committees listed above, a further standing committee, the Disclosure Committee, was established during the year. The committee is concerned with supervising the disclosure of material market sensitive information.

All Board committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties. The Board is satisfied that all members of the board committees have the necessary skills and experience to fulfil their roles effectively. The terms of reference of the board committees are available on request from the Company Secretary.

Executive Committees

Three executive committees, the Asset and Liability Committee ('ALCO'), the Credit Committee and the Operational Risk and Compliance Committee ('ORCC'), consisting of executive directors and appropriate senior members of staff report to the Risk and Compliance Committee. Details of their activities are given below.

- The Asset and Liability Committee ('ALCO'), comprising the heads of relevant functions and chaired by the Group Finance Director

The principal purpose of the ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clear delegated authorities, monitoring exposures and providing recommendations on actions required.

- The Credit Committee comprising senior managers from the finance, risk and operations functions and chaired by the Group Finance Director

The Credit Committee approves credit risk policies and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. The committee oversees the management of the credit portfolio, the post origination risk management processes and the management of past due or impaired credit accounts. It also makes recommendations for credit risk appetite and monitors performance against appetite on an on-going basis.

- The Operational Risk and Compliance Committee ('ORCC'), comprising heads of relevant functions and chaired by the Group Chief Risk Officer

The ORCC is responsible for overseeing the Group's operational risk management and compliance systems, ensuring that the business is operating within risk appetite. It considers key operational risk information such as loss events, emerging risks and control failures.

With respect to compliance, the ORCC is responsible for overseeing the maintenance of effective systems and controls to meet regulatory and conduct obligations and for countering the risk that the Group might be used to further financial crime. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Group Compliance function, including the annual Compliance Monitoring Plan.

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

Director	Position	Number of external appointments
Robert G Dench	Chairman	1
Nigel S Terrington	Chief Executive	-
Richard J Woodman	Finance Director	-
John A Heron	Director – Mortgages	-
Alan K Fletcher	Non-executive director	3
Peter J N Hartill	Non-executive director	3
Fiona J Clutterbuck	Non-executive director	2
Hugo R Tudor	Non-executive director	1

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

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

- The process for selecting members of the Board; and
- The Company's policy on diversity with regard to the selection of members of the Board

Paragon Bank

The Bank has its own internal governance structure, including a Board with independent non-executive directors. The governance structure is modelled on the provisions of the Code in so far as they can be adapted to apply to a subsidiary entity.

The Bank Board operates within a delegated authority from the Board of Directors of The Paragon Group of Companies PLC.

Leadership

The Bank's Board of Directors (the 'Bank Board') is responsible for overall strategy, for approving major agreements, transactions and other financing matters and for monitoring the progress of the Bank against budget. All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings and there is a formal schedule of matters reserved for decision by the Bank Board, which includes material asset acquisitions and disposals, granting and varying authority levels of the Chairman and the executive directors, determination and approval of the Bank's objectives, strategy and annual budget, investment decisions, corporate governance policies and financial and dividend policies.

During the year the Bank Board comprised the Chairman, Stephen Blaney, two executive directors, Richard Doe, the Managing Director and Andrew Smithson, the Finance Director, one non-executive director appointed by the Company as shareholder, Nigel Terrington, its Chief Executive, and two independent non-executive directors, Patrick Newberry and Finlay Williamson. All of the directors bring to the Bank Board a broad and valuable range of financial services experience.

The division of responsibilities between the Chairman and Managing Director is clearly established, set out in writing and agreed by the Bank Board. There is a strong non-executive representation on the Board. This provides effective balance and challenge.

The Bank Board has agreed a conflicts policy which includes a process to identify and authorise any conflicts which might arise. At each meeting of the Bank Board actual or potential conflicts of interest in respect of any director are reviewed.

The Bank Board also operates through a number of committees covering certain specific matters, these being:

Board Committees

- The Bank Remuneration Committee, which during the year consisted of Nigel Terrington (who chairs the Committee), Stephen Blaney, Patrick Newberry and Finlay Williamson. The Committee meets at least four times a year

- The Bank Audit Committee, which during the year consisted of Patrick Newberry (who chairs the Committee), Nigel Terrington, Stephen Blaney and Finlay Williamson. The Board is satisfied that all members of the Committee have recent and relevant financial experience. The Committee meets at least four times a year

- The Bank Risk and Compliance Committee, which during the year consisted of Finlay Williamson, (who chairs the committee), Stephen Blaney, Patrick Newberry and Nigel Terrington. The Committee meets at least four times a year

Executive Committees

- The Bank Asset and Liability Committee, which consisted of the heads of relevant functions and is chaired by the Bank's Finance Director. The Committee meets regularly and monitors the Bank's liquidity risks, interest rate risks, currency risks and treasury counterparty exposures

- The Bank Credit Committee, which consisted of the heads of relevant functions and is chaired by the Bank's Managing Director. It meets regularly and is responsible for establishing credit policy and monitoring compliance therewith

- The Bank Operational Risk and Compliance Committee, which consisted of the heads of relevant functions and is chaired by the Bank's Chief Risk Officer. It meets regularly and is responsible for operational, conduct and business risks

3. RISK MANAGEMENT

This section sets out

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

Introduction

The Group regards the effective identification, monitoring and control of risk as an integral part of its management processes. To support this, the Group's risk management framework and supporting risk committee structures have continued to be developed during the last year.

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

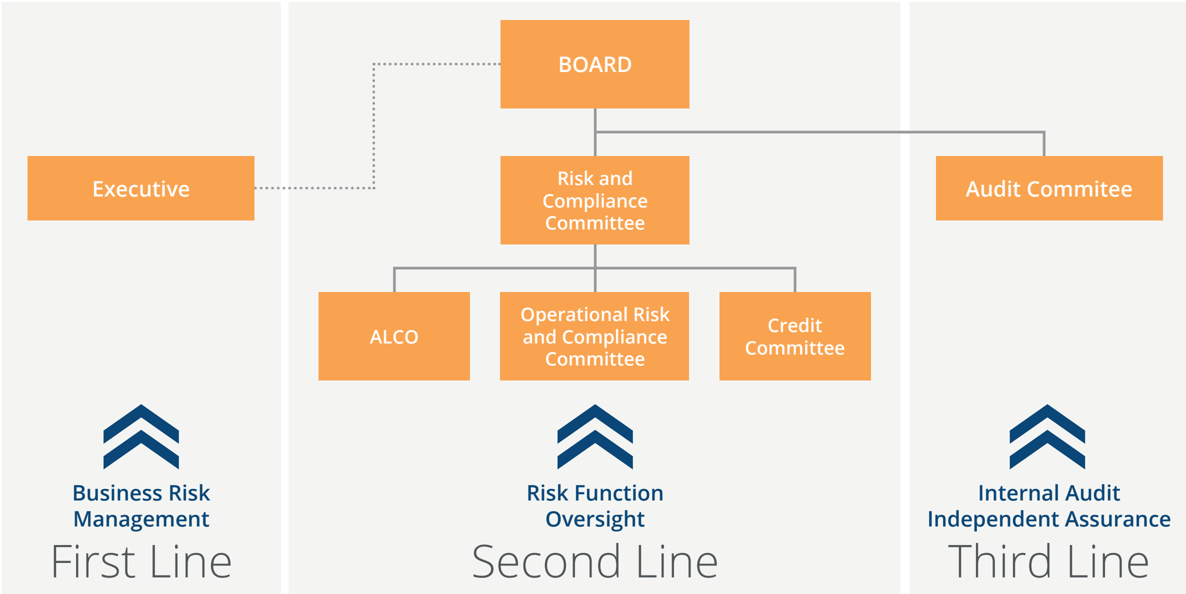
The Group's risk management framework operates within a 'Three Lines of Defence' model:

- The first line of defence, comprising the executive directors, their managers and people, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The second line of defence is provided by the Group Risk and Compliance Committee and supporting sub-committees together with oversight provided by the Group Risk and Compliance division, headed by the Chief Risk Officer and including Credit Risk, Operational Risk, Property Risk, Compliance and Conduct Risk and Financial Crime functions
- The third line of defence is provided by a Group Internal Audit function and the Group Audit Committee which are responsible for reviewing the effectiveness of the first and second lines of defence in the overall management of risk

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

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

Risk Management Model



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

- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction of the frequency and severity of risk events
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and to support the regulatory requirements associated with the ICAAP
- Provide senior management and relevant committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information included within these reports
- Promote an appropriate risk culture across the Group, consistent with its aim of operating as a prudent, risk focussed, specialist lender

The Group Accounts includes the report of the Risk and Compliance Committee, in section B5. This report sets out:

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

The maintenance of a standard, common risk language across the Group is a key enabler for risk identification and effective risk management. It provides a consistent basis for risk assessment and the development of policy, risk appetite and appropriate risk management structures. It also facilitates risk aggregation, risk reporting and segregation of accountabilities. Accordingly, the following common risk categorisations are used:

- Business Risk
- Credit Risk
- Conduct Risk
- Operational Risk
- Liquidity and Capital Risk
- Market Risk
- Pension Obligation Risk

The principal risks identified under each of these headings are discussed in detail below.

From a second line governance perspective, the risk categories map to the respective risk governance committees as follows:

Risk Governance Responsibilities

Principal Risks

The principal risks inherent in the Group's business model and the basis on which these are mitigated are summarised below:

Business Risk

Business risk is defined as any risk to the Group arising from changes in its business, including the risk that the business may not be able to implement its business plan and desired strategy.

Specific Risk

The Group's operations are domiciled entirely in the United Kingdom and therefore there is a risk that any deterioration in the general UK economy, particularly in light of the decision to leave the European Union, might adversely affect the Group's business. Adverse economic conditions might increase the number of customers that default on their loans, reduce the value of security held to support loans or unfavourably affect funding structures. This may increase the Group's costs and could result in losses on some of the Group's assets, or restrict the ability of the Group to develop in the future.

Mitigants

The Group operates as a specialist lender only in selected markets where its employees have significant levels of knowledge and expertise. Robust underwriting and monitoring processes are employed which reflect prudent credit policies designed to be maintained through economic cycles.

To support the validation of asset values for its core buy-to-let lending products, the Group maintains an in-house team of Chartered Surveyors with considerable experience and understanding of the sector.

The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic research companies. This ensures it is able to consider various economic scenarios within its formal business planning cycle.

As part of an established governance process, the Group's senior management undertake a review of strategic objectives each year. This helps to inform the development of detailed business plans for each of the Group's principal trading operations within which account is taken of key strategic risks.

Specific Risk

The Group is heavily reliant on lending to customers investing in the UK private rented sector. Demand for the Group's buy-to-let products is therefore significantly influenced by the performance of this sector, which in turn is dependent upon underlying factors such as house prices, supply of rental property, demographic changes and government housing policy. Demand for all of the Group's loan products is dependent upon such factors as market interest rates, employment levels and other factors that determine disposable income.

Mitigants

The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through the economic cycle together with regular independently conducted research commissioned over a period of more than ten years. It seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector both directly and through membership of the Council of Mortgage Lenders ('CML'), the Intermediary Mortgage Lenders Association ('IMLA') and the National Landlords Association.

Given its deep specialist knowledge of the sector and its historically prudent approach to underwriting, the Group is very well placed to cope with recent and emerging regulatory changes relating to buy-to-let, and to continue to provide appropriate products to customers in the new environment.

The Group also continues to exploit prudent opportunities to diversify the range of its activities and income streams. This is illustrated by the development of its Idem Capital debt acquisition business and the organic development, asset acquisitions and M&A activity within Paragon Bank.

Specific Risk

In the last year, the Group has acquired two asset finance businesses, Paragon Bank Asset Finance and Premier Asset Finance, in the last year, thereby extending its operations into a new sector. In addition, the Group remains alert to potential opportunities to complement organic growth through further good quality acquisitions. Any failure to integrate acquired businesses safely and effectively could impact adversely on the Group's financial performance and its reputation.

Mitigants

The Group's core strategy is only to consider acquisitions in areas that it understands and which are complementary to its existing business activities. Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors.

Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive directors Board.

Where necessary, enhancements have been made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider Group. Similarly, where necessary experienced additional resource has been recruited to ensure that operational and risk management capabilities are suitably robust.

Credit Risk

Credit risk is the risk that a loan customer or treasury counterparty will be unable to meet their obligations as they fall due. As a primary lender, the Group faces credit risk as an inherent component of its lending and asset purchase activities. Adverse changes in the credit quality of the Group's loan customers arising from their personal circumstances or from systemic risks in UK and global financial systems could reduce the recoverability and value of the Group's assets.

Specific Risk

As a lender, a failure to target and underwrite lending effectively could expose the Group to the risk of unexpected material losses in the event of customers being unable to repay their debts. Recoverable amounts on loans may also be affected by adverse movements in security values such as house prices.

Mitigants

In order to mitigate credit risk, the Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved and funds released. These policies are approved by the Credit Committee under authority granted by the Board Risk and Compliance Committee. Credit policies incorporate limits for concentration risk arising from factors such as large exposures to particular counterparties, geographical areas or types of lending. Exceptions to these policies, which are rare, require approval by the Group's Credit Risk function, operating under a mandate from the Credit Committee. Group Credit Risk is an integral part of the Group Risk and Compliance function and provides regular reports to the Credit Committee and Risk and Compliance Committee on the performance of the Group's lending.

Originated assets are subject to individual underwriting approval from experienced staff, with robust control and support provided by well-established decision tools, while purchased assets are subject to extensive pre-contract due diligence and rigorous ongoing analysis and monitoring.

The majority of the Group's loans by value are secured against residential property in England and Wales at conservative loan-to-value levels.

The Group's impairment rate remains very low, reflecting the maintenance of robust, proven credit disciplines, generally favourable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration following the referendum decision to leave the EU is being monitored closely across all Group portfolios. Currently no deterioration has been seen in actual performance, nor underlying customer profile.

Specific Risk

The Group is exposed to the failure of counterparties with which it places deposits. In addition, it is exposed to the risk of loss in the event of the failure of a counterparty with which it has negotiated hedging agreements to mitigate interest rate and foreign exchange risk.

Mitigants

The Group requires all counterparties with which it contracts to meet specific credit rating criteria. Exposure to these counterparties is monitored daily by senior management within the Group's Treasury function and is reported monthly to the ALCO, a sub-committee of the Board's Risk and Compliance Committee.

The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in sections 5 and 7 below.

Liquidity and Capital Risk

Liquidity and Capital risk is the risk that the Group, although solvent, has insufficient financial resources to enable it to meet its obligations as they fall due or finance its future plans, or can only secure such resources at excessive cost.

Specific Risk

The Group is exposed to the risk that increases in the cost or reductions in the availability of funding could adversely impact its business model and strategic objectives. The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines.

Mitigants

Comprehensive treasury policies are in place for both the Group and the Bank to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due.

The Group has a dedicated Treasury function which is responsible for the day-to-day management of its overall liquidity and wholesale funding arrangements.

The Board, through the delegated authority provided to the ALCO, sets strict limits as to the level, composition and maturity of liquidity arrangements. Compliance with the approved limits is monitored daily. Detailed management information is reported monthly to ALCO in order to ensure that the Group can maintain adequate liquidity even under stressed conditions.

The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources, to cover future business requirements, and liquidity to cover shorter term funding needs.

The Group uses securitisation to mitigate its exposure to liquidity risk on its borrowings, ensuring, as far as possible, that the maturities of assets and liabilities are matched. The Paragon Group of Companies PLC has a BBB- investment grade credit rating from Fitch to support maintenance of its access to funding markets.

Paragon Bank is authorised to accept deposits. As such it is subject to regulation by the PRA, which aims to ensure that sufficient liquid assets are held to mitigate the liquidity risk inherent in deposit taking.

Specific Risk

The major part of the Group's lending portfolio is secured on residential property. Proposals made by the BCBS regarding potential changes from 2021 to the minimum capital requirements for lending secured on such assets could have a material impact on the Group. In addition, the Group could be adversely impacted by the imposition of a standardised approach floor to address the variability in the levels of risk-weighted assets between banks using the Internal Ratings Based ('IRB') approach.

Mitigants

In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group has taken a strategic decision to seek the necessary regulatory approval to implement an IRB approach for credit risk.

The programme of work will cover all relevant areas including data integrity, the development of compliant models, training and development, governance and use tests. It is anticipated that work already completed in relation to IFRS 9 changes will allow for accelerated development of initial IRB models.

The Group's capital position and its policies in respect of capital management are described more fully in section 4 below.

Market Risk

Market risk is the risk of either a loss of capital or a reduction in earnings arising from an adverse movement in market prices or rates. The principal market risk to which the Group is exposed is interest rate risk in the banking book ('IRRBB').

Specific Risk

Changes in interest rates may adversely affect the Group's net income and profitability. In particular, the Group's profitability is determined by the difference between the rates at which it lends and those at which it can borrow. Therefore, any changes in market interest rates which result in a mismatch can impact the Group's profit.

Mitigants

Comprehensive treasury policies are in place to ensure that the risk posed by changes and mismatches in interest rates is effectively managed.

The Group manages this risk outside the Bank by maintaining floating rate liabilities and matching these with floating rate assets, by hedging fixed rate assets and liabilities using interest rate swap or cap agreements and by maintaining a proportion of fixed rate liabilities.

The Group has a dedicated Treasury function which is responsible for the day-to-day management and control of its exposure to interest rate risk.

ALCO monitors the interest rate risk exposure on the Group's loan assets and asset backed loan notes on a monthly basis. This ensures compliance with the requirements of the trustees in respect of the Group's securitisations and the terms of other borrowings, as well as adherence to internal policies.

Paragon Bank has its own Treasury Policy and ALCO which focuses on the risks within the Bank, including the retail deposit position. Notwithstanding this, the Group ALCO maintains oversight of market risk across the whole Group.

Paragon Bank's retail deposits either bear variable interest rates or are fixed rate liabilities which are hedged in accordance with the Group's interest rate risk management strategy.

The Group has no direct exposure to market interest rate risk.

The steps taken by the Group to mitigate against the long term effects of interest rate movements, through the structuring of its products and the use of hedging procedures, are described in section 8 below.

Conduct Risk

Conduct risk is the risk that decisions, behaviours, culture and approach lead to poor outcomes for customers.

Specific Risk

The Group provides a range of financial services products across a number of brands to consumers and small business customers. As a result, the Group is exposed to potential conduct risk should it fail to treat its customers fairly. This could arise, for example, if certain products fail to meet the needs of customers or customer complaints are handled ineffectively. Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in the Group's profitability.

Mitigants

In order to mitigate the risk of poor customer outcomes, the Group has a suite of policies in place covering areas of particular importance to the fair treatment of customers.

Within the Group's consumer loan servicing area there is a dedicated Quality and Control team which monitors the activities of customer facing staff to validate the delivery of fair treatment for customers. The team also undertakes thematic reviews and customer experience reviews to help inform management of changes required to processes or training.

The Group maintains a centralised complaint handling function to ensure complaints are dealt with in a consistent and efficient manner. This team also monitors the number of complaints arising and conducts root cause analysis to prevent issues recurring.

All employees are required to undertake conduct risk related training with those in consumer lending customer facing roles also receiving monthly focussed training which is subject to performance testing.

The ORCC's remit extends to overseeing compliance with the FCA's rules and guidance, including those relating to the fair treatment of customers. The Committee receives reports each month from selected business areas relating to customer treatment and complaint handling.

The Group Compliance function maintains a formal monitoring plan which is heavily focussed on conduct risk. The plan is reviewed by both the ORCC and the Risk and Compliance Committee at Board level. Management actions to address any adverse findings are overseen at both committees.

During the last year, various Group subsidiaries have made a number of successful applications for regulatory permissions in relation to consumer and mortgage lending. These applications have included reviews of key customer-related policies and procedures. Alongside the business-wide training noted above, this has served to enhance business areas' focus on customer outcomes.

Further information regarding the Group's approach to treating its customers fairly is given in section A5.3 of the Group Accounts.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes reputational risks associated with business practices or market conduct and the risk of failing to comply with applicable laws regulations or policies. It also includes failure to comply with relevant regulatory requirements and / or identify and assess the impact of future regulations.

Specific Risk

The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs and fail to offer adequate protection against the threat of cyber-crime. Failure in these systems, either in terms of capacity or security, could result in detriment to customers, regulatory censure and reputational damage, all of which could materially impact income and profitability. This also includes the risk that the Group's key outsourcing arrangements s with third parties could expose it to material loss or reputational damage.

Mitigants

The Group has a formally agreed IT Strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. These include the provision of management information to enable business heads to exercise effective control of key operational risks. The Group also employs a robust vendor management process to select and monitor third party IT suppliers.

The Group maintains an ongoing programme of investment in IT infrastructure and systems. This includes investment in security solutions to counteract cyber security threats. There is also continued focus on the information security management system to ensure that controls, testing and user awareness are maintained and improved. The Group, excluding the operations acquired in the year, is currently certified to ISO 27001 (Information Security Management). As part of this, a significant investment was made to enhance the Group's controls regarding data loss during the last year. Additional investment is currently being made in the IT systems of the acquired businesses

Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.

In order to ensure it can deal effectively with unexpected operational disruptions, the Group has a well-established Business Continuity plan which is updated and tested regularly. The Group, excluding the acquired businesses, is currently certified to ISO 22301 (Business Continuity).

Before the Group outsources any key activities to a third party, it undertakes robust due diligence on them and ongoing performance and customer outcome monitoring thereafter. The Group only outsources activities under formal contractual arrangements which clearly set out the rights and obligations of both parties.

Specific Risk

The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations. The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains much of its funding, have been subject to increasing legislative and regulatory intervention over recent years. In addition, many of the Group's own business activities are now also subject to direct and increasing levels of regulation.

Mitigants

In order to mitigate this risk, the Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert third party advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the Risk and Compliance Committee.

The Risk and Compliance function has a formal regulatory compliance monitoring plan which is reviewed by the ORCC and the Risk and Compliance Committee. It also provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements. All employees are required to undertake regulatory training.

Specific Risk

The Group recognises that its success is dependent upon recruiting and retaining skilled senior management and personnel at all levels of the organisation. Failure to maintain the necessary skill base would put at risk the Group's ability to successfully carry out its plans. This is a particular risk in respect of key specialist and executive positions, where the incumbents' institutional knowledge would be hard to replicate in the short term.

Mitigants

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

- Undertaking formal succession planning reviews covering all key roles
- Monitoring external remuneration and reward structures to ensure it remains competitive and is able to recruit and retain key personnel
- Offering a range of employee benefits in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related performance scheme for most employees
- Continuing to operate its defined benefit pension scheme in respect of those employees who joined before 2002
- Having an effective performance appraisal system to identify and provide appropriate training and development opportunities for employees; and
- Providing regular internal training for all employees and financial support to employees undertaking relevant professional qualifications

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

Pension Obligation Risk

Pension obligation risk is the risk of contractual or other liabilities in respect of the Group's pension arrangements leading to costs which would reduce its scope to undertake other business activities.

Specific Risk

The Group operates a defined benefit pension plan (the 'Plan'), which is closed to new entrants. Its commitments under this plan expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to the investment performance of the Plan or the present assumptions of future inflation and members' salaries or mortality rates being inaccurate.

Mitigants

In conjunction with the Trustee, the Group conducts 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.

The Group's exposure to risks relating to its pension arrangements is discussed in more detail in note 56 to the Group Accounts.

Other Risks

As part of the Group's ICAAP, consideration was given to the following additional risk categories which are noted for firms' appraisal in the requirements for ICAAPs set out in the PRA Rulebook:

- Residual Risk
- Securitisation Risk
- Risk of Excessive Leverage; and
- Group Risk

The directors concluded that these were not currently significant for the Group and hence are not discussed in this document in accordance with the materiality provisions of Article 432.

The Group's exposure to other financial risks, including certain liquidity risks and market risks not described above, together with the procedures in place to mitigate those risks are described in detail in note 7 to the Group Accounts.

Risk Appetite Statements

Introduction

The Board accepts that a certain level of risk is inherent in the Group's business model, but it maintains a conservative stance in its approach to the acceptance of risk. The articulation of what constitutes an acceptable level of risk is achieved through risk appetite statements. Risk appetite is defined as the amount and type of risk which we are prepared to seek, accept or tolerate in pursuit of our long term business objectives. By setting defined risk appetites, the Board communicates the level of acceptable risk and mandates that risk is proactively managed within those parameters.

The Board has established a number of core requirements that are intended to describe the overall landscape within which it wishes the Group to operate:

- The Board has no appetite for any risk arising from a systemic failure to deliver fair outcomes for customers
- The Board has no appetite for any regulatory non-compliance
- The Board has no appetite for undertaking business which would contravene regulations and legislation in place to prevent financial crime
- The Board wishes to maintain capital quantity and quality to cover current and anticipated future risks
- The Board wishes to maintain sufficient capital to be able to survive a range of severe but plausible stressed scenarios
- The Board wishes to utilise capital in order to generate a strong return for shareholders
- The Board wishes to maintain sufficient high-quality liquidity to cover both everyday business needs, and also any stressed conditions associated with either significant change to the business environment and / or significant changes to the Group's operating environment

In addition, the Group maintains a risk appetite for each of the principal risk categories outlined above which are summarised below:

Business Risk

Business risk is defined as any risk arising from changes to the business, including the risk that the business may not be able to implement its business plan and desired strategy. A key business risk is that there is insufficient capital to meet the expectations in the business plan.

The Board's risk appetite is that:

- The Group maintains capital quantity and quality to cover current and anticipated future risks
- The Group maintains sufficient capital to be able to survive a range of severe but plausible stressed scenarios
- There will be no material change to the annual business plan in terms of volumes or activities without the Board's consent

Credit Risk

The Group is exposed to credit risk principally through its origination and acquisition of buy-to-let, consumer and SME loans. In addition, through the Group's Treasury activities, the Group is exposed to risk of loss through failure of an investment counterparty with which funds have been placed.

The Board's risk appetite is that:

- All credit exposures are underwritten and accepted strictly in line with the individual credit policies which have been approved for each product type
- The credit quality of investment counterparties is closely monitored by and all limits approved by the ALCO with the primary objective being to minimise risk rather than maximise return
- Individual investment counterparty exposure is contained within approved limits for
    - Key systemically important relationship banks
    - Other banks and major UK building societies
    - Other UK building societies
    - Money market funds

Liquidity and Capital Risk

The Group seeks to minimise liquidity risk to a level which in the event of funding restrictions would provide continuity of lending and committed investments for the immediacy, until lending and investments can be wound down in an orderly manner, and in the case of business operations for a period which allows the business to be adjusted if required.

The Board's risk appetite is that:

- The minimum level of corporate liquidity will comprise six month cash outflows based on anticipated corporate business costs including other cash commitments net of senior administration income. This liquidity is to be in the form of cash or committed undrawn funding facilities
- A financing strategy will be put into place to cover maturing corporate debt prior to the scheduled maturity date and consistent with the debt amount and forecast cash flows
- Sufficient funding for the next three months' anticipated completions will be available between the Group's warehouse funding and the retail deposits held by the Group's banking subsidiary
- The Group has sufficient resources to meet capital investment requirements for warehouse special purpose vehicles ('SPVs') for the projected three month asset advances by reference to the annual business plan or current pipeline, whichever is the greater

Market Risk

Market risk is the risk of a loss to either capital or earnings arising from an adverse movement in market prices or rates.

The Board's risk appetite is that:

- Risk against interest rate movements is controlled by limiting the permitted level of mismatching between the re-pricing rates of fixed lending assets and funding liabilities. This will be calculated as the profit impact of asset and liability mismatches based on a +1% movement in interest rates

- There is to be no exposure to exchange rate risk given the high volatility of exchange rates and the lack of natural income offset that can be used in managing the exposure

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes reputational risks associated with business practices or market conduct and the risk of failing to comply with applicable laws, regulations or policies.

The Board's risk appetite is that:

- The Group should incur fewer than a defined number of material risk events in any single financial year based on any event with an actual or potential capacity to cause:

    - A major adverse impact on over 5% of the customer base

    - Direct financial loss of £100,000 or more

    - A worsening of the Group's relationship with its regulators

    - Adverse mainstream or specialist media interest

    - A requirement for significant executive or business resource involvement to resolve the issue

- Total IT systems downtime must not exceed six hours in any twelve month period

- There can be a period of no more than twelve months between full tests of the Group's business continuity plan

Conduct Risk

The Group and its subsidiaries take a cautious approach to conduct risk and endeavour to maintain an efficient operating environment adopting a culture, behaviours and approach to products and services that do not result in poor outcomes for customers.

The Board's risk appetite is that:

- Whilst acknowledging operational errors may lead to isolated instances of customer detriment (which must always be remediated) the Group has no appetite for any systemic failure to deliver fair outcomes for customers. In practice, this means that:
    - The Group will only accept introductions from intermediaries on whom it has conducted satisfactory due diligence
    - Customers are provided with sufficient (clear, fair and not misleading) information in order to take an appropriate and informed decision on any product
    - Products only reach the customers they were designed for
    - Products are suitable for the target customer's personal circumstances and meet their needs
    - Products function as expected
    - Credit decisions provide outcomes to customers that are fair and appropriate to their personal circumstances and meet their needs
    - Customers receive a fair and reasoned response to their expressions of dissatisfaction
    - Customers are only charged fees in line with their expectations
    - Customers can be confident that their data is secure
    - Customers can be confident that when an unexpected incident occurs, the business will be recovered and they will not suffer any unfair outcomes

Board Assessment of Risk Management Arrangements

During the year, the directors, as members or attendees of the Risk and Compliance Committee undertook reviews on a quarterly basis which included:

- Consideration and challenge of the ratings applied to the various risk categories to which the Group is exposed
- Consideration of the principal risks facing the Group
- Consideration of key regulatory developments

At the year end the directors reviewed this on-going work and the most recent risk information available to confirm the position of the Group at the balance sheet date.

The directors concluded that this process constituted a robust assessment of all of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

4. CAPITAL RESOURCES

This section sets out

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

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors against the risk of losses being incurred by the Group.

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

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

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

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

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

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

It should be noted that the regulatory capital disclosures in this section relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the year.

Capital resources

At 30 September 2016 the Group's regulatory capital of £1,005.6m (2015: £976.3m), was comfortably in excess of that required by the regulator. Throughout the period from authorisation to that date the Group's regulatory capital also complied with these requirements.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2016 is set out below.

		2016	2015
		£m	£m
Total equity		**969.5**	969.5
Deductions			
Proposed final dividend		**(25.5)**	(21.8)
Intangible assets		**(105.4)**	(7.7)
Deferred tax adjustment	*	**-**	(0.3)
Common Equity Tier 1 ('CET1') capital		**838.6**	939.7
Other tier 1 capital		**-**	-
Total Tier 1 capital		**838.6**	939.7
Corporate bond		**260.0**	110.0
Less: amortisation adjustment	†	**(97.8)**	(75.8)
		162.2	34.2
Collectively assessed credit impairment allowances		**4.8**	2.4
Total Tier 2 capital		**167.0**	36.6
Total regulatory capital		**1,005.6**	976.3

* Deferred tax assets in subsidiary companies are required to be deducted from regulatory capital. This balance is offset against the deferred tax liability in the consolidated accounts.

† When Tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. As the Group's £110.0m Corporate Bond matures in 2017, this adjustment is required in respect of this instrument. No such adjustment is required in respect of the Corporate Bond issued in the year, which matures in 2026.

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

The tier 2 capital instruments are fixed term corporate bonds, listed on the London Stock Exchange. £110.0m of these bonds mature in 2017, while the other £150.0m, issued in the year, mature in 2026. Further details of these bonds are given in note 55 to the Group Accounts.

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

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

	2016			2015		
	CET 1 £m	**Tier 2 £m**	**Total £m**	CET 1 £m	Tier 2 £m	Total £m
Capital at 1 October 2015	939.7	36.6	976.3	920.4	60.7	981.1
Trading transactions						
Profit after tax	116.0	-	116.0	107.1	-	107.1
Other comprehensive income	(26.4)	-	(26.4)	(5.9)	-	(5.9)
Charge for share based payment	4.4	-	4.4	4.5	-	4.5
Tax on share based payment	(0.2)	-	(0.2)	1.2	-	1.2
Movement in collectively assessed impairment allowances	-	2.4	2.4	-	(2.1)	(2.1)
Intangible assets arsing on acquisition	(97.9)	-	(97.9)	-	-	-
Purchase of intangible assets	(1.4)	-	(1.4)	(1.2)	-	(1.2)
Amortisation of intangible assets	1.6	-	1.6	1.4	-	1.4
Utilisation of tax losses	0.3	-	0.3	0.2	-	0.2
Capital transactions						
Proposed dividend at year end	(25.5)	-	(25.5)	(21.8)	-	(21.8)
Interim dividend paid in year	(12.1)	-	(12.1)	(10.8)	-	(10.8)
Share buy-backs	(51.0)	-	(51.0)	(49.7)	-	(49.7)
Shares issued	0.3	-	0.3	2.5	-	2.5
Shares purchased by ESOP	(9.2)	-	(9.2)	(8.2)	-	(8.2)
Issue of Tier 2 instruments	-	150.0	150.0	-	-	-
Amortisation of Tier 2 instruments	-	(22.0)	(22.0)	-	(22.0)	(22.0)
Capital at 30 September 2016	838.6	167.0	1,005.6	939.7	36.6	976.3

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

Total Risk Exposure

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

	2016 £m	2015 £m
Credit risk		
Balance sheet assets	**4,728.4**	4,426.8
Off balance sheet	**51.5**	88.7
Total credit risk	**4,779.9**	4,515.5
Operational risk	**445.7**	363.6
Market risk	-	-
Other	**61.9**	50.2
Total exposure amount	**5,287.5**	4,929.3
Solvency ratios	**%**	%
CET1	**15.9**	19.1
Total regulatory capital	**19.0**	19.8

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

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

	2015 RWA £m	Portfolio Quality £m	Portfolio Size £m	Acquisition £m	2016 RWA £m
First mortgages	3,429.2	(11.4)	30.9	-	3,448.7
Second charge mortgages	99.1	(7.9)	111.7	-	202.9
Development finance	-	-	13.7	-	13.7
Exposures secured on real estate	3,528.3	(19.3)	156.3	-	3,665.3
Retail exposures	478.4	(5.5)	(112.5)	-	360.4
Asset finance exposures	-	-	-	204.8	204.8
Exposure on loans to customers	4,006.7	(24.8)	43.8	204.8	4,230.5
Institutions	457.1	-	17.0	1.1	475.2
Other assets	51.6	-	(3.9)	26.5	74.2
	4,515.4	(24.8)	56.9	232.4	4,779.9

Credit RWAs have increased by approximately 5.6% since 30 September 2015. The principal cause of this increase has been the acquisition of the asset finance business which accounted for £204.8m of the total increase. Elsewhere in the Group, the impact on RWA from asset growth was mitigated by an improvement in book quality due to increased house prices and better performance.

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

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

Leverage ratio

The table below shows the calculation of the leverage ratio at the year end, based on the consolidated balance sheet assets, adjusted for amounts already provided in the Group Accounts and the post offer pipelines of loan assets at 30 September 2016.

	2016	2015
	£m	£m
Total balance sheet assets	**13,518.4**	11,878.9
Less: Derivative assets	**(1,366.4)**	(660.1)
On-balance sheet items	**12,152.0**	11,218.8
Less: Intangible assets	**(105.4)**	(7.7)
Total on balance sheet exposures	**12,046.6**	11,211.1
Derivative assets	**1,366.4**	660.1
Potential future exposure on derivatives	**68.6**	69.1
Total derivative exposures	**1,435.0**	729.2
Post offer pipeline at gross notional amount	**273.8**	482.3
Adjustment to convert to credit equivalent amounts	**(136.9)**	(241.1)
Off balance sheet items	**136.9**	241.2
Tier 1 capital	**838.6**	939.7
Total leverage exposure	**13,618.5**	12,181.5
Basel III leverage ratio	**6.2%**	7.7%

The reduction in the leverage ratio in the year relates principally to the reduction in the Group's regulatory capital arising from the acquisition of intangible assets and goodwill with the asset finance businesses purchased in the year, together with the Group's share buy-back programme and the deficit recorded on the Group's defined benefit pension plan. The reduction in leverage brings the ratio closer to a position which is sustainable in the long term.

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

Capital buffers

CRD IV establishes a number of capital buffers to be met with common equity tier 1 capital, in addition to the Group's funds requirement set through Pillar I and Pillar II (together referred to as the 'CRD IV Buffers'):

From 1 January 2016 new buffers were introduced under CRD IV and changes were made to the Group's ICG to allow for this.

These changes converted the existing ICG, expressed as a percentage of the Pillar 1 requirement, to a percentage of Total Risk Exposure ('TRE'), plus an add-on for pension risk. At the same time the existing capital buffer (which was expressed as an absolute amount) was retired and a PRA buffer was set as a percentage of TRE. The proposed capital buffers in the document are therefore also presented on the basis of a percentage of TRE.

The buffers which apply to the Group at 30 September 2016 and which are expected to apply in the near term are:

- A Capital Conservation Buffer ('CCoB') which is currently 0.625% of TRE, rising to 1.250% at 1 January 2017, 1.875% at 1 January 2018 and 2.500% at 1 January 2019

- A Counter Cyclical Buffer ('CCyB'), controlled by the Financial Policy Committee ('FPC'), which is currently 0.00% of TRE and is expected to remain so in the short term, the proposed increase to 0.50% at 29 March 2017 having been withdrawn by the FPC as a response to the Brexit referendum result. However the PRA have indicated that their expectation is that the level of the CCyB in a 'standard risk environment' would be 1.0%

- The PRA buffer, set for firms on an individual basis. The PRA and FPC have indicated their expectation that the PRA buffer will decrease in line with increases in the CCoB and CCyB, until it reaches zero, for most firms. The PRA announced a minimum buffer amount from 5 July 2016 of 0.625% in response to the Brexit referendum result. It should be noted that the PRA buffer is set as a percentage of TRE, rather than an absolute amount, so will vary with the balance sheet

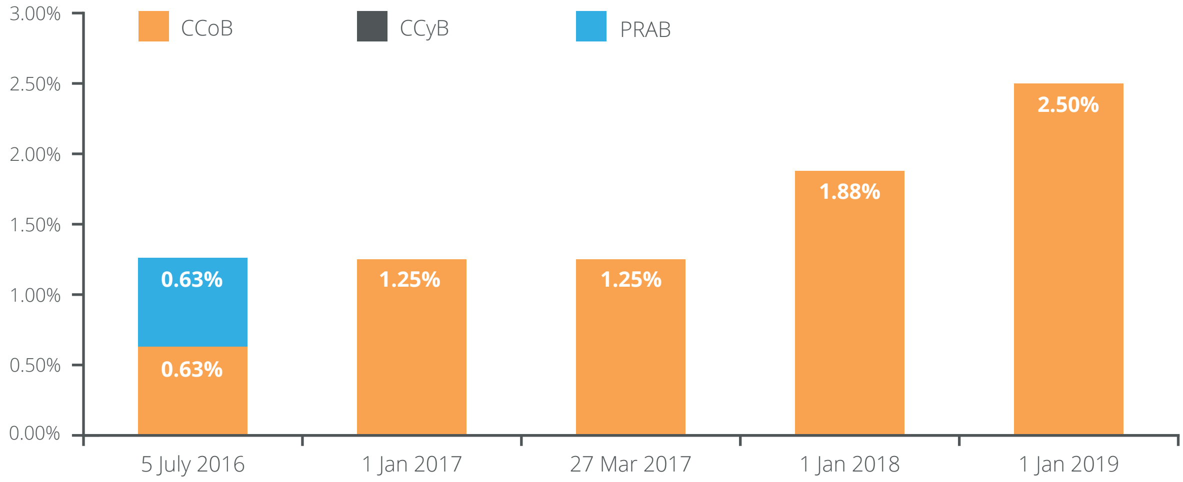
Additional buffers provided for by CRD IV do not apply to the Group.

While an institution's CCyB will be a weighted average of those set by the regulators in the jurisdictions in which it operates, forming an 'Institution Specific CCyB Rate', as all of the Group's risk exposure is within the UK, its rate will be equal to that set for the UK by the FPC. This is currently 0.00% and hence the Group's Institution Specific CCyB Requirement as 30 September 2016 was £nil (2015: £nil).

When announcing their minimum buffer, the PRA indicated that it would apply to the majority of firms and that it was likely to fall away when the CCoB increases to 1.25% in January 2017. The PRA have indicated that their intention is that their buffer will be used in future to address governance and risk management issues which have not been adequately addressed by firms. In the short term it is being used to supplement other CRD IV buffers where the overall capital buffer amount is less than the former capital planning buffer requirement.

The buffers presently expected to apply to the Group, based on the minimum PRA buffer, are shown below.

Projected CRD IV Buffers



The PRA buffer may be amended by the PRA as part of the SREP process, while the FPC may vary the CCyB from time to time. For forecasting purposes (but not in the diagram above) the Group has assumed a CCyB remaining at 0.0% until March 2018, when it increases to 0.5%, further increasing to 1.0% in 2020, as the FPC have indicated their withdrawal of the CCyB amount is intended as a short term measure.

In considering the amount of capital required to be held within the Bank, the PRA has stated that it will maintain its proportionate approach outlined in the 2013 'Barriers to Entry' report for newly authorised firms. Firms will hold a PRA buffer calculated as the fixed amount of wind down costs, minus the CCoB, calculated for the Bank itself. These wind down costs are currently £11.6m. If the wind down cost is less than or equal to the CCoB, the PRA buffer is zero; in that case the combined buffers will be equal to the CCoB plus any other applicable CRD IV buffers, but in excess of the wind down costs. This means that some firms may hold combined buffers greater than their wind down costs sooner than the three to five years after authorisation envisaged in the PRA's document.

CRD IV also sets minimum requirements for the quality of capital held.

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

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

5. CREDIT RISK

This section sets out

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

The Group's business objectives rely on maintaining the credit quality of its customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and in the collections process.

Primary responsibility for credit risk management across the Group lies with the Credit Committee. The Credit Committee is made up of seven senior employees, headed by the Group Finance 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.

In order to control credit risk relating to counterparties to the Group's derivative financial instruments, short-term investments and cash deposits, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits.

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

	2016	2015
	£m	£m
Loans to customers	**10,737.5**	10,062.4
Investments in structured entities	**-**	18.1
Derivative financial assets	**1,366.4**	660.1
Amounts owed by Group companies	**-**	-
Accrued interest income	**0.3**	0.4
CSA assets	**3.7**	0.9
Trade debtors	**2.4**	-
Short term investments	**7.1**	41.1
Cash	**1,237.6**	1,056.0
Maximum exposure to credit risk	**13,355.0**	11,839.0

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

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

		Exposure £m	Average risk weighting %	Risk weighted exposure £m	Minimum capital required £m
30 September 2016					
Government and central banks	(a)	322.1	-	-	-
Credit institutions	(f)	2,289.0	20.76	475.2	38.0
Total liquidity exposures		2,611.1	18.19	475.2	38.0
Local authorities	(b)	12.8	20.31	2.6	0.2
Corporate and similar exposures	(g)	81.6	100.00	81.6	6.5
Retail and SME lending	(h)	464.5	78.60	365.1	29.2
Residential lending	(i)	10,127.2	36.23	3,669.0	293.5
Non-performing	(j)	56.2	107.82	60.7	4.9
Loans and advances to customers		10,742.3	38.90	4,179.0	334.3
Fixed and other assets	(q)	68.3	108.64	74.2	6.0
Total on balance sheet exposures		13,421.7	352.34	4,728.4	378.3
Off balance sheet exposures - pipeline		228.7	22.52	51.5	4.1
Total credit risk exposure		**13,650.4**	**35.02**	**4,779.9**	**382.4**
30 September 2015					
Government and central banks	(a)	327.1	-	-	-
Credit institutions	(f)	1,430.1	31.96	457.1	36.6
Total liquidity exposures		1,757.2	26.03	457.1	36.6
Local authorities	(b)	-	-	-	-
Corporate and similar exposures	(g)	-	-	-	-
Retail and SME lending	(h)	480.7	97.86	470.4	37.6
Residential lending	(i)	9,531.2	35.59	3,392.5	271.4
Non-performing	(j)	55.0	100.36	55.2	4.4
Loans and advances to customers		10,066.9	38.92	3,918.1	313.4
Fixed and other assets	(q)	51.6	100.00	51.6	4.1
Total on balance sheet exposures		11,875.7	37.28	4,426.8	354.1
Off balance sheet exposures - pipeline		241.2	36.77	88.7	8.8
Total credit risk exposure		**12,116.9**	**37.27**	**4,515.5**	**362.9**

The additional categories arising in the year reflect the customer base of the asset finance businesses acquired in the period.

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

a) Exposures to central governments or central banks

b) Exposure to regional governments and local authorities

f) Exposure to institutions

g) Exposure to corporates

h) Retail exposures

i) Exposures secured by mortgages on immovable property

j) Exposures in default

q) Other items

There are no equity exposures.

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

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

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

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

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

	2016	2015
	£m	£m
Total balance sheet assets	**13,518.4**	11,878.9
Less amounts deducted in regulatory capital		
Intangible assets	**(105.4)**	(7.7)
Add back non-specific provisions		
Qualifying as Tier 2 capital	**4.8**	2.4
Other	**-**	2.1
Deferred tax asset netted off creditors in balance sheet	**3.9**	-
Total balance sheet exposure	**13,421.7**	11,875.7

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

Loans to customers and other investments in loan assets

The Group's credit risk is primarily attributable to its loans to customers. There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios.

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

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

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

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

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

The Group's loan assets at 30 September 2016 are analysed as follows:

	Gross loan assets £m	Impairment provisions £m	Net loan assets £m	%
30 September 2016				
Buy-to-let mortgages	9,700.0	78.8	9,621.2	89.6%
Owner-occupied mortgages	28.5	9.1	19.4	0.2%
Total first residential mortgages	9,728.5	87.9	9,640.6	89.8%
Secured loans	530.3	3.5	526.8	4.9%
Loans secured on residential property	10,258.8	91.4	10,167.4	94.7%
Development finance	9.1	-	9.1	0.1%
Commercial mortgages	3.4	0.5	2.9	-
Loans secured on property	10,271.3	91.9	10,179.4	94.8%
Car loans	96.0	0.7	95.3	0.9%
Retail finance loans	1.9	1.7	0.2	-
Other consumer loans	211.2	16.3	194.9	1.8%
Asset finance loans	252.6	2.2	250.4	2.3%
Factoring and discounting balances	17.4	0.5	16.9	0.2%
Other loans	0.4	-	0.4	-
Total loans to customers	**10,850.8**	**113.3**	10,737.5	100.0%
30 September 2015				
Buy-to-let mortgages	9,440.6	77.4	9,363.2	93.0%
Owner-occupied mortgages	56.2	8.6	47.6	0.5%
Total first residential mortgages	9,496.8	86.0	9,410.8	93.5%
Secured loans	392.8	5.7	387.1	3.9%
Loans secured on residential property	9,889.6	91.7	9,797.9	97.4%
Development finance	-	-	-	-
Commercial mortgages	-	-	-	-
Loans secured on property	9,889.6	91.7	9,797.9	97.4%
Car loans	44.0	0.6	43.4	0.4%
Retail finance loans	2.0	0.8	0.2	-
Other consumer loans	237.8	17.9	220.9	2.2%
Asset finance loans	-	-	-	-
Factoring and discounting balances	-	-	-	-
Other loans	-	-	-	-
Total loans to customers	**10,173.4**	**111.0**	**10,062.4**	**100.0%**

Impairment provisions at 30 September 2016 shown above include collectively assessed provisions of £4.8m. Of these provisions £2.9m related to buy-to-let mortgages, £0.3m to secured loans, £0.2m to car loans and £1.4m to asset finance loans.

An analysis of the movements in impairment provisions is given in note 36 to the Group Accounts. Analysis of this movement between specific and collectively assessed provisions has not been given due to the immateriality of the collectively assessed element.

First mortgages and secured loans are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities. Car loans and asset finance loans are effectively secured by the financed asset.

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

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

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

The Group's underwriting philosophy is based on a combination of sophisticated individual credit assessment and the automated efficiencies of a scored decision making process. Information on each applicant is combined with data taken from a credit reference bureau to provide a complete credit picture of the applicant and the borrowing requested. Key information is validated through a combination of documentation and statistical data which collectively provide evidence of the applicant's ability and willingness to pay the amount contracted under the loan agreement.

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

Despite the existence of the security described above, in assessing credit risk, an applicant's ability and propensity to repay the loan remain the principal factors in the decision to lend.

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

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on property by value at 30 September 2016 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2016 First Mortgages %	**2016 Secured Loans %**	2015 First Mortgages %	2015 Secured Loans %
Loan to value ratio				
Less than 70%	**60.7**	**50.9**	51.9	33.7
70% to 80%	**23.4**	**17.8**	27.6	16.3
80% to 90%	**11.3**	**13.0**	12.8	16.7
90% to 100%	**2.2**	**8.9**	4.9	13.5
Over 100%	**2.4**	**9.4**	2.8	19.8
	100.0	**100.0**	100.0	100.0
Average loan to value ratio	**67.1**	**72.7**	69.5	80.9
Buy-to-let	**67.2**		69.7	
Owner-occupied	**27.5**		28.8	

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 5.3% (2015: 3.8%) in the year ended 30 September 2016. The increase in average prices, however, is part of a more volatile picture, which has been particularly marked at the local and regional level. The Group maintains a specialist team of in-house surveyors to maximise its understanding of particular markets, both from a valuation and lettings standpoint.

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

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

An analysis of those loan accounts secured on property, classified by property location, by value at 30 September 2016 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2016	2015
	£m	£m
Region		
Greater London	**1,734.1**	1,664.7
South East	**2,991.5**	2,807.7
South West	**991.2**	976.4
East Anglia	**342.5**	336.4
East Midlands	**545.2**	540.9
West Midlands	**498.1**	481.9
North	**390.6**	385.5
North West	**1,065.0**	1,030.5
Yorkshire and Humberside	**1,054.4**	1,047.9
Total England	**9,612.6**	9,271.9
Northern Ireland	**22.9**	22.5
Scotland	**181.7**	182.7
Wales	**375.6**	366.6
Total United Kingdom	**10,192.8**	9,843.7

The amount analysed above represents the current balance of live loans before provision and includes £9,657.5m (2015: £9,428.1m) of first mortgage assets and £535.3m (2015: £390.9m) of secured loans. The reconciliation of these amounts to the carrying values is shown in the aged analysis later in this section.

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

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

	2016	2015
	£m	£m
Broadcast and audio	27.9	-
Veterinary services	7.4	-
Construction and plant hire	79.6	-
Print	23.6	-
Engineering	5.4	-
Distribution	11.2	-
Property	1.1	-
Forestry and agriculture	5.6	-
Waste	17.9	-
Packaging	0.4	-
Local Authority	14.7	-
Other Transport	20.1	-
Other Manufacturing	14.8	-
Other Services	40.9	-
Total	270.6	-

The nature of the assets providing security to the loans in the asset finance business is analysed below:

	2016	2015
	£m	£m
Asset finance		
Broadcast and audio	27.2	-
Veterinary services	7.4	-
Computer hardware and software	5.2	-
Gym Equipment	1.9	-
Print equipment	27.8	-
Other equipment and receivables	7.7	-
Contractors plant	30.4	-
Plant and equipment	51.3	-
Commercial vehicles and cars	61.1	-
Refuse collection vehicles	21.1	-
Machine tools	9.4	-
Forestry and agricultural equipment	5.1	-
Total asset finance	255.6	-
Commercial mortgages	2.9	-
Invoice discounting	12.1	-
	270.6	-

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

The Group conducts detailed analysis of customer servicing risk indicators across its portfolios, analysing some 615 million pieces of customer data each month to identify potential future arrears cases. The Group's customer servicing teams then work with the identified customers to prevent the accounts falling into arrears where possible.

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2016, compared to the industry averages at that date published by the CML and the Finance and Leasing Association ('FLA'), was:

	2016	2015
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.11**	0.19
Buy-to-let accounts excluding receiver of rent cases	**0.02**	0.04
Owner-occupied accounts	**3.23**	3.55
CML data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.55**	0.66
Buy-to-let accounts excluding receiver of rent cases	**0.50**	0.60
Owner-occupied accounts	**1.11**	1.27
All mortgages	**1.01**	1.17
Secured loans		
Accounts more than two months in arrears	**17.15**	19.56
FLA data for point of sale hire purchase	**12.50**	15.40
Car loans		
Accounts more than two months in arrears	**0.30**	0.67
FLA data for point of sale hire purchase	**1.50**	1.20
Asset finance loans		
Accounts more than two months in arrears	**0.82**	-
FLA data for business lease / hire purchase loans	**0.70**	0.80
Other loans		
Accounts more than two months in arrears	**96.35**	94.66

No published industry data for asset classes comparable to the Group's other books has been identified.

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 the CML in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will be higher for closed books such as the owner occupied mortgage book and the retail finance and unsecured loan books than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans and other loans include purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price.

The improvement in the arrears position for car loans shown above is due to the recommencement of lending in this market, through Paragon Bank, with the new performing cases reducing the overall average.

The payment status of the carrying balances of the Group's loan assets, before provision for impairment, at 30 September 2016 split between those accounts considered as performing and those included in the population for impairment testing, is shown below. Balances for immaterial asset classes are not shown. Asset finance loans below include other related balances. Fully provided non-live accounts are excluded from the tables below.

Days past due is not a relevant measure for the development finance or invoice discounting businesses, due to their particular contractual arrangements.

First mortgages

	2016	2015
	£m	£m
Not past due	9,528.1	9,274.0
Arrears less than 3 months	82.1	100.8
Performing accounts	9,610.2	9,374.8
Arrears 3 to 6 months	2.4	4.6
Arrears 6 to 12 months	2.8	4.1
Arrears over 12 months	11.0	15.8
Possessions and similar cases	31.1	28.8
Impairment population	47.3	53.3
Total gross balances	9,657.5	9,428.1
Impairment provision on live cases	(16.4)	(15.3)
Timing adjustments	(0.5)	(2.0)
Carrying balance	9,640.6	9,410.8

Consumer and asset finance

	Secured loans	Car loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2016				
Not past due	415.0	92.7	251.6	759.3
Arrears less than 2 months	33.3	3.0	1.5	37.8
Performing accounts	448.3	95.7	253.1	797.1
Arrears 2 to 6 months	20.3	0.2	1.0	21.5
Arrears 6 to 9 months	8.3	-	0.3	8.6
Arrears 9 to 12 months	7.4	-	-	7.4
Arrears over 12 months	51.0	0.2	0.4	51.6
Specifically impaired asset finance cases	-	-	3.3	3.3
Impairment population	87.0	0.4	5.0	92.4
Total gross balances	535.3	96.1	258.1	889.5
Impairment provision on live cases	(3.4)	(0.6)	(0.5)	(4.5)
Timing adjustments	(5.1)	(0.2)	(3.9)	(9.2)
Carrying balance	526.8	95.3	253.7	875.8

	Secured loans	Car loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2015				
Not past due	265.2	43.3	-	308.5
Arrears less than 2 months	25.7	0.2	-	25.9
Performing accounts	290.9	43.5	-	334.4
Arrears 2 to 6 months	20.2	-	-	20.2
Arrears 6 to 9 months	8.9	-	-	8.9
Arrears 9 to 12 months	7.4	-	-	7.4
Arrears over 12 months	63.5	0.4	-	63.9
Specifically impaired asset finance cases	-	-	-	-
Impairment population	100.0	0.4	-	100.4
Total gross balances	390.9	43.9	-	434.8
Impairment provision on live cases	(5.4)	(0.5)	-	(5.9)
Timing adjustments	1.6	-	-	1.6
Carrying balance	387.1	43.4	-	430.5

Other Loans

	2016	2015
	£m	£m
Not past due	**4.1**	6.7
Arrears less than 1 month	**0.3**	0.5
Performing accounts	**4.4**	7.2
Arrears 1 to 3 months	**0.4**	0.5
Arrears 3 to 6 months	**0.7**	0.9
Arrears 6 to 12 months	**2.3**	2.7
Arrears over 12 months	**203.5**	226.5
Impairment population	**206.9**	230.6
Total gross balances	**211.3**	237.8
Impairment provision	**(16.4)**	(16.9)
Timing adjustments	**-**	-
Carrying balance	**194.9**	220.9

Arrears in the tables above are based on the contractual payment status of the customers concerned. Where assets have been purchased by the Idem Capital loan investment business, customers may already have been in arrears at the time of acquisition and an appropriate adjustment made to the consideration paid.

Under the CRD, mortgages are past due if repayments are 90 days or more in arrears at the accounting date. The Group closely monitors arrears of loan repayments and impairment provisions are made where appropriate. The Group's accounting policy for impairments of loan assets is set out in note 3 to the Group Accounts and full details of movements in impairment provisions are set out in note 36 to the Group Accounts.

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

Investments in structured entities represent the Group's contribution made to SPV companies established and controlled by third parties to purchase pools of loan assets. All such investments are denominated in sterling and the underlying loans are made to United Kingdom borrowers. Cash generated by the assets is distributed to investors in accordance with a specified priority of payments. The Group has no obligation to make further contributions to the SPV companies concerned. These assets were paid off in full during the year.

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IAS 39 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability the 84 and 120 month ERC values for the Group's purchased assets included in the Idem Capital and Paragon Bank divisions are set out below, analysed by the balance sheet line on which they appear. These are derived using the same models and assumptions used in the IAS 39 Effective Interest Rate ('EIR') calculations, but the differing bases of calculation lead to different outcomes.

	2016	**2016**	**2016**	2015	2015	2015
	Carrying value	**84 month ERC**	**120 month ERC**	Carrying value	84 month ERC	120 month ERC
	£m	**£m**	**£m**	£m	£m	£m
Loans to customers	**533.9**	**651.3**	**740.7**	432.9	555.1	647.3
Investments in structured entities	**-**	**-**	**-**	18.1	25.7	30.4
	533.9	**651.3**	**740.7**	451.0	580.8	677.7

Amounts shown as loans to customers above include loans disclosed as first mortgages and other loans.

Trade Debtors

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

6. ASSET ENCUMBRANCE

This section sets out

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

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

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

Certain of the Bank's buy-to-let mortgage assets have been utilised as whole mortgage pools for the purpose of the Funding for Lending Scheme ('FLS'). This has enabled off balance sheet liquidity to be provided, based on the value of the assets pledged, subject to a haircut. The amount of the liquidity presently drawn is £108.8m (2015: £nil). Further mortgage assets of the Bank have been pre-positioned with the Bank of England for use in the FLS and other funding schemes.

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

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

	First mortgages £m	Other assets £m	Total £m
30 September 2016			
Loans funded by			
Securitisation structures	**6,845.8**	413.9	7,259.7
Warehouse facilities	**1,762.1**	-	1,762.1
Funding for Lending Scheme	**192.2**	-	192.2
	8,800.1	413.9	9,214.0
Prepositioned with Bank of England	**428.1**	-	428.1
Other Bank assets	**395.3**	670.5	1,065.8
Other loans to customers	**26.2**	3.4	29.6
	9,649.7	1,087.8	10,737.5

	First mortgages £m	Other assets £m	Total £m
30 September 2015			
Loans funded by			
Securitisation structures	**7,464.7**	448.4	7,913.1
Warehouse facilities	**1,566.5**	-	1,566.5
Funding for Lending Scheme	**-**	-	-
	9,031.2	448.4	9,479.6
Prepositioned with Bank of England	**-**	-	-
Other Bank assets	**349.6**	15.0	364.6
Other loans to customers	**30.0**	144.8	174.8
	9,410.8	608.2	10,019.0

Assets funded through retail deposits accepted by Paragon Bank are shown as 'Funding for Lending Scheme', 'Prepositioned with Bank of England' and 'Other Bank Assets' in the analysis above.

At 30 September 2016 84.0% (2015: 94.6%) of the carrying value of the Group's loans to customers was funded by securitisations and structures affecting the credit risk exposure of the Group in a similar way (see Section 9).

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

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

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

Assets (Template A)

	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
At 30 September 2016				
Assets of the reporting institution	13,096.1	N/A	472.0	N/A
Loans on demand	842.5	N/A	391.7	N/A
Debt securities	-	-	45.0	45.0
Of which: asset backed securities	-	-	38.0	38.0
Of which: issued by general government	-	-	7.1	7.1
Loans and advances other than loans on demand	10,710.5	N/A	27.6	N/A
Of which: mortgage loans	10,059.3	N/A	6.5	N/A
Other assets	1,543.1	N/A	7.7	N/A
At 30 September 2015				
Assets of the reporting institution	11,426.4	N/A	494.8	N/A
Loans on demand	835.0	N/A	220.3	N/A
Debt securities	-	-	85.5	85.5
Of which: asset backed securities	-	-	44.4	44.4
Of which: issued by general government	-	-	41.1	41.1
Loans and advances other than loans on demand	9,887.6	N/A	174.0	N/A
Of which: mortgage loans	9,574.1	N/A	57.0	N/A
Other assets	703.9	N/A	14.0	N/A

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

At 30 September 2016

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

At 30 September 2015

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
	£m	£m
Carrying amount of selected financial liabilities	8,479.9	12,180.1
Debt Securities issued	8,479.9	12,180.1
Of which: covered bonds issued	-	-
Of which: asset-backed securities issued	8,479.9	12,180.1
Other sources of encumbrance	2,135.3	-
Other	2,135.3	-
Total sources of encumbrance	**10,615.2**	**12,180.1**

7. COUNTERPARTY CREDIT RISK

This section sets out

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

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

In order to control credit risk relating to counterparties to the Group's derivative financial instruments and cash deposits, ALCO determines which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits. Exposure is monitored daily by senior management within the Group's Treasury function and is reported monthly to ALCO. Counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, must comply with criteria set out in the financing arrangements, which are monitored externally. Where a derivative counterparty fails to meet the required criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit. This is the only credit mitigation technique used by the Group. The amounts of these cash collateral deposits, which do not form part of the Group's cash position, are shown below.

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

Derivative financial assets

The Group's exposure to credit risk in respect of the counterparties to its derivative financial assets, analysed by their long term credit rating as determined by Fitch, and the Credit Quality Step ('CQS') to which these are mapped by the regulator, is set out below.

		Carrying value		Exposure value	
		2016	2015	**2016**	2015
		£m	£m	**£m**	£m
Counterparties rated					
AA-	(CQS 1)	**218.7**	91.9	**43.7**	18.4
A+	(CQS 2)	**58.1**	6.2	**29.0**	3.1
A	(CQS 2)	**969.2**	515.1	**484.6**	257.6
BBB+	(CQS 3)	**120.4**	46.9	**60.2**	23.5
Gross exposure		**1,366.4**	660.1	**617.5**	302.5
Collateral amounts posted		**(1,184.2)**	(753.5)	**(326.8)**	-
Net exposure		**182.2**	(93.4)	**290.7**	302.5

The values shown above are calculated as the fair value of the assets at the balance sheet date in accordance with the provisions of IFRS 13 – 'Fair Value Measurement'. The exposure values are calculated according to the Standardised Approach for risk weighting.

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

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

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

Short term investments

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

Cash and cash equivalents

The Group's cash balances are held in sterling at the Bank of England and highly rated banks in current accounts and as short fixed term deposits and money market placements. The Group has a large exposures policy to mitigate any concentration risk in respect of its cash deposits.

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

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

Summary of exposures

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

	Carrying value		Exposure value	
	2016	2015	**2016**	2015
	£m	£m	**£m**	£m
Institutional exposures				
Derivative financial assets	**1,366.4**	660.1	**290.7**	302.5
Bank deposits	**922.6**	770.0	**184.5**	154.6
Total institutional exposures	**2,289.0**	1,430.1	**475.2**	457.1
Sovereign exposures				
Short-term investments	**7.1**	41.1	**-**	-
Central bank deposits	**315.0**	286.0	**-**	-
Total sovereign exposures	**322.1**	327.1	**-**	-
Total counterparty credit exposures	**2,611.1**	1,757.2	**475.2**	457.1

8. INTEREST RATE RISK

This section sets out

- An overview of the Group's exposure to interest rate risk; and
- An illustration of the Group's sensitivity to movements in interest rates

The Group is exposed to interest rate risk, the risk that margins will be adversely affected by movements in market interest rates, through its lending, deposit taking and borrowing activities.

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

As identified in section 2 of this disclosure document, this is the risk of loss of income from movements in interest rates. Such losses can occur because of the differing characteristics of the various elements within the balance sheet and mismatches between balances with the same characteristics on opposite sides of the balance sheet.

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

These risks arise where balance sheet components are subject to different market forces. This includes exposures where interest is linked to different reference rates, the impact of fixed rate assets and liabilities and the effect of different classes of assets and liabilities re-pricing at different times.

The Group manages this position outside Paragon Bank by maintaining floating rate liabilities and matching these with floating rate assets, by hedging fixed rate assets and liabilities using interest rate swap or cap agreements and by maintaining a proportion of fixed rate liabilities.

Separately, within Paragon Bank, where there are fixed and floating rate loan assets, together with fixed and floating rate savings deposit liabilities, mismatches are managed using interest rate swap agreements to ensure any exposure remains appropriate to the Banks's risk appetite. The more dynamic position has become an increasingly significant element of the Group's risk position as the proportion of lending funded by retail deposits grows.

The Group's ALCO monitors the interest rate risk exposure on the Group's loan assets and asset backed loan notes and ensures compliance with the requirements of the trustees in respect of the Group's securitisations and the terms of other borrowings. Paragon Bank has its own ALCO which focuses on the risks within the Bank, including the retail deposit position, although the Group's committee maintains oversight.

The rates of interest payable on the loan facilities and on asset backed loan notes issued in the securitisation process are reset either quarterly or monthly on the basis of LIBOR. Where asset backed loan notes are issued in foreign currencies, cross-currency basis swaps are put in place converting the reference interest rate to a sterling LIBOR basis.

The Group's retail deposits either bear variable interest rates or are fixed rate liabilities which are hedged in accordance with the Group's risk management strategy. The interest rates paid on the Group's variable rate deposits are determined by reference to, inter alia, returns achievable in the Group's lending markets and the rates being charged on similar products in the market.

The Group's loan assets predominantly bear LIBOR linked interest rates or are hedged fixed rate assets. The interest rates charged on the Group's variable rate loan assets are determined by reference to, inter alia, the Group's funding costs and the rates being charged on similar products in the market.

Generally these factors ensure the matching of changes in interest rates on the Group's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term. Forward rate agreements may be used to hedge against any perceived risk of temporary increases in LIBOR rates at month ends.

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

Interest rate sensitivity

The sensitivity of the Group's earnings to movements in UK interest rates is illustrated below. This table shows the effect of a 1% movement in interest rates on the annual interest payable or receivable on those of the Group's assets and liabilities which bear interest at variable rates, based on the balances outstanding on such assets and liabilities at 30 September 2016 and 30 September 2015. For the purpose of this disclosure, movements in bank base rates and market interest rates are assumed to be broadly parallel and movements in market rates are assumed to be passed on immediately to borrowers and depositors where rates are in the Group's control.

	2016	2015
	£m	£m
Variable rate mortgage loans	**72.5**	78.3
Variable rate consumer loans	**6.9**	5.6
Portfolio hedging on fixed rate loans	**18.4**	12.9
Interest bearing cash balances	**11.6**	6.4
Sterling equivalent principal of FRN and warehouse borrowings	**(98.6)**	(90.6)
Variable rate retail deposits	**(5.4)**	(2.0)
Portfolio hedging on fixed rate retail deposits	**(3.5)**	(1.2)
	1.9	9.4

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

9. SECURITISATION

This section sets out

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

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

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

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

A more detailed description of the Group's securitisation activities and how they affect the Group's risk profile and contribute to its risk management objectives is given in note 7 to the Group Accounts.

There are no specific capital requirements for the Group's securitisation vehicle companies. Further information on the Group's securitisations, including average funding rates, outstanding balances and redemption dates, on a transaction by transaction basis is provided in note 55 to the Group Accounts and detailed information on each of the Group's public securitisation transactions is published in the 'Bond Investor' section of the Group's corporate website at www.paragon-group.co.uk.

The Group has no exposures to purchased securitisation positions.

10. REMUNERATION POLICIES AND PRACTICES

This section sets out

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

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

PRA supervisory statement LSS 8/13 'Remuneration Standards: the application of proportionality' (updated June 2015) categorises Paragon Bank within proportionality level 3 as a bank with total assets less than £5 billion, reducing the level of disclosures required by Part 8. This supervisory statement also sets out the PRA view that the requirement for remuneration disclosures applies only to CRR firms directly.

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

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

11. GLOSSARY

This section sets out

- A listing of defined terms used in the document

ALCO	Asset and Liability Committee
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
CCoB	Capital Conservation Buffer
CCyB	Counter Cyclical Buffer
CET1	Common Equity Tier 1
CML	Council of Mortgage Lenders
Code	UK Corporate Governance Code
COREP	Common Reporting Standards
CQS	Credit Quality Step
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSA	Credit Support Annex
EBA	European Banking Authority
ECAI	External Credit Assessment Institutions
ERC	Estimated Remaining Collections
ESOP	Employee Share Ownership Plan
EU	European Union
FCA	Financial Conduct Authority
FINREP	Financial Reporting Standards
FLA	Finance and Leasing Association
FLS	Funding for Lending Scheme
FPC	Financial Policy Committee (of the Bank of England)
FRC	Financial Reporting Council
FRN	Floating Rate Note
Group Accounts	Annual Report and Accounts of The Paragon Group of Companies PLC for the year ended 30 September 2016
ICAAP	Internal Capital Adequacy Assessment Process
ICG	Individual Capital Guidance
IMLA	Intermediary Mortgage Lenders Association
IRB	Internal Ratings Basis
IRRBB	Interest Rate Risk in the Banking Book
ISDA	International Swaps and Derivatives Association
LIBOR	London Interbank Offered Rate
LTV	Loan to value
MCR	Minimum Capital Requirement
ORCC	Operational Risk and Compliance Committee
PBAF	Paragon Bank Asset Finance Limited
Plan	The defined benefit pension plan operated by the Group
PRA	Prudential Regulation Authority
RWA	Risk Weighted Assets
SA	Standardised Approach
SME	Small and Medium Sized Enterprise
SPV	Special Purpose Vehicle
SREP	Supervisory Review and Evaluation Process
The Bank	Paragon Bank PLC
The Company	The Paragon Group of Companies PLC
The Group	The Paragon Group of Companies PLC and all its subsidiary entities
TRE	Total Risk Exposure
UK	United Kingdom

APPENDIX A

Own funds disclosures.

Capital instruments' main features

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

		1	2	3
		Equity	**2016 Corporate Bond**	**2005 Corporate Bond**
1	Issuer	The Paragon Group of Companies PLC	The Paragon Group of Companies PLC	The Paragon Group of Companies PLC
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for price placement)	ISIN GB00B2NGPM57	ISIN XS1482136154	ISIN XS0216276070
3	Governing law(s) of the instrument	England and Wales	England and Wales	England and Wales
	Regulatory treatment			
4	Transitional CRR rules	N/A	N/A	N/A
5	Post-transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2
6	Eligible at solo/(sub-) consolidated	Solo and (sub) consolidated	Solo and (sub) consolidated	Solo and (sub) consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary Shares	Corporate Bond	Corporate Bond
8	Amount recognised in regulatory capital (currency in million, as most recent reporting date)	£360.5m	£150.0m	£12.2m
9	Nominal amount of instrument	£295.5m	£150.0m	£110.0m
9a	Issue price	Nominal value £1 †	Par	99.347%
9b	Redemption price	N/A	Par	Par
10	Accounting classification	Shareholders' Equity	Liability-amortised cost	Liability-amortised cost
11	Original date of issuance	Original listing date 15 May 1989 *	9 September 2016	20 April 2005
12	Perpetual or dated	Perpetual	Dated	Dated
13	Original maturity date	No maturity	9 September 2026	20 April 2005
14	Issuer call subjet to prior supervisory approval	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	N/A	Callable by issuer on 9 September 2021 Tax and Regulatory calls also	Tax call only No specified dates
16	Subsequent call dates, if applicable	N/A	N/A	N/A

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

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

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

‡ Subject to market based repricing five years after issue.

Own funds disclosure

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

		2016 £m	2015 £m	Regulation (EU) No 575/2013 Article Reference
Common Equity Tier 1 (CET1) capital: instruments and reserves				
1	Capital instruments and the related share premium accounts	360.5	373.9	26 (1), 27, 28, 29
	Of which: ordinary shares	360.5	373.9	EBA list 26 (3)
2	Retained earnings	725.9	767.7	26 (1) (c)
3	Accumulated other comprehensive income (and other reserves)	(116.9)	(172.1)	26 (1)
3a	Funds for general banking risk	-	-	26 (1) (f)
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET 1	-	-	486 (2)
5	Minority interests (amount allowed in consolidated CET1)	-	-	84
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	(25.5)	(21.8)	26 (2)
6	**Common Equity Tier 1 (CET1) capital before regulatory adjustments**	**944.0**	**947.7**	**Sum of rows 1 to 5a**
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
7	Additional value adjustments (negative amount)	-	-	34, 105
8	Intangible assets (net of related tax liability) (negative amount)	(105.4)	(7.7)	36 (1) (b), 37
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	-	(0.3)	36 (1) (c), 38
11	Fair value reserves related to gains or losses on cash flow hedges	-	-	33 (1) (a)
12	Negative amounts resulting from the calculation of expected loss amounts	-	-	36 (1) (d), 40 159
13	Any increase in equity that results from securitised assets (negative amount)	-	-	32 (1)
14	Gains or losses on liabilities values at fair value resulting from changes in own credit standing	-	-	33 (1) (b)
15	Defined-benefit pension fund assets (negative amount)	-	-	33 (1) (e), 41
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	-	-	36 (1) (f), 42

		2016 £m	2015 £m	Regulation (EU) No 575/2013 Article Reference
17	Direct, indirect and synthetic holding of the CET 1 instruments of financial sector entities, where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	36 (1) (g), 44
18	Direct, indirect and synthetic holding of the CET 1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	36 (1) (h), 43, 45, 46, 49 (2) (3), 79
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	36 (1) (i), 43, 45, 47, 48 (1) (b), 49 (1) to (3), 79
20a	Exposure amount of the following items which qualify for a RW of 1250% where the institution opts for the deduction alternative	-	-	36 (1) (k)
20b	Of which: qualifying holdings outside the financial sector (negative amount)	-	-	36 (1) (k) (i), 89 to 91
20c	Of which: securitisation positions (negative amount)	-	-	36 (1) (k) (ii) 243 (1) (b), 244 (1) (b), 258
20d	Of which: free deliveries (negative amount)	-	-	36 (1) (k) (iii), 379 (3)
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the condition in Article 38 (3) are met (negative amount)	-	-	36 (1) (c), 38, 48 (1) (a)
22	Amount exceeding the 15% threshold (negative amount)	-	-	48 (1)
23	Of which: direct and indirect holding by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-	-	36 (1) (i), 48 (1) (b)
25	Of which: deferred tax assets arising from temporary differences	-	-	36 (1) (c), 38, 48 (1) (a)
25a	Losses for the current financial year (negative amount)	-	-	36 (1) (a)
25b	Foreseeable tax charges relating to CET1 items (negative amount)	-	-	36 (1) (i)
27	Qualifying AT1 deductions that exceed the AT1 Capital of the institution (negative amount)	-	-	36 (1) (j)
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**(104.5)**	**(8.0)**	**Sum of rows 7 to 20a, 21, 22 and 25a to 27**
29	**Common Equity Tier 1 (CET1)**	**838.6**	**939.7**	**Row 6 minus row 28**

		2016 £m	2015 £m	Regulation (EU) No 575/2013 Article Reference
Additional Tier 1 (AT1) capital instruments				
30	Capital instruments and the related share premium accounts	-	-	51, 52
31	Of which: classified as equity under applicable accounting standards	-	-	-
32	Of which: classified as liabilities under applicable accounting standards	-	-	-
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	-	-	486 (3)
34	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	-	-	85, 86
35	Of which: instruments issued by subsidiaries subject to phase out	-	-	486 (3)
36	**Additional Tier 1 (AT1) capital before regulatory adjustments**	**-**	**-**	**Sum of rows 30, 33 and 34**
Additional Tier (AT1) capital: regulatory adjustments				
37	Direct and indirect holdings by an institution of own AT1 instruments (negative amount)	-	-	52 (1) (b), 56 (a), 57
38	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	56 (b), 58
39	Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	56 (c), 59, 60, 79
40	Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	-	56 (d), 59, 79
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	-	-	56 (e)
43	**Total regulatory adjustments to Additional Tier 1 (AT1) Capital**	**-**	**-**	**Sum of rows 37 to 42**
44	**Additional Tier 1 (AT1) capital**	**-**	**-**	**Row 36 minus row 43**
45	**Tier 1 capital (T1 = CET1 + AT1)**	**-**	**-**	**Sum of row 29 and row 44**

		2016 £m	2015 £m	Regulation (EU) No 575/2013 Article Reference
Tier 2 (T2) Capital: Instruments and provisions				
46	Capital instruments and the related share premium accounts	162.2	34.2	62, 63
47	Amount of qualifying items referred to in article 484 (5) and the related share premium accounts subject to phase out from T2	-	-	486 (4)
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	-	-	87, 88
49	Of which: instruments issued by subsidiaries subject to phase out	-	-	486 (4)
50	Credit risk adjustments	4.8	2.4	62 (c) & (d)
51	**Tier 2 (T2) capital before regulatory adjustments**	**167.0**	**36.6**	**-**
Tier 2 (T2) capital: regulatory adjustments				
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	-	-	63 (b) (i), 66 (a), 67
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	-	66 (b), 68
54	Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in these entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	-	66 (c), 69, 70, 79
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	-	66 (d), 69, 79
57	**Total regulatory adjustments to Tier 2 (T2) capital**	**-**	**-**	**Sum of rows 52 to 56**
58	**Tier 2 (T2) capital**	**167.0**	**36.6**	**Row 51 minus row 57**
59	**Total capital (TC = T1 + T2)**	**1,005.6**	**976.3**	**Sum of row 45 and row 58**
60	Total risk weighted assets	5,287.5	4,929.3	-

		2016 £m	2015 £m	Regulation (EU) No 575/2013 Article Reference
Capital ratios and buffers				
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	15.9%	19.1%	92 (2) (a)
62	Tier 1 (as a percentage of total risk exposure amount)	15.9%	19.1%	92 (2) (b)
63	Total capital (as a percentage of total risk exposure amount)	19.0%	19.8%	92 (2) (c)
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	8.625%	8.0%	CRD 128, 129, 130, 131, 133
65	Of which: capital conservation buffer requirement	0.625%	-	-
66	Of which: countercyclical buffer requirement	-	-	-
67	Of which: systemic risk buffer requirement	-	-	-
67a	Of which: Global Systematically Important Institution (G-SII) or Other Systematically Important Institution (O-SII) buffer	-	-	-
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	7.9%	-	CRD 128
Capital ratios and buffers				
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	-	36 (1) (h), 46, 45 56 (c), 59, 60 66 (c), 69, 70
73	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institutions has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	-	-	36 (1) (h), 46 45 56 (c), 59, 60 66 (c), 69, 70
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	-	-	36 (1) (i), 45 48

		2016 £m	2015 £m	Regulation (EU) No 575/2013 Article Reference
Applicable caps on the inclusion of provisions in Tier 2				**36 (1) (c), 38, 48**
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	4.8	2.4	62
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	-	-	62
78	Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	-	-	62
79	Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	-	-	62
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)				
80	Current cap on CET1 instruments subject to phase out arrangements	-	-	484 (3), 486 (2) & (5)
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	-	-	484 (3), 486 (2) & (5)
82	Current cap on AT1 instruments subject to phase out arrangements	-	-	484 (4), 486 (3) & (5)
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	-	-	484 (4), 486 (3) & (5)
84	Current cap on T2 instruments subject to phase out arrangements	-	-	484 (5), 486 (4) & (5)
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	-	-	484 (5), 486 (4) & (5)

APPENDIX B

Leverage ratio disclosures

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

CRR Leverage Ratio

Reference date	30 September 2016
Entity name	The Paragon Group of Companies PLC
Level of application	Consolidated

Table LRSum: Summary reconciliation of assets and leverage ratio exposures

		Applicable Amount	
		2016	2015
1	Total assets as per published financial statements	13,518.4	11,878.9
2	Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	-	-
3	Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio total exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013)	-	-
4	Adjustments for derivative financial instruments	68.6	69.1
5	Adjustment for securities financing transactions (SFTs)	-	-
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	136.9	241.2
EU-6a	(Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No 575/2013)	-	-
EU-6b	(Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(14) of Regulation (EU) No 575/2013)	136.9	241.2
7	Other adjustments	(105.4)	(7.7)
8	Leverage ratio total exposure measure	13,618.5	12,181.5

Table LRCom: Leverage ratio common disclosure

		CRR leverage ratio exposures 2016 £m	CRR leverage ratio exposures 2015 £m
On-balance sheet exposures (excluding derivatives and SFTs)			
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	12,152.0	11,218.8
2	(Asset amounts deducted in determining Tier 1 capital)	(105.4)	(7.7)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**12,046.6**	**11,211.1**
Derivative exposures			
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	1,366.4	660.1
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	68.6	69.1
EU-5a	Exposure determined under Original Exposure Method	-	-
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework	-	-
7	Deductions of receivables assets for cash variation margin provided in derivatives transactions)	-	-
8	(Exempted CCP leg of client-cleared trade exposures)	-	-
9	Adjusted effective notional amount of written credit derivatives	-	-
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	-	-
11	**Total derivatives exposures (sum of lines 4 to 10)**	**1,435.0**	**729.2**
SFT exposures			
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	-	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
14	Counterparty credit risk exposure for SFT assets	-	-
EU-14a	Derogation for SFTs: Counterparty credit risk exposure in accordance with Articles 429b(4) and 222 of Regulation (EU) No 575/2013	-	-
15	Agent transaction exposures	-	-
EU-15a	(Exempted CCP leg of client-cleared SFT exposure)	-	-
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**-**	**-**
Other off-balance sheet exposures			
17	Off-balance sheet exposures at gross notional amount	273.8	482.3
18	(Adjustments for conversion to credit equivalent amounts)	(136.9)	(241.1)
19	**Other off-balance sheet exposures (sum of lines 17 and 18)**	**136.9**	**241.2**

		CRR leverage ratio exposures	
		2016 £m	2015 £m
Exempted exposures in accordance with Article 429(7) and (14) of Regulation (EU) No 575/2013 (on and off balance sheet)			
EU-19a	(Intragroup exposures (solo basis) exempted in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
EU-19b	(Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet))	-	-
Capital and total exposure measure			
20	Tier 1 capital	838.6	939.7
21	**Leverage ratio total exposure measure (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**13,618.5**	**12,181.5**
Leverage ratio			
22	**Leverage ratio**	**6.2%**	**7.7%**
Choice on transitional arrangements and amount of derecognised fiduciary items			
EU-23	Choice on transitional arrangements for the definition of the capital measure	Fully phased in	Fully phased in
EU-24	Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) No 575/2013	-	-

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

		CRR leverage ratio exposures	
		2016 £m	2015 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	12,152.0	11,218.8
EU-2	Trading book exposures	-	-
EU-3	Banking book exposures, of which:	12,152.0	11,218.8
EU-4	Covered bonds	-	-
EU-5	Exposures treated as sovereigns	322.0	327.1
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	12.8	-
EU-7	Institutions	922.6	770.0
EU-8	Secured by mortgages of immovable properties	10,127.2	9,531.2
EU-9	Retail exposures	464.5	480.7
EU-10	Corporate	81.6	-
EU-11	Exposures in default	56.3	55.0
EU-12	Other exposures (eg equity, securitisations, and other non-credit obligation assets)	165.0	54.8

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