

**PARAGON FINANCE PLC**

**Report and Financial Statements**

**Year ended 30 September 2021**

**CAUTIONARY STATEMENT**

Sections of this Annual Report, including but not limited to the Directors' Report and the Strategic Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of Paragon Finance PLC. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. These have been made by the directors in good faith using information available up to the date on which they approved this report and the Company undertakes no obligation to update these forward-looking statements other than in accordance with its legal or regulatory obligations (including under the Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority).

By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Company and depend upon circumstances that may or may not occur in the future that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, such as the Novel Coronavirus 19 ('Covid') pandemic and ongoing challenges and uncertainties posed by the Covid pandemic for businesses and governments around the world, including the duration, spread and any recurrence of the Covid pandemic and the extent of the impact of the Covid pandemic on overall demand for the Company's services and products; potential changes in dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Group operates) and the consequences thereof (including, without limitation, actions taken as a result of the Covid pandemic); actions by the Company's competitors or counterparties; third party, fraud and reputational risks inherent in its operations; the UK's exit from the European Union ('EU'); unstable economic conditions and market volatility, including currency fluctuations; the risk of a global economic downturn; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the Company operates.

Nothing in this Annual Report should be construed as a profit forecast.

**STRATEGIC REPORT****BUSINESS REVIEW AND PRINCIPAL ACTIVITIES**

Paragon Finance PLC ('the Company') is a wholly owned subsidiary of Paragon Bank PLC which is a wholly owned subsidiary of Paragon Banking Group PLC ('the Group'). During the year the Company operated in the United Kingdom. The principal activities of the Company are the provision of administration and other management services to other group companies and as an investor in special purpose vehicle companies within the Group.

The Company undertakes loan servicing and customer management on behalf of all of the Group's operating companies and certain third parties. To undertake these tasks it holds the Group's fixed assets, other than property, owns the rights to all of its infrastructure and intellectual property and employs the vast majority of the Group's people. There have been no significant changes in the Company's principal activities in the year under review and the directors are not aware, at the date of this report, of any likely major changes in the Company's activities in the next year.

During 2016, the Company obtained permission from the Financial Conduct Authority (FCA), for regulatory permission relating to its consumer credit regime. The Company also holds the requisite permission from the FCA to administer both second and first charge residential mortgages. The Company's registration in relation to the administration of consumer Buy to Let loans was also confirmed by the FCA.

As shown in the Company's profit and loss account on page 21, the Company's net interest income decreased from £7,823,000 to £7,372,000. This was principally due to a fall in interest receivable and similar income decreasing more than the fall of interest payable and similar charges. The return on pension scheme liabilities decreased from £415,000 to £320,000. All subordinated loans owed by group companies have been repaid during the year due to securitisation mortgage loans being sold to fellow group companies in the year. Therefore, interest charged on the subordinated loans provided to other group companies and related parties decreased. The provision on loans to group parties was £157,000 (2020: £897,000) due to the effects of trading between these entities and a decrease in reserves of those companies in the current year. The provision on investment in group companies and related parties was a release of £863,000 (2020: release of £800,000) due to the effects of trading between group companies and an increase in reserves of those companies. Therefore, in the current year there was a provision release of £1,521,000 compared to a charge of £80,000 for the preceding year. Other operating income has increased from £107,691,000 to £127,973,000. This was principally due to the costs recharged to other group companies increasing during the current year. Some securitisation mortgage loans were sold to fellow group companies in the year, therefore there was a decrease in administration fees received by the Company from various special purpose vehicle companies within the Group, as the Company administered the loans on their behalf. Operating expenses increased from £103,795,000 to £129,386,000. As a result of the above, operating profit before taxation has decreased from £11,639,000 to £7,480,000, and the profit after tax has decreased from £9,054,000 to £7,946,000 due to a tax credit in the current year compare to a tax charge in the preceding year.

The balance sheet on page 22 of the Financial Statements shows the Company's financial position at the year end. Net assets have increased by 7.35% (2020: 1.5% increase) due to the net effect of the profit for the year and actuarial gain on the pension fund. Details of amounts owed from and to other group companies are shown in notes 12 and 15.

No interim dividend was paid during the year (2020: £nil). No final dividend is proposed (2020: £nil).

**STRATEGIC REPORT (CONTINUED)****BUSINESS REVIEW AND PRINCIPAL ACTIVITIES (CONTINUED)**

The Group manages its operations on a centralised basis and compiles its management information, including key performance indicators, on a consolidated basis. This consolidated information is used in controlling the operations of the Company, which provides services to all Group entities. Given the pervasive involvement of the Company in the Group's activities, the Company's directors believe that further key performance indicators for the Company, compiled on a stand-alone basis, are not necessary or appropriate to provide an understanding of the development, performance or position of the Company's business. Details of the Group's financial performance, including key performance indicators, are given in the Annual Report of its ultimate parent company, which does not form part of this Report.

**PRINCIPAL RISKS AND UNCERTAINTIES**

The assets of the Company are located entirely in the United Kingdom and its results are therefore impacted by the economic environment within the UK. A material downturn in economic performance could increase the numbers of the Group's customers who default on loans and / or cause the values of the properties over which the Group enjoys security to fall with a consequential impact on the Company's investments.

The UK economy in the current year has been impacted significantly by the effects of the Covid virus. This has caused major economic disruption within the UK and global economy but has also driven governments and regulators to offer unprecedented levels of support to businesses and consumers, aimed at mitigating its impact.

The Company has put contingency plans in place to ensure that it can continue to service the Group's customers, provide services to the wider group and to satisfy its obligations under the Groups funding structures. However, should the pandemic have significant long-term impacts on the UK economy then this would significantly impact the Company's future cash flows and performance.

Together with continuing uncertainty arising from the potential economic impact of the UK's withdrawal from the European Union, the Covid pandemic has made the long-term economic prospects for the UK and their impacts on the Company much more difficult to forecast.

An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out on pages 7 to 13 and in note 22. A discussion of critical accounting judgements is set out in note 25 and a discussion of critical accounting estimates is set out in note 26.

**GOING CONCERN**

The performance of the Company is subject to analysis against plan, with key variances being analysed in detail on a monthly basis. This monitoring, particularly of credit and liquidity measures has been enhanced at Group level in response to the Covid situation.

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows on a company by company basis.

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

**STRATEGIC REPORT (CONTINUED)****GOING CONCERN (CONTINUED)**

After considering the above, the directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. This is further supported by the Group holding sufficient cash resources to support the Company's obligations as they fall due. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

**BOARD AND STAKEHOLDERS**

The Board is mindful of its duty to act in good faith and to promote the success of the Group for the benefit of its shareholders and with regard to the interests of all of our stakeholders. The Board confirms that, for the year ended 30 September 2021, it has acted to promote the success of the Company for the benefit of its members as a whole and continues to have due regard to the following matters (as per section 172 of the Companies Act 2006):

- a. The likely consequences of any decision in the long-term;
- b. The interests of the Company's employees;
- c. The need to foster the Company's business relationships with suppliers, customers and others;
- d. The impact of the Company's operations on the community and the environment;
- e. The desirability of the Company maintaining a reputation for high standards of business conduct; and
- f. The need to act fairly as between members of the Company.

The principal activities of the Company are the provision of administration services to other Group companies, including supporting their loan servicing activities and investments in special purpose vehicle companies within the Group. Therefore, there is substantial common identity between the external non-shareholder stakeholders of the Company and those of the Group. There are also significant Group stakeholders, including the entities to which the Company provides services, support and funding, aside from ownership interests.

As a consequence, engagement with external shareholders takes place at a Group level. The Company looks to Group initiatives for guidance and takes them into account in its decision making. The Company follows Group policies and procedures as mentioned above, including those relating to the fair treatment of customers, regulatory requirements, standards of business conduct, employees, the environment, the community and other stakeholders. More detail may be found in the Paragon Banking Group PLC 2021 Annual Report and Accounts.

However, in considering items of business the Company makes autonomous decisions on each decision's own merits, after due consideration of the long-term success of the Company, those factors set out in section 172 of the Companies Act 2006, where relevant, and the stakeholders impacted.

Board meetings are held periodically where the directors consider Company business, such as external contracts for property and establishment services, employment matters, loan administration arrangements, other management services to other Group companies, the management of its investments in special purpose vehicle companies of the Group, capital and distributions. The Board also considers all matters relevant to the Company's status as an FCA regulated entity and its relationship with the regulator.

The Board considers and discusses information from across the organisation to help it understand the impact of the Group's operations, and the interests and views of our key stakeholders. It also reviews strategy, financial, and operational performance, as well as information covering areas such as key risks and legal and regulatory compliance. This information is presented to the Board through reports sent in advance of each Board meeting and through in person presentations.

**STRATEGIC REPORT (CONTINUED)****BOARD AND STAKEHOLDERS (CONTINUED)**

The executive directors of the Group and the Group's Chief Operating Officer also sit on the Board of the Company ensuring that the Board is aware of all information on stakeholder impacts which is available at Group level.

**SHAREHOLDERS**

The Company has a single shareholder, Paragon Bank PLC, which is itself a wholly owned subsidiary of Paragon Banking Group PLC, the ultimate parent company of the Group. The interests of the Company's shareholders thus coincide with those of the shareholders of the Group (s172 (1)(f)).

**BUSINESS RELATIONSHIPS**

The Company provides facilities and establishment services to other Group companies and therefore is the principal group entity contracting with suppliers of goods and services for use in the business. The Company enters into a number of agreements with suppliers, customers and third parties which enables the Group to provide high standards of conduct.

The Group's Procurement function reviews and considers material contracts and works with key suppliers to maintain long-term and sustainable relationships, whilst identifying solutions to reduce the environmental impact of business activities (s172 (1)(c-e)). One example throughout the year is the launch of the Asset Finance Broker Portal, allowing for a more efficient, automated process for customers.

The Group has a Supplier Code of Conduct (published on the Paragon Banking Group PLC website), which sets out the Group's overall approach to supplier engagement and corporate responsibility, and importantly, the standards of behaviour expected from suppliers around bribery and corruption, data protection and modern slavery. It also includes important information concerning our employment practices, health and safety, community and environmental matters.

The Group is a signatory to the Prompt Payment Code and the Company is subject to the UK reporting requirements on supplier payment information.

Before the outbreak of Covid and during the pandemic, the Group has continued to engage with key suppliers ensuring continuing operational resilience and reduced risk. The Group has also continued to invest in its infrastructure, particularly in customer and broker facing systems. The Group's planned change programme progressed throughout the year with minimal impact from the pandemic, delivering new technology and operational enhancements which will generate efficiencies and improve customer experiences.

The Group policies on supplier and customer relationships, its support for human rights and measures taken to prevent bribery, corruption and financial crime, under which the Company operates, are described in more detail in the Paragon Banking Group PLC Annual Report, which does not form part of this Report.

**ENVIRONMENT**

The Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Group's activities. As the Group entity responsible for the procurement of power, office services and supplies, the Company has a significant impact on the management of the environmental impact of the Group's operations. The Company operates in accordance with Group policies, which are described in the Paragon Banking Group PLC Annual Report, which does not form part of this Report (s172 (1)(d)). Further information can also be found in the Group's inaugural Responsible Business Report (published on the Paragon Banking Group PLC website).

**STRATEGIC REPORT (CONTINUED)****EMPLOYEES**

The directors recognise the benefit of keeping employees informed of the progress of the business. Employees have been provided with regular information on the performance and plans of the Company and the financial and economic factors affecting it, through both information circulars and management presentations (s172 (1)(b)).

The directors encourage employee involvement at all levels through the staff appraisal process, the Group's People Forum, employee engagement surveys and regular communication between directors, managers, teams and individual employees. The Group's People Forum supported employees' return to the office to trial hybrid working.

The Company participates in a Sharesave share option scheme and a profit-sharing scheme, both of which enable eligible employees to benefit from the performance of the business.

The Company operates in accordance with Group employment policies, which are described in the Paragon Banking Group PLC Annual Report, which does not form part of this Report, together with additional information on the operations of the People Forum, employee consultation arrangements and key metrics on the workforce.

**EMPLOYMENT OF DISABLED PERSONS**

Full and fair consideration is given to applications for employment made by disabled persons having regard to their particular aptitudes and abilities. The Company has continued its policy of providing appropriate training and career development to such persons.

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



K G Allen

Director

21 January 2022

**PRINCIPAL RISKS AND MITIGATIONS**

The Company is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. The Company derives almost all of its income from the provision of finance, facilities and services to other Group companies. Its performance would therefore be materially either directly or indirectly affected by any downturn in the performance of the Group resulting from a crystallisation of any of the risks to which the Group is exposed. Therefore the risks to which the Company is exposed are the same as those for the Group as a whole.




A summary of those risks and uncertainties which could prevent the achievement of the Company’s strategic objectives, how the Company seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below.


This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Company but rather those which the Company believes have the potential to have a significant impact on its financial performance and future prospects.

The risks are set out in accordance with the Group’s amended classification of its principal risks, approved by the Board in the year. Therefore, the headings shown differ from those presented in previous annual reports. In particular, reputational risk, model risk and climate change risk are separately identified as principal risks for the first time.

Further information concerning the systems used to manage risk by the Group are included in section B6.4 of the Annual Report and Accounts of the parent company.



The changes in the perceived level of each risk in the last financial year are indicated using the symbols shown below:

	Risk increasing		Risk decreasing		Risk stable
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Capital Risk	
Description	Mitigation
<p>The Group faces the risk of insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within Board approved risk appetite and supporting the Group’s strategic goals.</p> <p>The BCBS has set 1 January 2023 as the implementation date for its revisions to the Basel III framework, including increases in risk weights for residential real estate exposures. There is therefore a risk that the Group’s capital requirements will be increased to some extent.</p>	<p>A robust process exists over Pillar 1 capital reporting, both internally and to the PRA, with a comprehensive annual ICAAP assessment including all material capital risks.</p> <p>An internal capital buffer is maintained in excess of minimum regulatory requirements to protect against unexpected losses or risk-weighted asset growth.</p> <p>The Group submitted the second stage of its application for the accreditation of its Internal Ratings Based (‘IRB’) approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021. The project continues to progress to plan, and work will continue through the next financial year.</p>
<p><b>Year on year change</b></p> <p style="text-align: center;"></p>	<p>While there has been little impact on the overall capital risk framework in the financial year and the Group’s assessment of the likely impact of these changes, the progress made in the Group’s balance sheet management, its IRB development programme and the positive results of the most recent PRA assessment of the Group’s risk profile mean that it is better placed to meet these challenges than it was a year ago.</p>





PRINCIPAL RISKS AND MITIGATIONS (CONTINUED)

Liquidity and Funding Risk	
Description	Mitigation
<p>The Group is exposed to the risk that it has insufficient funds to meet its obligations as they fall due.</p> <p>Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of funding required to sustain normal business activity.</p>	<p>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.</p> <p>Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due, even under stressed conditions.</p> <p>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 limits as to the level, composition and maturity of liquidity resources.</p>
<p><b>Year on year change</b></p> 	<p>The Group remains well placed to access funding from a wide range of sources to meet its future funding requirements. During the year a second fully retained securitisation was completed, boosting, contingent funding options and the TFSME, which remained open for drawings until 31 October 2021, was accessed.</p> <p>In addition, access to the retail savings market has broadened with new routes to market and the launch of an SME deposit product.</p>
Market Risk	
Description	Mitigation
<p>The Group is exposed to the risk that changes in interest rates at which it lends and those at which it borrows may adversely affect its net interest income and profitability. In addition, its financial performance may be affected by fluctuations in the exchange rates between currencies.</p>	<p>This risk is managed within Board approved risk appetite limits with comprehensive treasury policies in place to ensure that the risk posed by changes and mismatches in interest or exchange rates are effectively managed.</p> <p>Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury, with control and oversight provided by ALCO.</p> <p>The Group seeks to match the maturity profile of assets and liabilities and uses financial instruments, such as interest rate swaps, to hedge the exposure arising from repricing gaps.</p>
<p><b>Year on year change</b></p> 	<p>The Group's overall market risk profile, relative to its balance sheet, has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods.</p> <p>However, the transition of assets and liabilities from LIBOR to alternative risk-free rates is well progressed with the majority of assets and liabilities addressed, and the programme expected to be completed before the December 2021 cut-off date. This has removed a degree of uncertainty in relation to interest rate risk and so the risk profile has reduced.</p>



PRINCIPAL RISKS AND MITIGATIONS (CONTINUED)

Credit Risk	
Description	Mitigation
<p>Credit risk elements which could expose the Group to the risk of unexpected material losses include:</p> <ul style="list-style-type: none"> <li>• Customer risks through failure to screen potential borrowers, and manage repayments</li> <li>• Concentration risk in credit portfolios through an uneven distribution of exposures of borrowers, asset classes, sectors or geographies</li> <li>• Reduction in value of collateral owned by the Group, or secured against debt owed to it</li> <li>• Wholesale counterparty risk</li> <li>• Outsourcer default risk</li> </ul>	<p>The Group has a robust limit framework supported by comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Exceptions to credit policies require approval by the Credit Risk function, operating under a mandate from the Credit Committee.</p> <p>The Group uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting.</p> <p>The Group also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed specialist lender.</p> <p>The majority of the Group’s loans by value continue to be secured against UK residential property at conservative loan-to-value levels. The primary collateral therefore forms part of a highly mature, liquid, sustainable market demonstrated over many decades of operation.</p> <p>Exposure to wholesale counterparty credit risk is limited to counterparties that meet specific credit rating criteria per the Group’s comprehensive treasury policies. Exposure to approved counterparties is monitored daily by senior management within the Group’s Treasury function with all exposure managed within ALCO approved limits.</p> <p>Ongoing monitoring of the credit rating and financial performance of all outsourced relationships and critical suppliers is undertaken.</p>
<p><b>Year on year change</b></p> 	<p>Prudent credit tightening and pro-active customer contact strategy throughout the Covid pandemic, have combined with the Group’s consistently high lending standards to ensure that customers have maintained repayments and that arrears and losses have been minimised.</p> <p>The Group has returned to lending criteria that are generally in line with that in place pre-pandemic.</p> <p>Performance levels, both for the Group and the financial services sector more generally, coupled with a more positive outlook for the UK economy, including steadily rising house prices, and the progress of the Covid pandemic, indicate that this risk has reduced compared to 30 September 2020.</p>


PRINCIPAL RISKS AND MITIGATIONS (CONTINUED)

Model Risk	
Description	Mitigation
<p>Models are used across the Group to inform financial decision making and hence it is imperative that the environment in which the models are designed, implemented and operate is subject to appropriate rigour.</p>	<p>As the use of internally developed models has increased across the Group, a robust framework and governance has been developed to manage the associated risks. This includes the MRC which oversees the development, implementation and ongoing monitoring of models across the Group.</p> <p>The Model Governance Framework provides a structured and disciplined approach to the management of model risk. This includes clear development, implementation and ongoing oversight principles together with the requirements for independent validation based on model materiality criteria.</p>
<p><b>Year on year change</b></p> 	<p>It is recognised that the increasing use of internally developed models will drive a commensurate risk to the Group. However, given the strength of the framework and oversight processes, model risk remains within appetite and the outlook remains stable.</p>
Reputational Risk	
Description	Mitigation
<p>Maintenance of a strong reputation across all lines of business and operational activities is core to the Group's philosophy.</p> <p>Detrimental reputational impacts may result from crystallisation of other principal risks, but also through failure to safeguard the integrity of the brand or failing to meet external expectations in conducting business practices.</p>	<p>The reputational impacts of any changes to strategy, pricing, or processes are explicitly considered in the decision-making process and are reviewed by the Director of External Relations, and the Group will not undertake any activity it considers might be damaging to its reputation.</p> <p>The Group has an experienced External Relations function who manage all Group communications and ensure that the reputational profile of the Group remains protected at all times.</p> <p>All material risk events are reviewed for reputational impact and mitigating actions are initiated as appropriate.</p>
<p><b>Year on year change</b></p> 	<p>The Group continues to manage its reputation effectively in all its dealings. This has been particularly important given the potential impact of the Covid pandemic over the year.</p> <p>Whilst it is mindful that the threat to reputation can emanate from many sources, the Group remains well-placed to respond quickly and efficiently to any reputational issue.</p>


PRINCIPAL RISKS AND MITIGATIONS (CONTINUED)

Strategic Risk	
Description	Mitigation
<p>The Group’s strategy as a specialist lender is key to its operating model and business planning. However, there is a risk that changes to the business model or macroeconomic, geopolitical, regulatory, competitive or other factors may impact delivery of strategic objectives.</p>	<p>The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors.</p> <p>Stress testing is performed to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group’s capacity to withstand shocks of varying severities.</p> <p>The Group continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed lender.</p>
<p><b>Year on year change</b></p> 	<p>Prospects for UK economic performance remains unusually uncertain. The medium and longer-term impacts of Covid, together with the implications of the UK’s new trading relationships post-Brexit, are still to be determined.</p> <p>Whilst the Group has continued to remain resilient throughout the pandemic, and activity levels have been strong, the potential for future waves of the virus and associated lockdowns still present a risk.</p>
Climate Risk	
Description	Mitigation
<p>The Group considers the impact of climate change either directly on the Group or indirectly through its third-party relationships.</p> <p>This includes the transitional risk to its strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment</p>	<p>The Group proactively manages physical risk and has specific underwriting policies aimed at the mitigation of, for example, risks associated with flooding and coastal erosion.</p> <p>The potential for transition risk is monitored within the different business lines, with external events prompting consideration of amendments to credit policy and underwriting criteria.</p> <p>The CFO has been designated as the Senior Manager with responsibility for climate change and, during the year, the Group set up the Sustainability Committee, which supports ExCo in ensuring that the impacts of climate change are considered comprehensively across all aspects of the business.</p> <p>The tightening of efficiency standards for domestic properties has the potential to impact the buy-to-let market and the energy performance of property stock. The Credit Committee has considered the EPC data to provide an insight into the energy efficiency of properties on which the Group lends.</p> <p>Longer term strategic planning will also be informed by the ongoing analysis.</p>
<p><b>Year on year change</b></p> 	<p>The Group has made progress on its climate change agenda, with activity focused on incorporating climate risk considerations within the ERMF, while governance has been enhanced with the establishment of the Sustainability Committee.</p> <p>However, the levels of regulatory scrutiny and public interest in this area have increased significantly during the period and therefore the overall risk is considered to have increased over the year.</p>

PRINCIPAL RISKS AND MITIGATIONS (CONTINUED)

Conduct Risk	
Description	Mitigation
<p>The commitment to delivering fair customer outcomes is at the heart of the Group’s culture.</p> <p>Conduct risk arises where the culture and behaviours fail to promote the customer’s best interests resulting in unfair outcomes for the customer.</p>	<p>The Group has a formal Conduct Risk Management framework, which includes detailed policies addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy. This sets out the Group’s overarching approach to the management of conduct risk.</p> <p>The management of conduct risk within the Group is tailored to the specific product and customer type concerned including dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers and appropriate management of vulnerable customers.</p> <p>All employees are required to undertake conduct risk related training.</p> <p>The Group’s approach to employee remuneration means that very few staff are included in financial incentive schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.</p>
<p><b>Year on year change</b></p> 	<p>Despite the rapid implementation of tailored support to customers impacted by Covid last year, whilst some customers continue to require further support, the overarching conduct risk profile has remained broadly static.</p>

PRINCIPAL RISKS AND MITIGATIONS (CONTINUED)

Operational Risk	
Description	Mitigation
<p>Operational Risk arises across the Group through the possible inadequacy or failure of internal processes, people and systems or from external events.</p> <p>Operational risk is inherently diverse in nature. All the Group’s activities create various forms of operational risk which need to be managed through a strong control and oversight structure. Exposure to operational risk is exacerbated through any periods of transformation and / or stress.</p>	<p>The Group has an established operational risk framework which enables timely and accurate analysis of operational risk exposures and drives accountability and remedial actions where issues are identified.</p> <p>Management of operational risk is enabled through a comprehensive framework of policies which are designed to ensure that all key operational risks are managed consistently across the business. This includes risk areas such as Change Management, Procurement, Data Protection, Financial Crime and People.</p> <p>The Group is committed to ensuring it remains resilient, particularly in respect of IT capability. Significant investment has been undertaken to ensure it is well-protected in the face of the evolution of cyber threats. The Group relies on third party providers for a number of key services including in the provision of its savings offering and in respect of critical IT services. The robust oversight of third parties is seen as critical to overall resilience.</p> <p>Continued investment in people has been undertaken to ensure that risk exposures are minimised. This includes management of key dependency risk through effective succession planning, recruitment, development and retention strategies.</p>
<p><b>Year on year change</b></p> <p style="text-align: center;"></p>	<p>The Group successfully navigated the transition to operating effectively in the pandemic environment. Despite new working arrangements, rapid redeployment of people to support additional processes such as payment holidays and the need to manage the IT challenges, the control environment remained robust with no material increase in risk events.</p> <p>However, with regulatory compliance standards continuing to rise, the Group is committed to ensuring that it remains compliant in its operational activities. There is potential that as expectations increase gaps may be identified which will need addressing to reduce inherent operational risk exposures.</p>

**DIRECTORS' REPORT**

The directors present their Annual Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the audited Financial Statements of Paragon Finance PLC, a company registered in England and Wales with registration no: 01917566, for the year ended 30 September 2021.

**DIRECTORS**

The directors who served during the year and subsequently were:

N S Terrington

R D Shelton (resigned 3 February 2021)

R J Woodman

K G Allen

P E Rowland

**RESEARCH AND DEVELOPMENT**

During the year, the Company undertook certain projects to develop its IT capabilities which met the definition of research and development set out in the guidelines issued by the Department of Business Innovation and Skills. Claims in respect of these activities were made in the Company's tax returns. The amounts involved were modest in the context of the Company's accounts.

**DIRECTORS' INDEMNITY AND INSURANCE**

Under Article 161 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, for the purposes of section 234 of the Companies Act 2006, which were in place throughout the year and which remain in force at the date of this report, in the form of directors' and officers' liability insurance. The directors' and officers' liability insurance covers directors of all of the Company's subsidiary entities.

**AUDITOR**

The directors have taken all reasonable steps to make themselves and the Company's auditor, KPMG LLP, aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditor is unaware.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 (2) of the Companies Act 2006.

The directors, having considered the requirements for rotation of auditor, the length of service of KPMG LLP and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the re-appointment of KPMG LLP as the auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

**DIRECTORS' REPORT (CONTINUED)**

**INFORMATION PRESENTED IN OTHER SECTIONS**

Certain information required to be included in a directors' report by the Companies Act 2006 and regulations made there under can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

- Commentary on the likely future developments in the business of the Company is included in the Strategic Report.
- A description of the Company's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 22 to the accounts.
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in the Strategic report.
- Disclosure on any dividends paid during the year is included in the Strategic Report.

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



K G Allen

Director

21 January 2022

Registered Office: 51 Homer Road, Solihull, West Midlands, B91 3QJ



**STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS**

The directors are responsible for preparing the Annual Report the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) in conformity with the requirements of the Companies Act 2006 and applicable law.

Under Company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

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



K G Allen

Director

21 January 2022

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PARAGON FINANCE PLC**

### **Opinion**

We have audited the Financial Statements of Paragon Finance PLC for the year ended 30 September 2021 which comprise the profit and loss account, the statement of comprehensive income, the balance sheet, the statement of movements in equity and the related notes 1 to 27, including the accounting policies in note 24.

In our opinion the Financial Statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2021 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including Financial Reporting Standard 101 – 'Reduced Disclosure Framework'; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

### **Going concern**

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

In our evaluation of the directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period.
- However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Company will continue in operation.

### **Fraud and breaches of laws and regulations – ability to detect**

#### *Identifying and responding to risks of material misstatement due to fraud*

- To identify risks of material misstatement due to fraud ('fraud risks') we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

**INDEPENDENT AUDITOR'S REPORT  
TO THE MEMBERS OF PARAGON FINANCE PLC (CONTINUED)**

Our risk assessment procedures included:

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the high-level policies and procedures of the Paragon Group (of which this company is a part) to prevent and detect fraud, including the Internal Audit function, and the Company's channel for 'whistleblowing', as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Inspecting Board, Audit Committee and Risk Committee minutes.
- Considering remuneration incentive schemes and performance targets for management and directors.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that Company management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements such as loan loss provisioning. On this audit we do not believe there is a fraud risk related to revenue recognition, with the exception of the EIR adjustment. The revenue streams are considered non-complex and require limited judgement. However, we have recognised a fraud risk in respect of the EIR adjustment to interest income given the subjectivity inherent in the estimate.

We also identified a fraud risk related to estimation of loan loss provisioning, specifically relating to economic scenarios and qualitative adjustments in response to significant estimation that involves subjective judgments or uncertainties that are difficult to corroborate.

We also performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted by senior finance management and those posted and approved by the same user.
- Assessing significant accounting estimates for bias.

We discussed with the Audit Committee matters related to actual or suspected fraud, for which disclosure is not necessary, and considered any implications for our audit.

*Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations*

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations.

As the Company is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

We communicated identified laws and regulations throughout our team and remained alert to any indications of noncompliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF PARAGON FINANCE PLC (CONTINUED)**

Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies' legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Company's licence to operate. We identified the following areas as those most likely to have such an effect: conduct, money laundering and financial crime and certain aspects of company legislation recognising the financial and regulated nature of the Group's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore, if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

We discussed with the Directors matters related to actual or suspected breaches of laws or regulations, for which disclosure is not necessary, and considered any implications for our audit.

### *Context of the ability of the audit to detect fraud or breaches of law or regulation*

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

### **Strategic report and directors' report**

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

### **Matters on which we are required to report by exception**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

**INDEPENDENT AUDITOR'S REPORT  
TO THE MEMBERS OF PARAGON FINANCE PLC (CONTINUED)**

**Directors' responsibilities**

As explained more fully in their statement set out on page 16 the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

**Auditor's responsibilities**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

**The purpose of our audit work and to whom we owe our responsibilities**

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.



**Michael Davidson (Senior Statutory Auditor)**

**for and on behalf of KPMG LLP, Statutory Auditor**

*Chartered Accountants*

1 Sovereign Square

Sovereign Street

Leeds

LS1 4DA

21 January 2022

**PROFIT AND LOSS ACCOUNT****YEAR ENDED 30 SEPTEMBER 2021**

	<b>Note</b>	<b>2021 £000</b>	<b>2020 £000</b>
Interest receivable and similar income	2	8,909	10,696
Interest payable and similar charges	3	(1,537)	(2,873)
Net interest income		<u>7,372</u>	<u>7,823</u>
Other operating income	4	127,973	107,691
Total operating income		<u>135,345</u>	<u>115,514</u>
Operating expenses		(129,386)	(103,795)
Provisions for losses	5	1,521	(80)
Operating profit, being profit on ordinary activities before taxation	6	7,480	11,639
Tax on profit on ordinary activities	7	466	(2,585)
Profit on ordinary activities after taxation		<u><u>7,946</u></u>	<u><u>9,054</u></u>

All activities derive from continuing operations.

**STATEMENT OF COMPREHENSIVE INCOME****YEAR ENDED 30 SEPTEMBER 2021**

	<b>Note</b>	<b>2021 £000</b>	<b>2020 £000</b>
Profit for the year		<u>7,946</u>	<u>9,054</u>
<b>Other comprehensive income</b>			
<i>Items that will not be reclassified subsequently to profit or loss</i>			
Actuarial gain / (loss) on pension fund	21	8,194	(7,398)
Deferred tax on actuarial gain / (loss)	21	(947)	2,095
Other comprehensive income for the year net of tax		<u>7,247</u>	<u>(5,303)</u>
Total comprehensive income for the year		<u><u>15,193</u></u>	<u><u>3,751</u></u>

## BALANCE SHEET

30 SEPTEMBER 2021

	Note	2021 £000	2021 £000	2020 £000	2020 £000
<b>FIXED ASSETS</b>					
Intangible assets	8	3,379		2,005	
Property, plant and equipment	9	6,955		6,885	
Investments – group companies	11	182,890		250,959	
			193,224		259,849
<b>CURRENT ASSETS</b>					
Debtors falling due within one year	12	149,615		160,834	
Cash at bank		-		-	
			149,615		160,834
<b>TOTAL ASSETS</b>			<u>342,839</u>		<u>420,683</u>
Called up share capital	14	76,164		76,164	
Profit and loss account		179,491		161,981	
<b>TOTAL EQUITY</b>			255,655		238,145
<b>CREDITORS</b>					
Amounts falling due within one year	15	74,081		158,654	
Amounts falling due after more than one year	15	2,790		3,467	
Retirement benefit obligations	21	10,313		20,417	
<b>TOTAL LIABILITIES</b>			87,184		182,538
<b>TOTAL LIABILITIES AND EQUITY</b>			<u>342,839</u>		<u>420,683</u>

These Financial Statements were approved by the Board of Directors on 21 January 2022.

Signed on behalf of the Board of Directors



K G Allen

Director

## STATEMENT OF MOVEMENTS IN EQUITY

## YEAR ENDED 30 SEPTEMBER 2021

	Share capital £000	Profit and loss account £000	Total equity £000
<i>Total comprehensive income for the year</i>			
Profit for the year	-	7,946	7,946
Other comprehensive income	-	7,247	7,247
Total comprehensive income for the year	-	15,193	15,193
<i>Transactions with owners</i>			
Issue of shares	-	-	-
Tax on share based remuneration	-	2,317	2,317
Total Transactions with owners	-	2,317	2,317
Net movement in equity in the year	-	17,510	17,510
Opening equity	76,164	161,981	238,145
Closing equity	76,164	179,491	255,655

## YEAR ENDED 30 SEPTEMBER 2020

	Share capital £000	Profit and loss account £000	Total equity £000
<i>Total comprehensive income for the year</i>			
Profit for the year	-	9,054	9,054
Other comprehensive income	-	(5,303)	(5,303)
Total comprehensive income for the year	-	3,751	3,751
<i>Transactions with owners</i>			
Issue of shares	-	-	-
Tax on share based remuneration	-	(333)	(333)
Total Transactions with owners	-	(333)	(333)
Net movement in equity in the year	-	3,418	3,418
Opening equity	76,164	158,563	234,727
Closing equity	76,164	161,981	238,145



**NOTES TO THE ACCOUNTS****YEAR ENDED 30 SEPTEMBER 2021****1. GENERAL INFORMATION**

Paragon Finance PLC ('the Company') is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 01917566. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Company's operations and its principal activities are set out in the Strategic Report.

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

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

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

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

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

**2. INTEREST RECEIVABLE AND SIMILAR INCOME**

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
On loans to other group companies	2,358	4,047
On loans to related parties	285	1,010
On loan notes issued by related parties	4,168	5,262
On loan notes issued by other group companies	75	192
Unwinding of discount of purchase of loan notes in other group companies	2,023	184
On deposits	-	1
Total interest on financial assets	<u>8,909</u>	<u>10,696</u>

The above interest arises from financial assets held at amortised cost.

**3. INTEREST PAYABLE AND SIMILAR CHARGES**

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
On bank loans and overdrafts	52	61
On loans from parent undertaking	1,036	2,244
On loans from other group companies	-	18
On loans from related parties	20	1
Total interest on financial liabilities	<u>1,108</u>	<u>2,324</u>
On pension scheme deficit (note 21)	320	415
Discounting on lease liabilities	109	134
	<u>1,537</u>	<u>2,873</u>

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

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 4. OTHER OPERATING INCOME

	2021 £000	2020 £000
Loan account fee income	22	26
Insurance income	7	8
Administration fees	10,893	15,075
Costs recharged to other group companies	117,051	92,582
	<u>127,973</u>	<u>107,691</u>

Administration fees are in respect of income receivable from various special purpose vehicle ('SPV') companies within the group which own mortgage and loan assets administered by the Company. Further details are given in note 10.

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

## 5. PROVISIONS FOR LOSSES

	2021 £000	2020 £000
<b>(Release of provision) / impairment of financial assets</b>		
First mortgage loans	(18)	(11)
Investments in group companies (note 11)	(737)	(800)
Investments in related parties (note 11)	(126)	-
Loans to group companies	157	897
Loans to related parties	(797)	(6)
	<u>(1,521)</u>	<u>80</u>

## 6. OPERATING PROFIT, BEING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2021 £000	2020 £000
<b>Operating profit is after charging:</b>		
Amortisation of intangible assets (note 8)	1,166	1,033
Depreciation on operating assets (note 9)	2,487	2,325
Auditor remuneration - audit services	95	82
	<u>95</u>	<u>82</u>

Non-audit fees provided to the Group are disclosed in the accounts of the parent company and the exemption from disclosure of fees payable to the Company's auditor in respect to non-audit services in these financial statements has been taken.

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 7. TAX ON PROFIT ON ORDINARY ACTIVITIES

## a) Tax (credit) / charge for the year

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Current tax:		
Corporation tax	1,722	819
Adjustment in respect of prior periods	(1,521)	298
Total current tax	<u>201</u>	<u>1,117</u>
Deferred tax (note 13):		
Origination and reversal of timing differences	(73)	1,650
Recognition of previously unrecognised tax losses	(214)	201
Rate change	(380)	(383)
Total deferred tax	<u>(667)</u>	<u>1,468</u>
	<u>(466)</u>	<u>2,585</u>

## b) Factors affecting the tax (credit) / charge for the year

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Profit before tax	<u>7,480</u>	<u>11,639</u>
UK corporation tax at 19% (2020: 19%) based on the profit for the year	1,421	2,211
Effects of:		
Tax exempt expenses	285	2
Timing differences	(743)	(592)
Accelerated capital allowances	159	75
Tax on share based remuneration	527	773
Prior year (credit) / charge	(1,735)	499
Change in rate of taxation on deferred tax balances	(380)	(383)
	<u>(466)</u>	<u>2,585</u>

The standard rate of corporation tax in the UK applicable to the Company in the period was 19.0% (2020: 19.0%), based on currently enacted legislation. During the previous period, legislation was substantively enacted, reversing the reduction in the tax rate to 17.0% which had been due to come into effect from April 2020. In the current period legislation was substantially enacted that will increase the rate to 25% with effect from 1 April 2023. Consequently, temporary differences which had been expected to reverse at a tax rate of 19% in the current year or in subsequent years, have either reversed or are expected to reverse at 19% in the year ended 30 September 2022, 22% in the year ended 30 September 2023 or 25% in subsequent years. The impact of this change has been accounted for in the year.

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 8. INTANGIBLE ASSETS

	Computer software £000	Total £000
<b>Cost</b>		
At 1 October 2020	11,796	11,796
Transfer from group companies	115	115
Additions	2,425	2,425
Disposals	(24)	(24)
At 30 September 2021	<u>14,312</u>	<u>14,312</u>
<b>Accumulated amortisation</b>		
At 1 October 2020	9,791	9,791
Charge for the year	1,166	1,166
On disposals	(24)	(24)
At 30 September 2021	<u>10,933</u>	<u>10,933</u>
<b>Net book value</b>		
At 30 September 2021	<u>3,379</u>	<u>3,379</u>
At 30 September 2020	<u>2,005</u>	<u>2,005</u>

## 9. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £000	Plant and machinery £000	Total £000
<b>Cost</b>			
At 1 October 2020	7,335	9,875	17,210
Transfer from group companies	18	144	162
Additions	1,170	1,400	2,570
Disposals	(757)	(800)	(1,557)
At 30 September 2021	<u>7,766</u>	<u>10,619</u>	<u>18,385</u>
<b>Accumulated depreciation</b>			
At 1 October 2020	3,057	7,268	10,325
Charge for the year	1,064	1,423	2,487
On disposals	(757)	(625)	(1,382)
At 30 September 2021	<u>3,364</u>	<u>8,066</u>	<u>11,430</u>
<b>Net book value</b>			
At 30 September 2021	<u>4,402</u>	<u>2,553</u>	<u>6,955</u>
At 30 September 2020	<u>4,278</u>	<u>2,607</u>	<u>6,885</u>

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 9. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

The carrying values of right of use of assets, in respect of leases where the Company is the lessee, included in tangible fixed assets are set out below.

	Land and buildings £000	Plant and machinery £000	Total £000
<b>Cost</b>			
At 1 October 2020	4,421	1,259	5,680
Transfer from group companies	18	-	18
Additions	220	853	1,073
Disposals	(563)	(652)	(1,215)
At 30 September 2021	<u>4,096</u>	<u>1,460</u>	<u>5,556</u>
<b>Accumulated depreciation</b>			
At 1 October 2020	875	571	1,446
Charge for the year	940	604	1,544
On disposals	(563)	(481)	(1,044)
At 30 September 2021	<u>1,252</u>	<u>694</u>	<u>1,946</u>
<b>Net book value</b>			
At 30 September 2021	<u>2,844</u>	<u>766</u>	<u>3,610</u>
At 30 September 2020	<u>3,546</u>	<u>688</u>	<u>4,234</u>

## 10. SECURITISATIONS

As part of the Group's financing arrangements, Group companies have sold portfolios of mortgages or other loans to a number of other group companies referred to as 'special purpose vehicles' or SPVs.

The SPVs have issued securities which are secured on the assets acquired, to finance the purchase of those assets. In each case the Company has provided a subordinated loan to the issuer and met its front end expenses which will be recovered over time. In certain cases the Company has also taken a minority shareholding or subscribed for loan stock.

The Company has entered into agreements with the SPVs under which it administers and manages the assets purchased by those companies. Other than its responsibilities with regard to these arrangements and the warranties given in the mortgage sale agreements, the Company has no commitment to repurchase the assets acquired by the SPVs or invest further in the SPVs and has no other liability in respect thereof.

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

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

**10. SECURITISATIONS (CONTINUED)**

The Company has identified the following transactions which are required to be disclosed under the terms of IAS 24 - 'Related Party Disclosures' ('IAS 24').

**Transactions with Paragon Mortgages (No. 23) PLC ('PM23')**

During the preceding year the Company acted as servicer of the mortgages for PM23, a company under common control as defined by IAS 24, and earned £nil during the preceding year in servicing fees. At the balance sheet date PM23 owed £nil (2020: £nil) to the Company in relation to servicing fees.

In the preceding year, the Company held the subordinated loan for PM23 and Class E notes issued by PM23. During the preceding year the Company earned £14,000 in subordinated loan interest and £10,000 in Class E note interest.

**Transactions with Paragon Mortgages (No. 24) PLC ('PM24')**

During the preceding year the Company acted as servicer of the mortgages for PM24, a company under common control as defined by IAS 24, and earned £58,000 during the preceding year in servicing fees. At the balance sheet date PM24 owed £nil (2020: £nil) to the Company in relation to servicing fees.

In the preceding year, the Company held the subordinated loan for PM24 and Class E notes issued by PM24. During the preceding year the Company earned £224,000 in subordinated loan interest and £203,000 in Class E note interest.

The Company was the Fee Letter provider to PM24 which is repaid over a four year period. At the balance sheet date, the outstanding Fee Letter was £nil (2020: £nil). During the preceding year the Company earned £9,000 in Fee letter interest.

**Transactions with Paragon Mortgages (No. 25) PLC ('PM25')**

The Company acted as servicer of the mortgages for PM25, a company under common control as defined by IAS 24, and earned £1,160,000 (2020: £1,295,000) during the year in servicing fees. At the balance sheet date PM25 owed £182,000 (2020: £206,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date, the Company was owed £1,056,000 (2020: £1,537,000) by PM25 in relation to payments made on behalf of PM25, which is included in other debtors.

The Company is the Fee Letter provider to PM25 which is repaid over a four-year period. At the balance sheet date, the outstanding Fee Letter was £982,000 (2020: £1,542,000), which is included within other debtors as mentioned above. During the year the Company earned £54,000 (2020: £87,000) in Fee letter interest and at the balance sheet date PM25 owed £5,000 (2020: £8,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 10. SECURITISATIONS (CONTINUED)

**Transactions with Paragon Mortgages (No. 25) PLC ('PM25') (Continued)**

At the balance sheet date, the Company held the following asset backed loan notes issued by PM25, which are included in investments. It shows the amount of interest earned during the current and preceding years by the Company from holding the asset backed loan notes and what the Company is owed in interest at the 30 September 2021 and 30 September 2020 which is included in prepayments and accrued income:

Notes	Maturity date	Call date	Principal notes held		Interest Company earned		Interest Company was owed	
			2021	2020	2021	2020	2021	2020
			£000	£000	£000	£000	£000	£000
'A'	May 2050	May 2023	22,286	25,500	171	334	20	23
'B'	May 2050	May 2023	1,700	1,700	17	26	2	2
'C'	May 2050	May 2023	1,500	1,500	20	28	3	3
'D'	May 2050	May 2023	24,700	24,700	411	536	52	51
'Z'	May 2050	May 2023	17,600	17,600	470	560	59	58
'S'	May 2050	May 2023	8,200	9,200	355	448	42	46
'SVFN'	May 2050	May 2023	-	-	-	-	-	-

**Transactions with Paragon Mortgages (No. 26) PLC ('PM26')**

During the year the Company, a company under common control as defined by IAS 24, acted as servicer of the mortgages for PM26 and earned £900,000 (2020: £1,056,000) in servicing fees. At the balance sheet date, PM26 owed £142,000 (2020: £160,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £1,165,000 (2020: £2,003,000) from PM26 in relation to payments made on behalf of PM26, which is included in other debtors.

The Company is the Fee Letter provider to PM26 which is repaid over a four-year period. At the balance sheet date, the outstanding Fee Letter was £1,103,000 (2020: £1,858,000), which is included in the balances above. During the year the Company earned £68,000 (2020: £104,000) in Fee letter interest and at the balance sheet date PM26 owed £6,000 (2020: £10,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.



## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 10. SECURITISATIONS (CONTINUED)

**Transactions with Paragon Mortgages (No. 26) PLC ('PM26') (Continued)**

At the balance sheet date, the Company held the following asset backed loan notes issued by PM26, which are included in investments. It shows the amount of interest earned during the current and preceding years by the Company from holding the asset backed loan notes and what the Company is owed in interest at the 30 September 2021 and 30 September 2020 which is included in prepayments and accrued income:

Notes	Maturity date	Call date	Principal notes held		Interest Company earned		Interest Company was owed	
			2021	2020	2021	2020	2021	2020
			£000	£000	£000	£000	£000	£000
'A1'	May 2045	Aug 2024	9,400	12,200	119	212	13	17
'A2'	May 2045	Aug 2024	7,600	7,600	95	117	12	12
'B'	May 2045	Aug 2024	24,700	24,700	483	556	61	60
'C'	May 2045	Aug 2024	18,600	18,600	427	482	54	53
'D'	May 2045	Aug 2024	20,100	20,100	533	593	67	66
'Z'	May 2045	Aug 2024	20,100	20,100	734	795	92	91
'S'	May 2045	Aug 2024	6,300	7,200	270	364	32	36
'SVFN'	May 2045	Aug 2024	-	4,700	51	329	-	24

**Transactions with Paragon Mortgages (No. 27) PLC ('PM27')**

During the year the Company, a company under common control as defined by IAS 24, acted as servicer of the mortgages for PM27 and earned £1,496,000 (2020: £641,000) in servicing fees. At the balance sheet date, PM27 owed £372,000 (2020: £383,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £1,416,000 (2020: £1,556,000) from PM27 in relation to payments made on behalf of PM27, which is included in other debtors.

The Company is the Fee Letter provider to PM27 which is repaid over a four-year period. At the balance sheet date, the outstanding Fee Letter was £1,200,000 (2020: £1,505,000), which is included in the balance above. During the year the Company earned £54,000 (2020: £26,000) in Fee letter interest and at the balance sheet date PM27 owed £10,000 (2020: £13,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 10. SECURITISATIONS (CONTINUED)

**Transactions with Paragon Mortgages (No. 28) PLC ('PM28')**

During the year the Company, a company under common control as defined by IAS 24, acted as servicer of the mortgages for PM28 and earned £1,267,000 in servicing fees. At the balance sheet date, PM28 owed £116,000 to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £551,000 from PM28 in relation to payments made on behalf of PM28, which is included in other debtors.

The Company is the Fee Letter provider to PM28 which is repaid over a four-year period. At the balance sheet date, the outstanding Fee Letter was £1,067,000, which is included in the balance above. During the year the Company earned £44,000 in Fee letter interest and at the balance sheet date PM28 owed £2,000 in relation to Fee Letter interest, which is included in prepayments and accrued income.

**Transactions with Paragon Seventh Funding Limited ('P7F')**

The Company acted as servicer of the mortgages for P7F, a company under common control as defined by IAS 24, and earned £348,000 (2020: £210,000) during the year in servicing fees. At the balance sheet date P7F owed £65,000 (2020: £nil) to the Company in relation to other fees, which is included in other debtors.

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 11. INVESTMENTS - GROUP COMPANIES

	2021 £000	2020 £000
At 1 October 2020	250,959	312,070
Investment during the year	-	918
Other debits	2,023	184
Provisions movement (note 5)	863	800
Repayment of loans	(70,955)	(63,013)
At 30 September 2021	182,890	250,959

The investments are loans to the Group companies which are not subsidiaries of the Company. The investments include subordinated loans amounting to £nil (2020: £48,713,000) and investments in mortgage-backed floating rate notes amounting to £182,890,000 (2020: £202,246,000).

The investments in mortgage-backed floating rate notes represents the Company's investment in publicly traded, mortgages backed floating rate notes originally issued by:

Paragon Mortgages (No. 25) PLC

Paragon Mortgages (No. 26) PLC

During the year Paragon Mortgages (No. 14) PLC repaid all of the outstanding mortgage-backed floating rate notes.

All companies mentioned above are SPVs. These companies were established and controlled by entities in common control with the Company to purchase pools of mortgage assets.

These investments are denominated in sterling and are considered to be debt investments as defined by IFRS. The underlying assets are mortgage loans made to United Kingdom borrowers. The Company is under no obligation to make any contribution to the SPV and its maximum loss is limited to the carrying value of its investment.

Other debits include primarily interest charged and other changes in the amortised cost of the assets caused by the effective interest rate method.

The Company itself is a wholly-owned subsidiary and, therefore, no consolidated accounts have been prepared.

The directors consider that the value of the investments in subsidiary companies is at least equal to the amounts at which they are stated.

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 12. DEBTORS

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Amounts falling due within one year:		
Amounts due from group companies	61,482	97,453
Current tax assets	57,592	32,862
Deferred tax assets (note 13)	10,355	8,845
Other debtors	18,841	18,999
Sundry financial assets	<u>148,270</u>	<u>158,159</u>
Prepayments and accrued income	1,345	2,675
	<u><u>149,615</u></u>	<u><u>160,834</u></u>

Included in the amount due from group companies is £59,452,000 (2020: £95,063,000) which is interest bearing.

## 13. DEFERRED TAX

The movements in the net asset for deferred tax are as follows:

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Balance at 1 October 2020	8,845	9,324
Credit to reserves	843	989
Profit and loss (credit) / charge (note 7)	73	(1,650)
Prior year profit and loss (credit) / charge (note 7)	214	(201)
Rate change (note 7)	380	383
Balance at 30 September 2021	<u><u>10,355</u></u>	<u><u>8,845</u></u>

The net deferred tax asset recognised is analysed as follows:

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Accelerated tax depreciation	575	489
Retirement benefit obligations	4,422	6,729
Share based payments	5,191	1,653
Impairment and other provisions	167	(26)
Net deferred tax asset	<u><u>10,355</u></u>	<u><u>8,845</u></u>

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 14. CALLED UP SHARE CAPITAL

	2021 £000	2020 £000
Allotted:		
101,552,255 ordinary shares of 75p each	76,164	76,164

## 15. CREDITORS

	2021 £000	2020 £000
Amounts falling due within one year:		
Bank loan and overdrafts	275	388
Amounts due to parent undertaking	37,143	126,954
Amounts due to group companies	8,626	16,433
Other creditors	728	822
Accruals and deferred income	26,113	12,893
Lease payables (note 16)	1,196	1,164
	<u>74,081</u>	<u>158,654</u>

The amounts due to parent undertaking are interest bearing and included in the amount due to group companies is £16,162,000 (2020: £16,162,000) which is interest bearing.

	2021 £000	2020 £000
Amounts falling due after one year:		
Lease payables (note 16)	2,790	3,467
	<u>2,790</u>	<u>3,467</u>

## 16. LEASE PAYABLES

	2021 £000	2020 £000
Leasing Liabilities fall due		
In more than five years	-	552
In more than two but less than five years	1,765	2,051
In more than one year but less than two years	1,025	864
In more than one year (note 15)	<u>2,790</u>	<u>3,467</u>
In less than one year (note 15)	1,196	1,164
	<u>3,986</u>	<u>4,631</u>

## NOTES TO THE ACCOUNTS - ANALYSIS

## YEAR ENDED 30 SEPTEMBER 2021

## 17. LEASING ARRANGEMENTS

*As Lessee*

The Company's use of leases as a lessee, relates to the rent of an office building(s) and company cars. Under IFRS 16 these have been accounted for as right of use assets and corresponding lease liabilities under IFRS 16.

The average term of the current building leases from inception is 9 years (2020: 9 years) with rents subject to review every five years, while the average term of the vehicle leases and office equipment is 3 years (2020: 3 years).

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

Disclosure	Note
Depreciation on right of use assets	6
Interest expense on lease liabilities	3
Additions to right of use assets	9
Carrying amount of right of use assets	9

There was no subleasing of any right of use asset and the total cash flows relating to leasing as a lessee were £1.1m (2020: £1.7m).

## 18. RELATED PARTY TRANSACTIONS

Related party transactions are discussed in note 10.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

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

## 19. DIRECTORS AND EMPLOYEES

## a) Directors

Two of the directors during the period (2020: three) were also directors of the parent company, Paragon Banking Group PLC. Their remuneration from the Paragon Group is set out in the Directors' Remuneration Report of Paragon Banking Group PLC. No amounts in respect of their emoluments are included in the disclosures below.

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
<b>Directors' emoluments:</b>		
Other emoluments	852	998
	<u>852</u>	<u>998</u>
Pension contributions paid in respect of directors	<u>32</u>	<u>29</u>
Emoluments of the highest paid director:		
Excluding pension contributions	487	398
Pension contributions	-	7
	<u>487</u>	<u>405</u>

The number of directors during the year to whom retirement benefits were accruing under money purchase schemes was one (2020: one). The number of the directors during the year in respect of whose service shares were received or receivable under the Group's long-term incentive schemes was five (2020: seven) (two of whom are directors of the parent company (2020: three)). Two of these directors (2020: three), including the highest paid director exercised awards during the year.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 19. DIRECTORS AND EMPLOYEES (CONTINUED)

## b) Employees

The average number of persons (including directors) employed by the Company during the year was 1,354 (2020: 1,379). The costs incurred during the year in respect of these employees were:

	2021	2021	2020	2020
	£000	£000	£000	£000
Share based remuneration	8,404		2,678	
Other wages and salaries	64,511		50,834	
Total wages and salaries	<u>72,915</u>	72,915	<u>53,512</u>	53,512
National insurance on share based remuneration	2,286		(129)	
Other social security costs	7,134		6,376	
Total social security costs	<u>9,420</u>	9,420	<u>6,247</u>	6,247
Defined benefit pension cost	1,810		1,966	
Other pension costs	2,965		2,288	
Total pension costs	<u>4,775</u>	4,775	<u>4,254</u>	4,254
Total staff costs	<u>87,110</u>	87,110	<u>64,013</u>	64,013

Details of the pension schemes operated by the Company are given in note 21.



## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION

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

The effect of the share based payment arrangements on the Company's profit is shown in note 19.

A summary of the number of share awards outstanding under each scheme at 30 September 2021 and at 30 September 2020 is set out below.

	Number 2021	Number 2020
(a) Sharesave Plan	3,227,430	3,793,473
(b) Performance Share Plan	5,030,388	4,536,293
(c) Company Share Option Plan	197,324	372,531
(d) Deferred Bonus Plan	1,340,237	819,265
(e) Restricted Stock Units	273,193	265,672
	<u>10,068,572</u>	<u>9,787,234</u>

**(a) Share option schemes**

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

A reconciliation of movements in the number and weighted average exercise price of options over £1 ordinary shares during the year ended 30 September 2021 and the year ended 30 September 2020 is shown below.

	2021 Number	2021 Weighted average exercise price p	2020 Number	2020 Weighted average exercise price p
<b>Options outstanding £1 ordinary shares</b>				
At 1 October 2020	3,793,473	295.40	2,375,606	336.98
Granted in the year In respect of employees	371,296	424.00	2,533,109	278.56
transferring out	-	-	(5,266)	341.76
Exercised in the year	(682,312)	304.57	(931,139)	348.35
Lapsed during the year	(255,027)	316.95	(178,837)	351.68
At 30 September 2021	<u>3,227,430</u>	<u>305.50</u>	<u>3,793,473</u>	<u>295.40</u>
Options exercisable	<u>89,402</u>	<u>303.93</u>	<u>316,115</u>	<u>341.85</u>

The weighted average remaining contractual life of options outstanding at 30 September 2021 was 32.4 months (2020: 36.8 months). The weighted average market price at exercise for share options exercised in the year was 526.83p (2020: 441.06p).

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

## (a) Share option schemes (continued)

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

Grant date	Period exercisable	Exercise price	Number 2021	Number 2020
<b>Sharesave Schemes</b>				
11/06/2015	01/08/2020 to 01/02/2021	345.68p	-	8,242
20/06/2016	01/08/2021 to 01/02/2022	249.44p	57,724	410,565
28/07/2017	01/09/2020 to 01/03/2021	341.76p	2,633	307,873
28/07/2017	01/09/2022 to 01/03/2023	341.76p	20,971	22,726
31/07/2018	01/09/2021 to 01/03/2022	408.80p	29,045	146,256
31/07/2018	01/09/2023 to 01/03/2024	408.80p	18,924	18,924
30/07/2020	01/09/2022 to 01/03/2023	360.16p	325,421	355,542
30/07/2020	01/09/2024 to 01/03/2025	360.16p	4,577	5,742
27/07/2020	01/09/2023 to 01/03/2024	278.56p	1,904,216	2,012,882
27/07/2020	01/09/2025 to 01/03/2026	278.56p	492,877	504,721
28/07/2021	01/09/2024 to 01/03/2025	424.00p	296,053	-
28/07/2021	01/09/2026 to 01/03/2027	424.00p	74,989	-
			<u>3,227,430</u>	<u>3,793,473</u>

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

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

The fair value of options granted is determined using a trinomial model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2021 and the year ended 30 September 2020, which were all made under the Sharesave scheme, are shown below.

Grant date	<b>28/07/21</b>	<b>28/07/21</b>	<b>27/07/20</b>	<b>27/07/20</b>
Number of awards granted	296,307	74,989	2,028,388	504,721
Market price at date of grant	554.50p	554.50p	343.20p	343.20p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	<u>1.41</u>	<u>1.17</u>	<u>0.62</u>	<u>0.55</u>
<b>Inputs to valuation model</b>				
Expected volatility	38.77%	33.10%	34.24%	32.98%
Expected life at grant date (years)	3.42	5.43	3.45	5.45
Risk-free interest rate	0.19 %	0.31%	(0.13) %	(0.11) %
Expected dividend yield	3.90%	3.90%	4.34%	4.34%
Expected annual departures	5.00%	5.00%	5.00%	5.00%

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

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

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

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

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

The conditional entitlements outstanding under this scheme at 30 September 2021 and 30 September 2020 were:

Grant Date	Period exercisable	Number 2021	Number 2020
17/12/2010	17/12/2013 to 16/12/2020 †	-	9,925
21/12/2011	21/12/2014 to 20/12/2021 †	5,093	5,093
28/02/2013	28/02/2016 to 27/02/2023 †	4,578	5,443
10/12/2013	10/12/2016 to 09/12/2023 †	2,132	6,210
18/12/2014	18/12/2017 to 17/12/2024 †	5,366	6,277
22/12/2015	22/12/2018 to 21/12/2025 †	13,451	15,411
01/12/2016	01/12/2020 to 30/11/2026 β	323,425	432,176
08/12/2017	08/12/2020* to 07/12/2027 β	331,357	1,092,483
14/12/2018	14/12/2021* to 13/12/2028 ‡	1,400,742	1,400,742
06/07/2020	07/12/2022* to 05/07/2030 φ	1,020,729	1,053,341
06/07/2020	07/12/2024* to 05/07/2030 φ	509,192	509,192
11/12/2020	07/12/2023* to 05/07/2031 δ	1,028,616	-
11/12/2020	07/12/2025* to 05/07/2031 δ	385,707	-
		5,030,388	4,536,293

\* Estimated date

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

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

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

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

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

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

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

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

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

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

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

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

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

- δ These awards are subject to performance criteria, similar to those described at φ above, except that:
- Under the EPS condition full vesting occurs if EPS for the third year of the test period is at least 66p, 25% vesting if EPS in this year is 58p and vesting between those points on a straight line basis.
  - The ability of the Remuneration Committee to adjust specifically for windfall gains was not a condition of this grant

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

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

The fair value of awards granted under the Performance Share Plan is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2021 and the year ended 30 September 2020 are shown below:

Grant date	<b>11/12/20</b>	<b>06/07/20</b>
Number of awards granted	1,439,026	1,694,982
Market price at date of grant	446.80p	360.60p
Contractual life (years)	3.0	2.4
Fair value per share at date of grant	<u>407.50p</u>	<u>301.32p</u>
<b>Inputs to valuation model</b>		
Expected volatility	37.85%	33.93%
Expected life (years)	3.0	2.4
Risk-free interest rate	<u>(0.12)%</u>	<u>(0.06)%</u>

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

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

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

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each member of staff may be granted up to a maximum total value of £30,000 of tax benefitted options. No new CSOP awards were made in the year ended 30 September 2021 or 30 September 2020.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

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

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2021 and the year ended 30 September 2020 is shown below.

	2021 Number	2021 Weighted average exercise price p	2020 Number	2020 Weighted average exercise price p
<b>Options outstanding</b>				
At 1 October 2020	372,531	419.97	654,463	397.25
Granted in the year	-	-	-	-
Exercised or surrendered in the year	(74,590)	397.33	(204,153)	361.88
Lapsed during the year	(100,617)	471.06	(77,779)	372.15
At 30 September 2021	<u>197,324</u>	<u>404.96</u>	<u>372,531</u>	<u>419.97</u>
Options exercisable	<u>62,049</u>	<u>433.25</u>	<u>74,985</u>	<u>361.88</u>

The weighted average remaining continental life of options outstanding at 30 September 2021 was 81.5 months (2020: 89.5 months). The weighted average market prices at exercise for share options exercised in the year was 466.70.

The conditional entitlements outstanding under this scheme at 30 September 2021 and 30 September 2020 were:

Grant date	Period Exercisable	Exercise Price	Number 2021	Number 2020
01/12/2016	01/12/2020 to 30/11/2026 †	361.88p	18,177	74,985
08/12/2017	08/12/2020 to 07/12/2027 β	477.76p	29,151	147,550
14/12/2018	14/12/2021 to 13/12/2028 β	396.04p	149,996	149,996
			<u>197,324</u>	<u>372,531</u>

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

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

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place. No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

## (d) Deferred Bonus awards

These plans are generally used for the deferral in shares of annual bonus awards made to executive directors and certain other senior managers. Additionally, in 2020 a one-off award was made on an all-employee basis.

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2021 and 30 September 2020 were:

Grant date	Period exercisable	Number 2021	Number 2020
10/12/2013	10/12/2016 to 09/12/2023	55,302	55,302
18/12/2014	18/12/2017 to 17/12/2024	52,888	52,888
22/12/2015	22/12/2018 to 21/12/2025	60,042	60,042
01/12/2016	01/12/2019 to 30/11/2026	71,235	105,318
08/12/2017	08/12/2020 to 07/12/2027	67,572	102,516
14/12/2018	14/12/2021 to 13/12/2028	334,498	334,498
12/12/2019	12/12/2022 to 11/12/2029	108,701	108,701
11/12/2020	11/12/2023 to 10/12/2030	378,904	-
11/12/2020 *	11/12/2023 to 10/12/2024	211,095	-
		1,340,237	819,265

\* All employee award

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

The all-employee awards will vest on the third anniversary of the grant date and the shares will be automatically transferred to the participants as soon as reasonably practicable thereafter. The period exercisable shown above therefore illustrates the latest date by which it is anticipated that these transfers will have been made.

In the event of death or redundancy the all-employee awards may vest early. Awards lapse on the cessation of employment, other than in 'good leaver' circumstances. Except in these regards the all-employee awards operate in the same way as the executive awards.

The Deferred Bonus shares granted in December 2016 accrue dividends only over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2021 and the year ended 30 September 2020 are shown below.

Grant date	11/12/20 <i>All employee</i>	11/12/20 <i>Executive</i>	12/12/19 <i>Executive</i>
Number of awards granted	211,095	378,904	108,701
Market price at date of grant	446.80p	446.80p	489.20p
Fair value per share at date of grant	353.62p	353.62p	489.20p

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 20. SHARE BASED REMUNERATION (CONTINUED)

**(d) Deferred Bonus awards (continued)**

No departures are expected for grantees under this plan, except for grants under the on-off all-employee grant in 2020, where a departure rate of 7.5% per annum is expected.

**(e) Restricted Stock Units ('RSUs')**

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

The conditional entitlements outstanding under this scheme at 30 September 2021 and 30 September 2020 were:

Grant date	Period exercisable	Number 2021	Number 2020
08/12/2017	08/12/2020 to 07/12/2027	-	22,672
14/12/2018	14/12/2021* to 13/12/2028	52,040	52,040
06/07/2020	07/12/2022* to 05/07/2030	190,960	190,960
11/12/2020	11/12/2023* to 10/12/2030	30,193	-
		273,193	265,672

\*Estimated Date

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2021 and the year ended 30 September 2020 are shown below.

Grant date	<b>11/12/20</b>	<b>06/07/20</b>
Number of awards granted	30,193	190,690
Market price at date of grant	446.80p	360.60p
Contractual life (years)	3.0	2.4
Fair value per share at date of grant	446.80p	360.60p

For all of these grants no departures are expected.



## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS

**(a) Defined benefit plan - Description**

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

*Scheme benefit changes*

During the year, following consultation with the active members of the Plan, changes were made affecting the accrual of benefits by members after 1 July 2021. The principal changes were:

- The earliest age that members can access benefits building up after 1 July 2021 without any reduction for early payment is 65, rather than 60
- The rate of salary increase counting towards benefits and contributions in the Plan is capped at 2.5% per annum
- Member were allowed to elect to either contribute 8% of capped salary to accrue benefits at the rate of 1/70 of capped final salary per year or continue to contribute 5% of capped salary to accrue benefits at the rate of 1/75 of capped final salary per year

The changes do not affect benefits already accrued to that date.

*Employee contributions and benefits*

The scheme was closed to new entrants in February 2002. Employees who are members of the plan are entitled to receive a pension of 1/60 of their final basic annual salary per year of service up to 30 June 2021. After that date further accrual is at a rate of 1/70 or 1/75 of capped final salary depending on the level of contributions. After 1 July 2021 employee contributions were either 5% or 8% of capped salary. Before that date all active members contributed at a rate of 5% of salary.

Dependants of Plan members are eligible for a dependants pension and the payment of a lump sum in the event of death in service.

*Actuarial risks*

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

- **Investment risk** – The present value of the defined benefit liabilities is calculated using a discount rate set by reference to high quality corporate bond yields. If plan assets underperform corporate bonds, this will increase the deficit. The strategic allocation of assets under the Plan is currently weighted towards equity assets and diversified growth funds as its liability profile is relatively immature, and it is expected that these asset classes will, over the long term, outperform gilts and corporate bonds. In consultation with the Company, the Trustee keeps the allocation of the Plan's investments under review to manage this risk on a long-term basis.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

## (a) Defined benefit plan – Description (continued)

- **Interest risk** – A fall in corporate bond yields would reduce the discount rate used in valuing the Plan liabilities and increase the value of the Plan liabilities. The Plan assets would also be expected to increase, to the extent that bond assets are held, but this would not be expected to fully match the increase in liabilities, given the weighting towards equity assets and diversified growth funds noted above.
- **Inflation risk** – Pensions in payment are increased annually in line with the Retail Price Index ('RPI') or the Consumer Price Index ('CPI') for Guaranteed Minimum Pensions built up since 1988. Pensions built up since 5 April 2006 are capped at 2.5% and pensions built up before 6 April 2006 are capped at 5%. For employees who have left the Company but have deferred pensions, these also revalue over the period to retirement predominantly in line with RPI. Therefore, an increase in inflation would also increase the value of the pension liabilities. The Plan assets would also be expected to increase, to the extent that they are linked to inflation, but this may not fully match the increase in liabilities.
- **Longevity risk** – The value of the Plan deficit is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would increase the deficit in the Plan.
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on the expected rate of inflation. Should the salaries of Plan members increase at a higher rate, then the deficit will be higher. For service from 1 July 2021, a 2.5% cap on individual pensionable salary applies, mitigating this risk.

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

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

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

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

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

**(b) Defined benefit plan – Financial impact**

For accounting purposes, the valuation at 31 March 2019 was updated to 30 September 2021 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

As the changes in the Plan described above did not affect benefits built up before 1 July 2021, the impact on the IAS 19 basis was immaterial and no remeasurement of assets and liabilities at 30 June 2021 has taken place. The service cost for the period between 1 July 2021 and 30 September 2021, and the associated interest cost and expected return, have been adjusted to reflect the value of benefits accruing from 1 July 2021.

The major categories of assets in the Plan at 30 September 2021 and 30 September 2020 and their fair values were:

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
Cash	17,092	28,650
Equity instruments	73,388	60,664
Debt instruments	54,848	34,906
Real estate	-	10,257
<b>Total fair value of Plan assets</b>	<u>145,328</u>	<u>134,477</u>
Present value of Plan liabilities	<u>(155,641)</u>	<u>(154,894)</u>
(Deficit) in the Plan	<u><u>(10,313)</u></u>	<u><u>(20,417)</u></u>

At 30 September 2021 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets.

Towards the end of the year the Plan disposed of its holdings in real estate funds, following a review of its investment strategy. These are currently in the process of reinvestment in other asset classes, with part of the proceeds held in cash at the year end.

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

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

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

A further judgement relating to GMP equalisation within historic transfer values was handed down in November 2020. The impact has been allowed for in employment cost for the year ended 30 September 2021, but is not significant.

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

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
At 1 October 2020	134,477	112,867
Interest on Plan assets	2,331	2,284
Cash flows		
Contributions by the Group	4,828	24,521
Contributions by Plan members	235	234
Benefits paid	(6,790)	(2,914)
Administration expenses paid	(788)	(676)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	11,035	(1,839)
At 30 September 2021	<u>145,328</u>	<u>134,477</u>

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

The actual return on scheme assets in the year ended 30 September 2021 was £13,366,000 (2020: £445,000).

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

	<b>2021</b>	<b>2020</b>
	<b>£000</b>	<b>£000</b>
At 1 October 2020	154,894	147,350
Current service cost	1,780	1,966
Past service cost	30	-
Funding cost	2,651	2,699
Cash flows		
Contributions by scheme members	235	234
Benefits paid	(6,790)	(2,914)
Remeasurement (gain) / loss		
Arising from demographic assumptions	1,091	1,193
Arising from financial assumptions	1,750	5,957
Arising from experience adjustments	-	(1,591)
At 30 September 2021	<u>155,641</u>	<u>154,894</u>

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

Following the changes in the plan described above, liabilities for benefits accruing for service up to 1 July 2021 are calculated separately from those accruing in respect of service after that date.

The major weighted average assumptions used by the actuary were (in nominal terms):

	<b>2021</b>	<b>2020</b>
In determining net pension cost for the year		
Discount rate	1.75%	1.85%
Rate of compensation increase		
Pre July 2021-accrual	2.95%	3.20%
Post 1 July 2021 accrual	2.50%	n/a
Rate of price inflation	2.95%	2.70%
Rate of increase of pensions	2.95%	2.65%
In determining benefit obligations		
Discount rate	2.00%	1.75%
Rate of compensation increase		
Pre July 2021-accrual	3.40%	2.95%
Post 1 July 2021 accrual	2.50%	n/a
Rate of price inflation	3.40%	2.95%
Rate of increase of pensions	3.15%	2.85%
Further life expectancy at age 60		
Male member aged 60	28	28
Female member aged 60	29	29
Male member aged 40	29	30
Female member aged 40	31	31

In determining benefit obligations mortality is projected using the S3PA CMI Projection Model with 1.5% long-term improvement rate. At 30 September 2021 the 2020 (All) Year of Birth version of the model was used (2020: 2019 (All) Year of Birth, 2019: 2018 Light Year of Birth).

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The amounts charged in the profit and loss account in respect of the Plan are:

	Note	2021 £000	2020 £000
Current service cost		1,780	1,966
Past service cost		30	-
Total service cost		<u>1,810</u>	<u>1,966</u>
Administration expenses		788	676
Included within operating expenses		<u>2,598</u>	<u>2,642</u>
Funding cost of scheme liability		2,651	2,699
Interest on Plan assets		(2,331)	(2,284)
Net interest expense	3	<u>320</u>	<u>415</u>
Components of defined benefit costs recognised in profit and loss		<u><u>2,918</u></u>	<u><u>3,057</u></u>

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

	2021 £000	2020 £000
Return on Plan assets (excluding amounts included in interest)	11,035	(1,839)
Actuarial gains / (losses)		
Arising from demographic assumptions	(1,091)	(1,193)
Arising from financial assumptions	(1,750)	(5,957)
Arising from experience adjustments	-	1,591
Total actuarial gain / (loss)	<u>8,194</u>	<u>(7,398)</u>
Tax credit thereon	(947)	2,095
Net actuarial gain / (loss)	<u><u>7,247</u></u>	<u><u>(5,303)</u></u>

Of the remeasurement movements reflected above:

- the return on plan assets to 30 September 2021 represents better than expected investment performance, including an element of post-Covid recovery in investment markets generally, as well as a reversal of the lower than expected returns in the year ended 30 September 2020.
- The change in demographic assumptions in the year ended 30 September 2021 predominantly reflects the adoption of new commutation factors by the Trustee from January 2021, which increased liabilities in respect of non-retired members. For the year ended 30 September 2020, the change in demographic assumption related to updated mortality assumptions, using the most recent version of the tables adopted by the Trustee in the triennial valuation, which predict marginally higher life expectancy among members than the previous versions.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

- The change in financial assumptions in the year ended 30 September 2021 reflects principally the impact of market implied inflation expectations increasing the value of Plan liabilities, although this was partially offset by higher discount rates, which are derived from market bond yields. Much of the change in the year ended 30 September 2020 resulted from the impact of falling bond yields on the discount rate used in the valuation.
- The experience adjustments in 2020 arose on the adoption of the 2019 Plan valuation as the basis of the IAS 19 valuation in that year. This exercise only takes place triennially.

**(c) Defined benefit plan – Future cash flows**

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2021, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

<b>Assumption</b>	<b>Increase in assumption</b>	<b>Impact on scheme liabilities</b>
Discount rate	0.1% p.a.	2.2% decrease
Rate of inflation *	0.1% p.a.	2.0% increase
Rate of salary growth	0.1% p.a.	0.4% increase
Rates of mortality	1 year of life expectancy	3.0% increase

\* maintaining a 0.0% assumption for real salary growth

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

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

Following a review of the Plan's investment strategy, the current target asset allocations for the year ending 30 September 2022 are 60% growth assets (primarily equities), and 40% matching assets (primarily bonds).

Following the finalisation of the March 2019 valuation, the agreed rate of employer contributions in respect of future service increased to 43.8% from 32.0% with effect from 1 July 2020. Additional contributions of £2.5m per annum for deficit reduction, including amounts payable under the PFP, and £0.4m per annum in respect of costs, each payable monthly, were also agreed. An additional contribution of £20.0m was made by the Group in June 2020. With effect from 1 July 2021, when the changes in the Plan benefits described above were implemented, the level of employer contributions for future service reduced to 25.0% of capped salary.

## NOTES TO THE ACCOUNTS – EMPLOYMENT COSTS

## YEAR ENDED 30 SEPTEMBER 2021

## 21. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2022 is £4.1m.

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

<b>Category of member</b>	<b>2021 Years</b>	<b>2020 Years</b>
Active members	24	24
Deferred pensioners	23	23
Current pensioners	15	15
All members	<u>22</u>	<u>22</u>

**(d) Defined contribution arrangements**

The Company sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Company successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme. During the year ended 30 September 2020 the Group increased its contribution to the scheme for those employees making the maximum 6% contribution to 10% of salary from 6%, generating an increase in the amounts being saved by employees.

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

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2021, which represent the total cost charged against income, were £3.7m (2020: £3.1m) (note 19).



## NOTES TO THE ACCOUNTS – FINANCIAL RISK

## YEAR ENDED 30 SEPTEMBER 2021

*The notes below describe the processes and measurements which the Company use to manage their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk.*

**22. FINANCIAL RISK MANAGEMENT**

The Company's operations were financed principally by a mixture of share capital and loans from other group companies. In addition, various financial instruments, for example debtors and accruals, arise directly from the Company's operations.

The principal risks arising from the Company's financial instruments are credit risk, liquidity risk and interest rate risk. The board of the Company's holding company reviews and agrees policies for all companies in the group managing each of these risks and they are summarised below. These policies have remained unchanged throughout the year and since the year end.

**Credit risk**

The Company's credit risk is primarily attributable to its subordinated loans to other group companies and its loans to customers. Subordinated loans made to other group companies provide the credit enhancement for the company to commence trading. The repayment of these loans is dependent on the credit performance of the loan assets in the creditor company and hence the credit risk on these balances is managed through careful management of the credit risk on the groups loans to customers.

The loans to customers in the Company and the Group are secured by first charges over residential properties in the United Kingdom. Despite this security, in assessing credit risk an applicant's ability to repay the loan remains the overriding factor in the decision to lend by the originator.

The Company administers the mortgages and the collections process is the same as that utilised for all companies in the group.

The maximum credit risk at 30 September 2020 approximates to the carrying value of subordinated loans (note 11). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios of other group companies.

In order to control credit risk relating to counterparties to the Company's financial instruments, the board of the Company's holding company determines on a group basis, which counterparties the Group will deal with, establishes limits for each counterparty and monitors compliance with those limits.

**Liquidity risk**

It is the Company's policy to ensure that adequate resources are available at all times to provide for the day to day activities of the Company and to meet regulatory requirements. Management considers the year end position satisfactorily reflects the policies and objectives set out above.

The Company has no external borrowings and liquidity is provided as part of the Group's working capital arrangements. The securitisation process and the terms of the warehouse facility effectively limit liquidity risk from the funding of the Group's loan assets. It remains to ensure that sufficient funding is available to fund the Group's participation in the SPVs, provide capital support for new loans and working capital for the Group. This responsibility rests with the Asset and Liability Committee which sets the Group's liquidity policy and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

**NOTES TO THE ACCOUNTS – FINANCIAL RISK****YEAR ENDED 30 SEPTEMBER 2021****22. FINANCIAL RISK MANAGEMENT (CONTINUED)****Interest rate risk**

The Company's policy is to maintain floating rate liabilities and match these with floating rate assets by the use of interest rate swap or cap agreements.

The Company's assets predominantly bear LIBOR linked interest rates or are hedged fixed rate assets. The interest rates charged on the Company's variable rate loan assets are determined by reference to, inter alia, the Company's funding costs and the rates being charged on similar products in the market. Generally this ensures the matching of changes in interest rates on the Company's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

**Currency risk**

The Company has no material exposure to foreign currency risk.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021**

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

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

**23. BASIS OF PREPARATION**

The Financial Statements have been prepared in accordance with applicable UK accounting standards. Disclosures have been made in accordance with Financial Reporting Standard 101 – ‘Reduced Disclosure Framework’ (‘FRS 101’).

As permitted by FRS 100 – ‘Application of Financial Reporting Requirements’ (‘FRS 100’) the Company has applied the measurement and recognition requirements of International Financial Reporting Standards (‘IFRS’) as adopted by the EU, but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of disclosure exemptions provided by FRS 101 has been taken.

The “requirements of the Companies Act 2006” here means accounts being prepared in accordance with “international accounting standards” as defined in section 474(1) of that Act, as it applied immediately before IP Completion Day (the end of the UK’s transition period) (‘IPCD’), including where the Company also makes use of standards which have been adopted for use within the United Kingdom in accordance with regulation 1(5) of the International Accounting Standards and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, subsequent to the IPCD.

Under the Listing Rules of the FCA, despite the UK’s exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Company until its first financial year commencing after the IPCD on 31 December 2020.

Therefore, while EU endorsed IFRS applies to these financial statements, those for the year ending 30 September 2022 will instead be prepared under ‘UK-adopted international accounting standards’.

The changes in the way that the basis of preparation is described, as a result of the UK’s exit from the EU, including the move to UK-adopted international accounting standards from the Company’s financial year commencing 1 October 2021, do not represent a change in the basis of accounting which would necessitate a prior year restatement.

**Adoption of new and revised reporting standards**

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

- 2020 amendments to IAS 39 – ‘Interest Rate Benchmark Reform’ and consequential amendments to IFRS 7

## NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

## YEAR ENDED 30 SEPTEMBER 2021

**23. BASIS OF PREPARATION (CONTINUED)****Adoption of new and revised reporting standards (continued)***IAS 39 amendments ‘Interest Rate Benchmark Reform’*

In August 2020 the IASB issued a further amendment to IAS 39 ‘Interest Rate Benchmark Reform – Phase 2’. This amendment sets out accounting requirements for the treatment of Interbank Offered Rate (‘IBOR’) - linked financial assets and liabilities under the amortised cost method when a firm replaces the IBOR linkage in the underlying instruments with a replacement benchmark. It is therefore potentially applicable to the Company’s London Interbank Offered Rate (‘LIBOR’) - linked intercompany loans and those FRN liabilities / assets where interest is charged on the basis of LIBOR or other IBOR rates.

The intention of the standard is that, where the transition is effectively a like for like replacement, no windfall gain or loss should occur on transition.

This amendment is effective from the Company’s financial year ending 30 September 2022 but has been endorsed by both the EU and the UK.

The Company has utilised, and will continue to utilise, the provisions of the amendment as it transitions its IBOR-linked assets and liabilities. The impact of the amendment will depend upon the IBOR related assets, and liabilities at the point at which transition occurs.

**Standards not yet adopted**

There are no standards and interpretations in issue but not effective which address matters relevant to the Company’s accounting and reporting.

**24. ACCOUNTING POLICIES**

The particular accounting policies applied are described below.

**Accounting convention**

The Financial Statements are prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

**Consolidated accounts**

The Company is exempt under Section 400 of the Companies Act 2006 from the obligation to prepare group financial statements, being a wholly-owned subsidiary undertaking of Paragon Banking Group PLC.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021****24. ACCOUNTING POLICIES (CONTINUED)****Going concern**

The financial statements of the Company for the year ended 30 September 2021 have been prepared on the going concern basis, as defined in IAS 1 – ‘Presentation of Financial Statements’. In order to prepare financial statements on this basis the directors must conclude that the management does not intend to liquidate the Company or cease trading, and that the Company has the ability to continue to trade and will be able to satisfy its liabilities as they fall due. Particular focus is given to the Group’s financial forecasts to ensure the adequacy of resources available for the Company to meet its business objectives on both a short term and strategic basis.

The Group has a formalised process of budgeting, reporting and review. The Group’s planning procedures forecast its profitability, capital position, funding requirement and cash flows on a company-by-company basis. In compiling the most recent forecast, for the period commencing 1 October 2021, particular attention was paid to the potential consequences of Covid on the Group’s operations, customers, funding and prospects, both in the short and longer term. This included consideration of a number of different scenarios with impacts of varying duration and severity. In common with the Group’s approach to IFRS 9, the economics used in the forecasting process were updated in October in light of the continuing development of the Covid crisis, based on updated external projections. Future business activity was reforecast reflecting the potential impacts of the pandemic on markets and products.

On the basis of this analysis, the directors have concluded that the Company is able to continue as a going concern for at least twelve months from the date of approval of these financial statements and that therefore it is appropriate to continue to adopt the going concern basis in the preparation of these financial statements.

**Leases**

For leases where the Company is the lessee a right of use asset is recognised in property plant and equipment on the inception of the lease based on the discounted value of the minimum lease payments at inception. A lease liability of the same amount is recognised at inception, with the unwinding of the discount included in the interest payable.

Leases where the Company is lessor are accounted for as operating or finance lease in accordance with IFRS 16 – ‘Lease’. A finance lease is one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Rental income and costs on operating leases are charged or credited to the profit and loss account on a straight-line basis over the lease term. The associated assets are included within property plant and equipment.

**Intangible assets**

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

## NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

## YEAR ENDED 30 SEPTEMBER 2021

## 24. ACCOUNTING POLICIES (CONTINUED)

**Property, plant and equipment**

Property, plant and equipment is stated at cost less accumulated depreciation.

The assets' residual values and useful lives are reviewed by management and adjusted, if appropriate, at each balance sheet date.

Depreciation on operating assets is provided on cost in equal annual instalments over the lives of the assets. Land is not depreciated. The rates of depreciation are as follows:

Short leasehold premises	over the life of the lease
Plant and machinery	25% per annum
Computer equipment	25% per annum
Furniture, fixtures and office equipment	15% per annum

Depreciation on right of use assets recognised in accordance with IFRS 16 is provided on a straight-line basis over the term of the lease.

**Loans to customers**

Loans to customers includes assets accounted for as financial assets. The Company assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Company has concluded that its business model for its customer loan assets is of the type defined as 'Hold to collect' by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest ('SPPI'). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procurement fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision impairment.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021****24. ACCOUNTING POLICIES (CONTINUED)****Impairment of loans and receivables**

The carrying values of all loans to customers, whether accounted for under IFRS 9, are reduced by an impairment provision based on their expected credit loss ('ECL'), determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

All assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as 'Stage 1' accounts, assets which have experienced an SICR but are not credit impaired are referred to as 'Stage 2' accounts, while credit impaired assets are referred to as 'Stage 3' accounts.

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, i.e. the total expected ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring; or
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, i.e. the total expected ECL that results from any future default events, weighted by the probability of those events occurring.

In establishing an ECL allowance, the Company assesses its probability of default, loss given default and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

Within its buy-to-let portfolio the Company utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver, a tenant is in place and arrears are reduced or cleared, the account will not necessarily be considered to be credit impaired. Properties in receivership are eventually either returned to their landlord owners or sold.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

**Investments**

The Company's investments in subsidiary undertakings are valued at cost less provision for impairment.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021****24. ACCOUNTING POLICIES (CONTINUED)****Current tax**

The charge for taxation represents the expected UK corporation tax and other income taxes arising from the Company's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

Tax relating to items taken directly to equity is also taken directly to equity.

**Deferred taxation**

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

**Cash at bank**

Balances shown as cash at bank in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

**Borrowings**

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the profit and loss account as interest payable over the term of the borrowing on an EIR basis.

**Amounts owed by or to group companies**

The balances owed by or to other group companies are carried at the current amount outstanding less any provision.

**Retirement benefit obligations**

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the profit and loss. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the profit and loss account for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.



## NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

## YEAR ENDED 30 SEPTEMBER 2021

**24. ACCOUNTING POLICIES (CONTINUED)****Revenue**

The revenue of the Company comprises interest receivable and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

**Fee and commission income**

Other income includes administration fees charged to borrowers, which are credited to the profit and loss account when the related service is performed.

**Share based payments**

In accordance with IFRS 2 – ‘Share based payments’ (‘IFRS 2’), the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group’s various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

**Disclosures**

In preparing these financial statements the Company has taken advantage of the exemptions from disclosure provided by FRS 101 in respect of:

- The requirement to produce a cash flow statement and related notes
- The requirement to provide comparative period reconciliations in respect of fixed assets
- The requirement to provide comparative period reconciliations in respect of intangible assets
- Disclosures in respect of transactions with wholly owned subsidiaries
- Disclosures in respect of capital management
- The effects of new, but not yet effective IFRSs
- Disclosures in respect of key management personnel
- Disclosures of transactions with a management entity which provides key management personnel services to the Company

As the consolidated financial statements of Paragon Banking Group PLC, the ultimate parent undertaking of the Company, include equivalent disclosures the Company has also taken advantage of these further exemptions provided by FRS 101:

- Certain disclosures required by IFRS 3 ‘Business Combinations’ in respect of business combinations undertaken by the Company.
- Certain disclosures required by IFRS 13 – ‘Fair Value Measurement’
- Certain disclosures required by IFRS 7 – ‘Financial Instruments Disclosures’

The Company presently intends to continue to apply these exemptions in future periods.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021****25. CRITICAL ACCOUNTING JUDGEMENTS**

The most significant judgements which the directors have made in the application of the accounting policies set out in note 24 relate to:

**Significant Increase in Credit Risk ('SICR')**

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated probability of default, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have a SICR, for account types where days overdue is an appropriate measure.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

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

**Definition of default**

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021****25. CRITICAL ACCOUNTING JUDGEMENTS (CONTINUED)****Classification of financial assets**

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how it intends to generate cash and profit from the assets
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit or loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Company has classified its customer loan assets as carried at amortised cost.

## NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

## YEAR ENDED 30 SEPTEMBER 2021

## 26. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the Financial Statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are:

**Impairment losses on loans to customers**

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Company must derive a set of scenarios which are internally coherent. The Company addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Company's approach to account management given a particular scenario.

**NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****YEAR ENDED 30 SEPTEMBER 2021****26. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)****Effective interest rates**

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each loan and hence the cash flows relating thereto. For purchased accounts this will involve estimating the likely future performance of the accounts at the time of acquisition. These estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and that predicted, which in turn would depend directly or indirectly on customer behaviour.

**Retirement benefits**

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions. These are listed in note 21. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

**27. ULTIMATE PARENT COMPANY**

The Company's immediate parent undertaking is Paragon Bank PLC. The Company's ultimate parent company and ultimate controlling party is Paragon Banking Group PLC. The smallest and largest group into which the Company is consolidated is that of Paragon Banking Group PLC, registered in England and Wales.

Copies of the financial statements of the Company and Paragon Banking Group PLC may be obtained from the Company Secretary, 51 Homer Road, Solihull, West Midlands, B91 3QJ.