CORPORATE GOVERNANCE

How the Group is run and how risk is managed

B1
Chair's statement on corporate governance

Fiona Clutterbuck, Chair of the Board

I welcome the emphasis on workforce engagement and diversity at all levels and look forward to working with the Board and management team in developing further our initiatives in these areas...

Dear Shareholder

It is with pleasure that I introduce the corporate governance report this year in what has been another significant year with most companies adopting the UK Corporate Governance Code 2018 ('the 2018 Code') during the calendar year. The 2018 Code emphasises strongly the contribution of good corporate governance in the achievement of long-term sustainable success and focusses on a number of areas that have developed in priority, rightly so, since the first introduction of the UK Corporate Governance Code in 1992, as well as being a step change from the 2016 version of the Code. In particular, I welcome the emphasis on workforce engagement and diversity at all levels and look forward to working with the Board and management team in developing further our initiatives in these areas.

As a Board we have chosen to utilise a formal workforce advisory panel, the People Forum, as the mechanism to engage with the Group's workforce. This forum has been based on an existing feedback mechanism. In addition to feedback from such meetings being advised to the Board on a regular basis there will also be attendance at the People Forum by myself and/or a non-executive director at least twice a year, with the first meeting, on executive remuneration, having taken place in November 2019. The Board and the Forum will consider other areas to discuss over the coming year, to ensure two-way communication and facilitated dialogue exists between the Board and the workforce, with information feeding into the Board's decision-making process and communications back to the workforce on how the Board has considered and acted on it.

Dialogue with shareholders and regulators, two of our key stakeholders, takes place frequently during the year and, as part of the annual regulatory and governance cycles, I, as well as a number of my Board colleagues, meet with these stakeholders. It is important to maintain and manage positively such relationships and I consider these discussions are key to ensuring the ongoing sustainability of the Group. The Group also considers its other stakeholders including its workforce, the wider community and environment; customers; brokers and other intermediaries, as appropriate, during its operating cycle.

As I noted in last year's report, the Board has adopted the Hampton-Alexander Review target of at least a third female representation on the Board by the end of 2020 and we have been working towards this target during the year. I am passionate about ensuring that the Board and the Group are diverse, reflective of the communities in which we operate, and it is one of my personal goals as Chair to improve the Group's position. Work undertaken during the year in respect of below-board Hampton-Alexander targets, as part of the Women in Finance Charter, has resulted in 'female senior managers as a percentage of total senior management' reaching its target of 35% as at 30 September 2019 and I congratulate management on reaching this milestone more than a year ahead of our target date.

With the upcoming retirement of Peter Hartill in February 2020 the Board is currently recruiting for a new Audit Committee Chair. To help ensure that we meet the Hampton-Alexander target, diversity of gender and background has been emphasised when considering candidates. It has proved a challenging recruitment, with strong candidates being in high demand. However, I am hopeful of an appointment being announced shortly after the AGM in February (subject to regulatory and Board approval). In addition, options for the appointment of a new Senior Independent Director are currently being considered. Further detail on this and the other work of the Nomination Committee during the year can be found in section B4.

Both Peter Hartill and John Heron are due to retire before the 2020 AGM and I would like to thank them personally, and on behalf of the Board, for their longstanding commitment to the Group. Peter has been the Senior Independent Director throughout my period as Chair, and as such his support and challenge have been hugely appreciated. He has considerable knowledge of the Group and its people and this experience has been invaluable to me. John is the Group's longest serving employee and his in-depth knowledge of the buy-to-let mortgage market will be greatly missed as well as his broader, very valuable contribution to Board and management discussions. Mine and the Board's best wishes for the future go to both of them.

During the year the Board undertook its triennial externally facilitated board evaluation with the assistance of Independent Board Evaluation's Ffion Hague. It was a thorough, and forward-focused evaluation and further detail can be found later in the report. We will be working on the outputs from the evaluation during the upcoming financial year and an action plan is currently being produced.

Another area that we are particularly proud of at Paragon is our strong culture, which is also highlighted in the 2018 Code. In the upcoming year, for the second time, a review of culture will be undertaken in addition to a review of the Group's risk culture. In addition, during the Investors in People assessment which took place in the financial year under review, various indictors were considered and notable strengths identified included a strong values-based culture, a clear people strategy that is built on high levels of empowerment and devolved accountability. As the Group grows in size the Board is committed to ensuring that these values remain a key element of the business.

My meetings with shareholders, and shareholder advisory bodies, as part of the remuneration review (see B6 for further detail) have frequently also touched on other governance matters, such as succession planning, diversity and workforce engagement and such discussions help to assist in the development of the governance process both at board level and within the wider organisation. I would like to thank shareholders for their continued interest in the Group and the questions and challenges they raise when we meet.

The Company will be holding its AGM on 13 February 2020 and I look forward to welcoming shareholders and discussing the Group's progress.

Fiona Clutterbuck

Chair of the Board

26 November 2019

B2
Board of directors

Fiona J Clutterbuck (Age 61)

Chair of the Board

Appointed to the Board as an independent non-executive director in 2012 and became Chair of the Board in May 2018

Experience

Fiona Clutterbuck has many years of corporate finance experience at leading UK and international investment banks, specialising in financial institutions.

During her career she has held the positions of Head of Strategy, Corporate Development and Communications at Phoenix Group, Managing Director and Head of Financial Institutions Advisory at ABN AMRO Investment Bank, Managing Director and Global Co-Head of Financial Institutions Group at HSBC Investment Bank and was a director at Hill Samuel Bank Limited.

Specific areas of expertise*

- Long term understanding of the Group, its markets and its people
- Strong and broad listed plc experience
- Strategic analysis skills
- Detailed knowledge of the executive remuneration market

Committee membership

Chair: Nomination Committee

Member: Risk and Compliance and Remuneration Committees

Current external appointments

Non-executive director of Hargreaves Lansdown PLC, chair of its remuneration committee and member of its audit, risk and nomination committees

Non-executive director of Sampo PLC (Finnish listed financial services company) and a member of its audit committee

Nigel S Terrington (Age 59)

Chief Executive

Appointed to the Board as Treasury Director in 1990, Finance Director in 1992 and became Chief Executive in 1995

Experience and expertise*

Nigel Terrington's early career began in investment banking, which included working for UBS where he ran its Financial Institutions Group. He joined the Group in 1987, becoming Treasurer shortly thereafter, before being appointed as Finance Director and then Chief Executive.

He has been Chair of the Council of Mortgage Lenders ('CML'), Chair of the Intermediary Mortgage Lenders Association ('IMLA'), Chair of the FLA Consumer Finance Division, a member of the Mortgage Board of UK Finance (previously CML) and a Board member of the FLA.

Nigel is an associate of the Chartered Institute of Bankers. In 2017, he received an Honorary Doctorate from Birmingham City University for services to the finance industry.

Overall, Nigel has expertise gained from long term, through-the-cycle, strategic and detailed understanding of the Group, its markets, its operations and its people. He saw the Group through both the 1992 and 2007 financial crises and has led the diversification of the Group from a monoline buy-to-let lender to its current broadly-based specialist banking group.

Current external appointments:

Member of HM Treasury's Home Finance Forum

Member of Bank of England's Residential Property Forum

Richard J Woodman (Age 54)

Chief Financial Officer

Appointed to the Board as Director of Corporate Development in 2012 and became Chief Financial Officer in June 2014

Experience and expertise*

Richard Woodman joined the Group in 1989 and has held various senior strategic and financial roles, including Director of Business Analysis and Planning and Managing Director of Idem Capital.

He has taken a lead role in the Group's strategic development and, in particular, in the loan portfolio acquisition programme through Idem Capital and the Group's M&A programme.

He is a member of the Chartered Institute of Management Accountants.

Broadly, Richard has expertise gained from long term, through-the-cycle, knowledge and understanding of the Group, its markets and its operations, in particular its financial management controls, liquidity and stress testing.

Current external appointments:

None

John A Heron (Age 60)

Managing Director, Mortgages

Appointed to the Board in 2003

Not seeking re-election at 2020 AGM

Experience and expertise*

John Heron joined the Group in January 1986 following a number of years in the building society industry and is the Group's longest serving employee.

John has been instrumental in the development of Paragon's buy-to-let mortgage lending programme.

As Managing Director, Mortgages, John is responsible for all aspects of the Group's mortgage business which includes the origination and management of buy-to-let and residential first and second charge mortgages.

He has been Chair of the Buy-to-Let Panel of the CML and a member of the IMLA Board.

He is a fellow of the Chartered Institute of Bankers.

John has long term, through-the-cycle, understanding of the Group, the buy-to-let lending market, its operations, its management and its people. He has been a significant leader in the buy-to-let lending market since its establishment in the late 1990s.

Current external appointments:

Member of UKF Mortgages Product Board

* All directors have broad knowledge of all areas of the Group's business but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success

B2
Board of directors

Peter J N Hartill (Age 70)

Non-executive director

Non-executive director since 2011 and became Senior Independent Director in June 2018

Appointed in 2011 – eight years served

Not seeking re-election at 2020 AGM

Experience

Peter Hartill spent forty years with Deloitte, becoming a senior audit partner and a business advisor with experience across a wide range of industries and business issues. Specifically, he has considerable experience in acquisitions and disposals, capital raising, risk control and corporate governance in the financial services sector.

He is a Chartered Accountant and has been Chair of the Audit Committee since 2011.

Specific areas of expertise*

- Detailed knowledge and experience of the financial services sector, accounting and auditing practice as well as of the audit market and accounting regulations
- Detailed knowledge of the Group's financial accounting practices

Committee membership

Chair: Audit Committee

Member: Risk and Compliance, Remuneration and Nomination Committees

Current external appointments

Chair: Deeley Group Limited

Hugo R Tudor (Age 56)

Non-executive director

Appointed in 2014 – five years served

Skills and experience

Hugo Tudor spent 26 years in the fund management industry, originally with Schroders and most recently with BlackRock, covering a wide range of UK equities. He is a Chartered Financial Analyst and a Chartered Accountant.

Specific areas of expertise*

- Detailed knowledge of the investor perspective
- A strong understanding of the executive remuneration market

Committee membership

Chair: Remuneration Committee

Member: Audit and Risk and Compliance Committees

Current external appointments

Director: Damus Capital Limited

Director: Vitec Global Limited, Vitec Air Systems Limited and Vitec Aspida Limited

Barbara A Ridpath (Age 63)

Non-executive director

Appointed in 2017 – two years served

Skills and experience

Barbara Ridpath has worked in finance for most of her career, in New York, London and Paris at the Federal Reserve Bank of New York, Standard & Poor's and JPMorgan.

She was instrumental in the development of UK mortgage securitisation in the late 1980s and went on to lead the Standard & Poor's Ratings Group in Europe, the Middle East and Africa.

Specific areas of expertise*

- Strong knowledge of the operation of and implementation of operational risk management systems
- Detailed knowledge of the securitisation market

Committee membership

Member: Audit, Nomination (since 24 January 2019) and Risk and Compliance Committees

Current external appointments

Non-executive director of ORX, a trade association for operational risk professionals

Member of the Ethical Investment Advisory Group of the Church of England

Member of the International Advisory Council of the Institute of Business Ethics ('IBE') from November 2019

Commissioner of the Marshall Aid Commemoration Commission until July 2019 and member of the council and executive committee at Chatham House (the Royal Institute of International Affairs) until July 2019

Finlay F Williamson (Age 60)

Non-executive director

Appointed in 2017 – two years served

Skills and experience

Finlay Williamson was Finance Director of Virgin Money between 2009 and 2014, where he was responsible for supporting the design and delivery of the company's growth strategy, including the assessment of potential markets, the development of key propositions and the pursuit of non-organic opportunities.

Prior to joining Virgin Money, Finlay had a long career at Royal Bank of Scotland ('RBS'), where he held a number of senior finance roles, latterly as Finance Director for RBS's Manufacturing and Retail Direct divisions.

He was appointed to the Board of Paragon Bank PLC in February 2015 and was Chair of its Risk and Compliance Committee from that date.

Finlay is a Chartered Accountant and a fellow of the Chartered Institute of Bankers in Scotland.

Specific areas of expertise*

- In depth knowledge and experience of financial services sector, accounting and risk operations
- Detailed experience of overseeing the development of risk management in the Group

Committee membership

Chair: Risk and Compliance Committee

Member: Audit Committee

Current external appointments

None

* All directors have broad knowledge of all areas of the Group's business but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success

B2
Board of directors

Graeme H Yorston (Age 62)
Non-executive director
Appointed in 2017 – two years served

Skills and experience

Graeme Yorston was Group Chief Executive of Principality Building Society, the 6th largest mutual in the UK. He has over 43 years' experience in financial services having carried out a number of senior roles in Abbey National (now Santander).

Graeme has served on the CBI Council for Wales, the Board of Business in the Community in Wales and was HRH Ambassador for BITC in Wales for two years. He was awarded Director of the Year in Wales by the Institute of Directors in 2016.

Graeme is a Fellow of The Chartered Institute of Banking, holds an MBA from Warwick Business School and was awarded an Honorary Doctorate in Business Administration by Cardiff Metropolitan University in 2017.

Specific areas of expertise*

- Strong retail banking sector knowledge and experience
- Detailed experience of overseeing IT systems

Committee membership

Member: Nomination, Remuneration (both since 24 January 2019) and Risk and Compliance Committees

Current external appointments

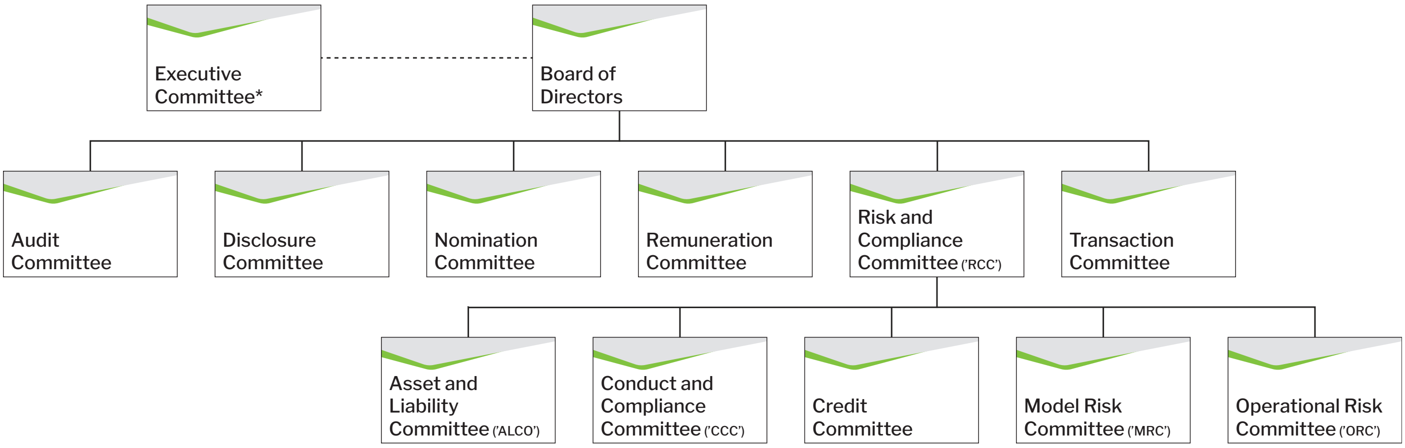
None

* All directors have broad knowledge of all areas of the Group's business but the 'areas of expertise' highlight specific areas in relation to an individual's contribution to the Group's long-term sustainable success

B3
Corporate governance

B3.1 Board and Committee structures

Corporate governance snapshots



* Not a board committee

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

Committee	**Audit**	**Remuneration**	**Risk and Compliance**	**Nomination**
Chair	P J N Hartill	H R Tudor	F F Williamson	F J Clutterbuck
Minimum number of meetings	4	3	4	2
Further information	Section B5	Section B6	Section B7	Section B4

Members	**Independent non-executive**	**Audit**	**Remuneration**	**Risk and Compliance**	**Nomination**
F J Clutterbuck	Until 10 May 2018	No	Yes	Yes	Yes
P J N Hartill	Yes	Yes	Yes	Yes	Yes
H R Tudor	Yes	Yes	Yes	Yes	Until 24 January 2019
B A Ridpath	Yes	Yes	No	Yes	From 24 January 2019
F F Williamson	Yes	Yes	No	Yes	No
G H Yorston	Yes	Until 24 January 2019	From 24 January 2019	Yes	From 24 January 2019
P Newberry	Yes	Until 31 December 2018	Until 31 December 2018	Until 31 December 2018	Until 31 December 2018

Executive Committee is not a committee of the Board but provides support to the Chief Executive Officer ('CEO') in the day-to-day running and management of the Group and, where necessary and appropriate, items discussed at Executive Committee are escalated to the Board for further discussion.

Further documentation available on the Group's website

- Matters Reserved for the Board
- Division of responsibilities – Chair, CEO and Senior Independent Director
- Terms of Reference – Audit, Nomination, Remuneration and Risk and Compliance Committees
- Internal Audit Charter

B3.2 Operation of the Governance Framework

Board leadership and company purpose

The Board of Directors is responsible for promoting the long-term, sustainable success of the Group, generating value for shareholders and contributing to wider society. It establishes the Group's overall purpose, values and strategy and ensures the delivery of these within a robust corporate governance and corporate responsibility framework. Purpose, values and strategy are described in section A2 and the corporate governance framework is described in the following pages.

Code compliance

The Board is committed to the principles of corporate governance contained in the UK Corporate Governance Code issued by the FRC in April 2016 ('the 2016 Code') and which is publicly available at www.frc.org.uk. Throughout the year ended 30 September 2019 the Company complied with the principles and provisions of the 2016 Code (with one exception, as noted below). The Board has considered the impact of the provisions of the 2018 Code, which is applicable to the Company from 1 October 2019, and has made a number of amendments to its practices and procedures which it will continue to monitor during the year to ensure compliance.

During the year under review, there was a short period when the Company was not fully in compliance with the provisions of the 2016 Code due to the period between the retirement of a director and a refresh of committee membership. The provision which the Company did not comply with, and the period of non-compliance was:

- From 1 January 2019 until 24 January 2019 there were only two independent non-executive directors on the Remuneration Committee (2016 Code provision D.2.1)

During this period no meetings of the Remuneration Committee were scheduled or held.

Committee structures

The Board operates through a number of committees covering certain specific matters, illustrated in the chart shown in section B3.1 and the membership of those committees is also shown in that section.

In addition to the regular committee structures the Board has also established a Disclosure Committee which assists in the design, implementation and evaluation of disclosure controls and procedures; monitors compliance with the Company's disclosure controls; considers the requirements for announcement; and overall determines the disclosure treatment of material market information. The Committee's members are the Chair, CEO and CFO, of which any two can form a quorum.

Further, the Transaction Committee, which reports directly to the Board, consists of the CEO and the CFO, the Director of Treasury and Structured Finance and the CRO, any two of which can form a quorum, but that quorum should include either the CEO or CFO. The Committee meets to consider potential acquisitions or disposals of loan assets by the Idem Capital business, where these are not large enough to require consideration at the Board, and also to approve, within delegated limits, wholesale term and/or revolving credit facilities proposed by the Group's Structured Lending operation.

Five main executive committees, the Asset and Liability Committee ('ALCO'), the Credit Committee, the Model Risk Committee ('MRC'), the Operational Risk Committee ('ORC') and the Conduct and Compliance Committee ('CCC'), with the membership consisting of executive directors and appropriate senior employees, report to the Risk and Compliance Committee. All of these committees are described further in the Risk Management Section B7. During the year Hugo Tudor became a permanent attendee at the Model Risk Committee as part of the Group's governance changes aligned with its application for IRB status.

In addition, the Group's Executive Committee provides support to the CEO in the day-to-day running and management of the Group.

All committees operate within defined terms of reference and sufficient resources are made available to them to undertake their duties. The terms of reference of the Board's main committees, being Audit, Nomination, Risk and Compliance and Remuneration are available on the Group's website.

Board and committee attendance

The attendance of individual directors at the regular meetings of the Board and its main committees in the year is set out below, with the number of meetings each was eligible to attend shown in brackets. Directors who are unable to attend meetings receive the papers and any comments from them are reported to the relevant meeting. Directors have attended a number of ad hoc meetings during the year in addition to the regular Board meetings and have contributed to discussions outside of the regular meeting calendar.

Director	Board	Audit Committee	Risk and Compliance Committee	Remuneration Committee	Nomination Committee
Fiona J Clutterbuck	10 (10)	-	5 (5)	4 (4)	5 (5)
Nigel S Terrington	10 (10)	-	-	-	-
Richard J Woodman	10 (10)	-	-	-	-
John A Heron	9 (10)	-	-	-	-
Peter J N Hartill	10 (10)	6 (6)	5 (5)	4 (4)	5 (5)
Hugo R Tudor	10 (10)	6 (6)	5 (5)	4 (4)	1 (1)
Barbara A Ridpath	10 (10)	6 (6)	5 (5)	-	4 (4)
Finlay F Williamson	10 (10)	6 (6)	5 (5)	-	-
Graeme H Yorston	10 (10)	1 (1)	5 (5)	3 (3)	-
Alan K Fletcher	2 (2)	-	-	-	-
Patrick J Newberry	2 (2)	1 (1)	1 (1)	1 (1)	0 (0)

Directors also attended an annual two-day strategy event, held off site, to enable further, more detailed, discussion of the Group's position and future development. This strategy event has been a regular fixture in the Group's governance calendar for a number of years and recently has also been attended by the Group's executive management group.

The Remuneration Committee held a workshop and a number of ad hoc meetings of its working group in respect of the proposed new policy during the year.

Conflicts of interest

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

The Board recognises the benefits that can flow from non-executive directors holding other appointments but requires them to seek the agreement of the Chair before entering into any commitments that might affect the time they can devote to the Company.

Whistleblowing

The Group maintains a whistleblowing process to enable employees or other stakeholders to raise concerns anonymously. This is described further in section B5.7.

Culture

The Group is proud of its supportive culture which has been noted as part of its Investors in People accreditation (see Section A5.2), renewed at Gold level in the year. In the financial year ending 30 September 2020 it is intended that a review of the Group's culture will be undertaken which will be considered by the Risk and Compliance Committee and any necessary actions arising from that report will be considered by the Board. It is the intention that a culture review will form an annual part of the Compliance monitoring plan in future. In addition, a review of the risk culture will be undertaken by Internal Audit and reported to the Audit Committee.

The welfare, development and engagement of employees is central to Paragon's culture. There is a robust Well-Being Strategy in place with an Emotional Well-Being Team who are fully supported and invested in by keeping their knowledge current. The Group is a member of the Lord Mayor's Appeal "This is Me" which is a campaign to provide employers with the tools to change cultures relating to mental health. During the year a number of workshops have been held on increasing education in areas such as the menopause, health and well-being, nutrition and weight management. See also Section A5.2 for information relating to how the Group invests in its people.

To encourage employee participation within our communities, a scheme was introduced in the year whereby employees have a paid annual volunteer day to use at a charity of their choice. Further detail on other charitable activities can be found at A5.4.

Board and stakeholders

The Board, in its deliberations and decision-making processes takes into account the views of the Group's stakeholders and, where applicable, considers the impact of those decisions on the communities and environment within which the Group operates. While good corporate governance is important to the Board, so too is maintaining a reputation for high standards of business conduct in all of the Group's operations, and management of conduct risk is a key part of the risk management framework. Section A5 sets out information on corporate responsibility including the Group's people policies and engagement with employees, its involvement in industry initiatives, its support for the community and its environmental, social and conduct impacts.

The People Director and the executive directors report to the Board regularly on the views of the Group's employees and the impact of new projects on the workforce is taken into account. With the 2018 Code applying to the Company from 1 October 2019 the channels for interactions between employees and the Board have been reviewed and strengthened, with the People Forum becoming the formal workforce advisory panel as provided for by the 2018 Code. For further information on the operation of the People Forum, see section A5.2 and the Chair's introduction. For information on investing in and rewarding the workforce see section A5.2.

Regard is had to the impact of principal strategic decisions on employees, for example, due diligence on potential acquisitions will consider remuneration packages in the target in comparison to Group employees. Performance on the integration of employees of acquired entities, post-acquisition, will be reported at board level.

A number of its brokers, contractors and other suppliers are of significant importance to the Group's operations and a close relationship is maintained, and reported to the Board, to help ensure that the Group runs effectively.

The Group also endeavours to maintain an open and transparent relationship with its various regulators, including the PRA and FCA. Its relationship with HMRC and the principles it applies to its tax affairs are described in section A5.4. Interactions with the PRA during the year have included meetings with the Chair and other non-executive directors as well as those involving executive directors.

Shareholders

The Board encourages communication with the Company's institutional and private investors. All shareholders have at least twenty working days' notice of the AGM at which the directors and committee chairs are available for questions. The AGM is held in London during business hours and provides an opportunity for directors to report to investors on the Group's activities, to answer their questions and receive their views. At all general meetings shareholders have an opportunity to vote separately on each resolution and all proxy votes lodged are counted and the balances for, against and directed to be withheld in respect of each resolution are announced.

The Chair, CEO and CFO have a full programme of meetings with institutional investors during the course of the year and investors' comments are communicated to all members of the Board, enabling them to develop an understanding of major shareholders' views of the Group, and take those views into account when determining strategy. During the year ended 30 September 2019 meetings were held with investors from the UK, Europe and North America. From time to time other presentations are made to institutional investors and analysts to enable them to gain a greater understanding of important aspects of the Group's business, including, this year on the introduction of IFRS 9.

The Chair of the Board, the Chair of the Remuneration Committee and the Company Secretary consulted with a number of the Company's larger shareholders during Summer 2019 to discuss remuneration policies and other corporate governance matters. The Company made approaches to all its significant shareholders and meetings were held with 18 shareholders representing approximately 69% of total voting rights. The comments received were considered by the Remuneration Committee in determining the Group's approach to executive compensation and amendments made to the initial proposals. In addition, the results of all of these meetings were reported to the Board so that all directors were made aware of shareholder views.

The Senior Independent Director is also made aware of views expressed by shareholders to other members of the Board, via the Company's brokers or through the Investor Relations team and is available to meet with shareholders should they wish. Such meetings can be arranged via the Company Secretary.

Division of responsibilities

Currently the Board consists of the Chair, three executive directors and five independent non-executive directors. At the start of the year the Board included six independent non-executive directors, and a non-independent non-executive director Alan Fletcher. Patrick Newberry and Alan Fletcher resigned on 31 December 2018. All the directors bring a broad and valuable range of experience to the Company and further details, together with other biographical details, are set out in Section B2. The Chair's other business commitments are also set out in the biographical details section.

Throughout the year the independent non-executive directors have formed the majority of the Board and consequently the balance between independent and non-independent directors has been appropriate. There is a strong non-executive representation on the Board, including the Senior Independent Director, providing effective balance and challenge. The non-executive directors meet with the Chair, from time to time, without the presence of the executive directors. All non-executive directors are appointed for fixed terms. The Chair was considered independent on appointment.

All directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that board procedures are complied with. Both the appointment and removal of the Company Secretary are matters for the Board as a whole.

The division of responsibilities between the Chair, CEO and Senior Independent Director is clearly established, set out in writing, agreed by the Board and is available on the Group's website.

Matters reserved for the Board

The schedule of matters reserved for the Board, which was reviewed during the year and is available on the Group's website, details the key matters for which the Board is responsible, including:

- Promoting the long-term sustainable success of the Company and Group, generating value for shareholders and contributing to wider society
- Setting and confirming the Group's purpose, values and strategy in a manner that aligns with and promotes the Group's culture
- Approving major capital projects and material acquisitions and disposals
- Approving the annual corporate plan including the business plan, operating and capital expenditure budgets and any material changes to them ensuring that the necessary resources are in place for the Group to meet its objectives and measure performance against those objectives
- Approving the Company's dividend and corporate governance arrangements
- Establishing procedures to manage risk, oversee the internal control framework and determine the nature and extent of the principal risks the Group is willing to take in order to achieve its long-term strategic objectives
- Ensuring that the workforce can raise any matters of concern in confidence and, if they wish, anonymously and that there are no negative repercussions from doing so

Matters considered by the Board

The Board has reviewed a number of discrete projects/items during the year as follows:

- Monitored and reviewed the Group's ongoing project for the submission of its application to the PRA in respect of IRB
- Discussed future IT strategy in particular for SME lending but also on a groupwide basis
- Discussed the integration of the Titlestone acquisition as well as the re-positioning of Paragon Development Finance
- With the Nomination Committee, considered the appointment of a new Audit Committee Chair/Senior Independent Director and other changes to the structure of its committees
- Addressed various governance regulation changes including the 2018 Code
- Considered and managed the potential impact of Brexit and other macro-economic uncertainties on the Group

In addition, it regularly receives, reviews and considers reports on the following matters:

- Strategic matters
- Potential acquisition opportunities
- Business performance
- Results, management accounts and financial commentary
- Operational reports from business areas
- Treasury and funding matters
- Legal and governance matters
- The work of the Board's committees
- Matters arising from subsidiary company board and management meetings
- Investor relations and shareholder feedback

All directors receive sufficient relevant information on financial, business and corporate issues prior to meetings.

Subsidiary governance

A number of the corporate entities within the Group are regulated either by the PRA and the FCA or solely by the FCA. The Company has oversight of these entities as part of its overall responsibility for the management of the Group and also to ensure that the Group's values and standards in regulated spheres are met.

Since the completion of the strategic reorganisation of the Group in September 2017 the directors of the Company have also comprised the Board of Paragon Bank PLC. The boards of both companies meet jointly in most circumstances and the meetings described earlier in the report (with the exception of the meetings of the Nomination Committee) were joint meetings. Oversight of Paragon Bank PLC, consequently, forms an intrinsic part of the board and committee meetings of the Company. Consequently, although Paragon Bank PLC may not be obliged to report its corporate governance arrangements against the 2016 Code, it has, since September 2017, had arrangements similar to those of the Company, excepting that it has no external shareholders.

Composition, succession

Composition and succession for the Board and senior management are considered within the Nomination Committee's report.

Board evaluation

The Board, individual directors and the Board's main committees are reviewed annually, with this year's review being an externally facilitated triennial review as required by the 2016 Code.

A number of providers were considered to undertake this important review, with Independent Board Evaluation ultimately being appointed. The lead review work was undertaken by Ffion Hague. Neither Independent Board Evaluation nor Ffion Hague have undertaken any other work for the Group and have no other connection with the Group.

The evaluation considered the performance of the Board and its Committees and all individual directors (except John Heron, who is due to retire and it is not intended to replace the executive director element of his role), including the Chair. The evaluation process consisted of detailed interviews in June 2019 with every board member. All participants were interviewed for 1.5 hours by Ffion Hague according to a set agenda, tailored for the Board. In addition, the Group's People Director, Chief Risk Officer, Director of Internal Audit and Company Secretary were also interviewed.

Draft conclusions were discussed with the Chair and subsequently discussed with the Board at its meeting in July 2019 with Ffion Hague present. Ffion Hague gave individual feedback to committee chairs on the performance of each committee and discussed the report on the Chair's performance with the Senior Independent Director. This report was subsequently discussed with the Chair. In addition, the Chair received a report with feedback on individual directors (excluding John Heron). Discussion and review of the performance of the executive directors took place at the Remuneration Committee meeting in September 2019 that considered remuneration packages for 2019/20.

A schedule of follow up matters was considered by the Board in October 2019 and actions will be refined and monitored over the next financial year.

The broad message across all contributors to the review was that the Board was covering the appropriate ground, took its responsibilities very seriously and was capable of very effective challenge, for example where acquisition decisions were being considered.

More detailed findings from the evaluation included the following against which progress will be reported next year.

Issue	Recommendation / Action
Board	
Board composition and induction	Certain skills gaps to be filled through future appointments with an emphasis on public company experience. Skills matrix to be updated and regularly reviewed by Nomination Committee, with enhanced training on bespoke topics for non-executive directors.
Succession planning	Succession plans to be enhanced with an emphasis on recruiting for public company experience and training internal candidates. A long-serving executive team requires enhanced succession planning with the depth and range of executive team experience to be enhanced. The Board will identify opportunities to meet high-potential individuals throughout the business as part of its greater focus on succession planning.
Agendas, papers and presentations	Maximising efficiency through condensing presentations, challenging the need for extraneous detail and ensuring all papers are distributed well in advance of meetings. Revised templates to be used to ensure a standard approach to presentations with an appropriate limit on length. Enhanced metrics for non-financial issues to be produced, particularly in relation to customers and employees. Work has commenced on revising presentation methods and styles and will continue during the year.
Board and committee interaction	Enhanced committee reporting to be implemented. Greater challenge in all meetings to be encouraged, with sufficient time allocated for each topic as appropriate.
Nomination Committee	
Succession planning for the Executive Directors to be a key focus for the year ahead.	This will be incorporated, in detail, into the Committee's annual timetable.
Risk and Compliance Committee	
Tighter procedure around committee papers and discipline around the separation between the Committee and main board should be adopted.	Work has commenced to revise presentation methods and styles as noted above, and this will be particularly emphasised for the Risk and Compliance Committee.

Training

The non-executive directors have received presentations during the year on various aspects of the Group's activities. The Board has dedicated one and a half days to training annually and will undertake additional training as required by the Group's strategy and operational needs. By way of example, the Board has received training/updates on such matters as IRB and IFRS9 as well as operational resilience and cyber security during the year. In addition, training has been provided by external advisers on topics such as the economy, and the markets and regulatory environments in which the Group operates or is considering operating in.

The non-executive directors also completed a variety of the regular training modules that are mandatory for all employees. Subjects covered in the year included modern slavery, equality and diversity, health and safety, data protection, money laundering, financial crime, whistleblowing, business continuity, information security and conduct risk.

The Chair concluded her induction programme during the year and this covered such areas as Asset Finance, Savings and operational resilience.

Ongoing development opportunities for all directors will be provided, as required, during the forthcoming financial year. A training schedule is maintained by the Group's Human Resources department.

At the Annual General Meeting the Chair will confirm to shareholders, when proposing the re-election of any non-executive director, that, following formal performance evaluation, the individual's performance continues to be effective and demonstrates commitment to the role. The letters of appointment of the non-executive directors will be available for inspection at the Annual General Meeting.

Audit, risk and internal control

Information on how the Group has applied the provisions of the 2016 Code relating to audit, risk and internal control is set out in section B5.

The directors' responsibility for the financial statements is described in Section B8.

Remuneration

Information on how the Group has applied the provisions of the 2016 Code relating to remuneration is set out in the Directors' Remuneration Report in Section B6.

B4
Nomination Committee

Operation of the Committee

The Committee currently comprises three independent non-executive directors and the Chair of the Board who also chairs the Committee. Additionally, during the year, Patrick Newberry was a member of the Committee until 31 December 2018 and on 24 January 2019 Graeme Yorston was appointed in his place, while Barbara Ridpath replaced Hugo Tudor. Therefore, throughout the year, all of the Committee's members were independent non-executive directors. The Chair was considered independent on appointment as Chair of the Board.

The Committee's role includes:

- Ensuring that there is a formal, rigorous and transparent procedure for the appointment of new directors to the Board of Directors of the Company; to lead the process for Board appointments and make recommendations to the Board. Ultimate responsibility for any appointment remains with the Board
- Keeping under review the structure, size and composition of the Board (including its skills, experience, independence, knowledge and diversity) and making any recommendations it deems necessary to ensure that it is effective and able to operate in the best interests of shareholders and other stakeholders
- Considering re-appointment of directors, re-election of directors and the independence of non-executive directors
- Ensuring that plans are in place for orderly succession to positions on the Board and senior management and overseeing the development of a diverse pipeline for succession to the Board and senior management roles
- Overseeing the Group's initiatives on management diversity, with a particular focus on its participation in external programmes, such as the Women in Finance Charter and reporting such as gender pay reporting

During the coming financial year, the Committee will take on the additional responsibility of monitoring workforce engagement on behalf of the Board.

Issues considered by the Committee during the year

Succession planning - Board

During the year the Committee initiated a search for a new Audit Committee Chair due to the impending retirement of Peter Hartill. This search was undertaken in conjunction with an external management consulting company (Korn Ferry) which has no other connection with the Group or any individual director. A candidate list which emphasised diversity of gender and background was requested and received from Korn Ferry. The search involved candidate interviews with various members of the Board and senior management to ensure cultural fit and the capacity for the candidate to devote sufficient time to the appointment as well as the competence in accounting and auditing necessary for the Audit Committee Chair role.

The Committee considered the balance of skills, experience, independence and knowledge on the Board and in the light of this a description of the role and capabilities required for these appointments was prepared.

In January 2019 the Committee also reviewed the structure of the Board committees following changes to the Board and it proposed that Graeme Yorston cease to be a member of the Audit Committee and became a member of the Remuneration Committee, Hugo Tudor cease to be a member of the Nomination Committee and that Barbara Ridpath be appointed to the Nomination Committee. This was part of the Committee's role to keep under review the structure, size and composition of the Board's Committee and to ensure that each non-executive director has sufficient time to undertake their committee responsibilities as well as broadening the skills base for recently appointed directors to ensure future successful operation of the committees. These changes were agreed by the Board on 24 January 2019.

Succession plans for the Board and senior management were reviewed during the financial year. The tenure of non-executive directors is monitored by the Committee. Emergency cover is in place for the executive directors and their direct reports.

Succession planning – senior management

The Human Resources department has a wider succession development plan for senior management roles across the Group, prioritising those positions likely to require recruitment within the next five years. The Committee has received reports during the year on the Group's senior leadership development programme and will continue to monitor this on a regular basis. Further information can be found in Section A5.2.

Risk mitigation for the loss of senior employees will continue to include the ongoing development of employees, as well as work to further validate potential candidates for senior positions. Development work on potential candidates occurs with those employees remaining in their current roles, as this training is undertaken so as to minimise business impact while ensuring that candidates are enabled to undertake a more senior role in due course. The Group's preference, where possible, is that internal candidates are developed and supported to undertake senior roles as this assists in the ongoing maintenance of its strong culture and values. In addition, the senior leadership development programme is also focusing on increasing the diversity of the Group's talent pool in support of the overall approach to equality and diversity.

Board skills matrix

The Committee considered a revised skills matrix at its September 2019 meeting following the outputs from the Strategy Event in June 2019. The revised matrix will reflect the strategy of the Group becoming a technology-enabled specialist bank by 2025 and as such includes skills consideration on such matters as demonstrating sound knowledge of the UK financial services sector; understanding capital requirements and liquidity models; insight into the application of technology in a financial services environment; and understanding the specialist lending sector.

Diversity

The Group recognises the importance of diversity, including gender diversity, at all levels of the organisation. The Group strongly values diversity on the Board, not only of gender, but also of experience and background, recognising the contribution such diversity can make towards achieving the appropriate balance of skills and knowledge which an effective board of directors requires. The Board is committed to ensuring, in line with the Hampton-Alexander Review recommendations, that female directors will comprise 33% of the Board by the end of 2020 and, as noted above, the Committee is endeavouring to make progress towards this target, despite a challenging market, with the candidate list that was considered for the role of Audit Committee Chair.

The Board has always believed, and continues to believe, in appointing the best person to any role regardless of gender or other points of diversity and this belief is reflected and operates across all appointments made by the Group. However, the Board recognises that measurement and publication of targets can assist in driving forward change and developing a talent pipeline in a sector where gender diversity has been difficult to achieve. For this reason, the Group signed up to HM Treasury's Women in Finance Charter initiative during 2016 and agreed targets in respect of gender and ethnic diversity amongst the Group's senior management.

By the end of September 2019 slightly in excess of 35% of senior roles, using the Hampton-Alexander measure, were female, meaning that the Group had achieved its Women in Finance Charter commitment for 35% of senior management roles to be held by women by 2022, in advance of that date. The Board will review the targets for Women in Finance during the upcoming year.

During the year the Committee reviewed the Group's gender pay report and supporting analysis. It closely monitored changes since the previous report and considered the underlying challenges with the reporting and in the management structure that make balancing gender pay difficult for the Group, as is the case for other financial services firms. This will continue to be a focus for the Committee.

As is clear from the existence of the Women in Finance initiative, obtaining full diversification of gender in the financial services sector is particularly challenging given the size of the female talent pool across the industry. Similar issues apply to advancing diversity of ethnicity in the sector. The targets adopted reflect the Board's commitment to ensuring that diversity considerations throughout the Group are wider than gender. The Committee regularly reviews the Group's Equality, Diversity and Inclusion Policy to ensure good practice is achieved and that policies are compliant with the 2016 Code requirements.

The Group's diversity policies are described in Section A5.2. The Equality, Diversity and Inclusion policy was updated during the year to reflect the 2018 Code. Information on the composition of the workforce, including the gender balance of those in senior management and their direct reports, is given in Section A5.2 and the Group's gender pay statistics are also discussed in that section.

Workforce engagement

The Committee will, in the future, receive an annual report on workforce engagement, as noted in the Chair's statement, and this will form part of its monitoring and reviewing responsibilities under the 2018 Code. In addition to the enhanced role for the People Forum, an overarching framework of workforce engagement will coordinate current employee feedback methods. These include formal structured engagement surveys (which occur in depth on an 18-month cycle as well as more regularly on ad-hoc topics), yearly employee presentations, appraisals, one-to-ones and team meetings, as well as less formal structures such as senior leaders 'walking the floor'. The results from these will be gathered by the People Director and reported to the Executive Committee and the Conduct and Compliance Committee, with the effectiveness of these channels assessed and reported on an annual basis to the Nomination Committee. All employee feedback, either using the existing methods or through the People Forum consultations with the relevant Board member(s), will be collected and analysed to distil a wide range of views for the Board to consider as part of its decision-making process.

B5
Audit Committee

B5.1 Statement by the Chair of the Audit Committee

Peter Hartill, Chair of the Audit Committee

The introduction of IFRS 9 in the period has impacted on the most significant judgemental areas of the Group's accounting...

Dear Shareholder

The year ended 30 September 2019 has been one which has seen significant developments in the auditing, accounting and reporting landscape affecting the Group combining to provide the Committee with a full agenda.

The introduction of IFRS 9 in the period has impacted on the most significant judgemental areas of the Group's accounting with the Committee having to consider the appropriateness of transition adjustments as well as the embedding of the new rules on a business as usual basis.

At the same time, the Committee had to consider changes to its remit required by the introduction of the new Code from 1 October 2019, as well as potential regulatory changes affecting accounting, reporting and auditing in the UK, including those which might arise from the various potential outcomes of the Brexit process.

Internally, as described in Section B4, the membership of the Committee was reviewed following Board changes to enable the remaining non-executive members to provide greater focus on the Committee's remit. The Committee was also subject to review as part of the external board effectiveness assessment (see section B3.2) and welcomed Sarah Mayne as the Group's new Internal Audit Director.

This activity has taken place against a background of growth and change in the Group's business, increasing regulations and guidance and increased focus on audit and reporting issues across the corporate sector as a whole.

As a Committee, our responsibility is to ensure that financial information published by the Group properly presents its activities to all stakeholders and other interested parties in a way that is transparent, useful and understandable, as well as overseeing the effective delivery of both external and internal audit services.

During the year, the Committee met five times and its principal activities were as follows:

- The review of the annual and half-yearly financial statements to ensure these properly present the Group's activities in accordance with accounting standards, law, regulations and market practice
- The consideration of the appropriateness and application of the Group's accounting policies for the recognition of interest income and loan impairment amongst other significant accounting issues
- In particular, considering the impact on accounting for credit losses of the transition to IFRS 9 from 1 October 2018. This included assessment of the approach adopted, assumptions made and disclosures provided in the Group's external and internal reporting

- The review of other financial information published by the Group, such as Pillar III disclosures required by banking regulations
- The supervision of the process leading to the appointment of a new Internal Audit Director and her induction into the business
- The supervision of the internal audit function and consideration of its findings
- Overseeing the integration of the Titlestone operation acquired in the year ended 30 September 2018 into the Group's financial reporting and control framework
- Approval of new terms of reference for the Committee to ensure compliance with the 2018 Code from 1 October 2019
- Considering the Group's readiness to address other forthcoming accounting changes which will affect it, such as IFRS 16

In the financial year ending 30 September 2020 the Committee's main priorities will include:

- Continued monitoring of the Group's IFRS 9 impairment processes in the light of best practice developments and actual outturns
- Considering ongoing developments in the regulatory environments surrounding accounting, reporting and auditing and ensuring the Group is well positioned to respond appropriately
- Ensuring that the Group's control processes evolve alongside developments in the business

This will be my last report as Audit Committee Chair, having announced my intention to stand down from the Board at the next AGM. I would like to thank my colleagues on the Committee, the Group's Internal Audit and Finance teams and the external auditors, both KPMG and the previous incumbents, Deloitte, for their contributions to the Committee's deliberations over the nine years I have served as Chair. These nine years have seen momentous changes in the Group's business, its regulatory landscape and the accounting standards affecting it, and I do not expect any reduction in the pace of change - I wish my successor well in dealing with it.

I commend this report to shareholders and ask you to support the resolutions concerning the reappointment of KPMG LLP ('KPMG') as auditors and their remuneration at the AGM in 2020.

Peter Hartill

Chair of the Audit Committee

26 November 2019

B5.2 Operation of the Committee

The Audit Committee currently comprises four independent non-executive directors of the Company whose relevant experience is set out in Section B2. Additionally, Patrick Newberry served as a member of the Committee until his resignation from the Board on 31 December 2018 and Graeme Yorston was a member of the Committee until 24 January 2019. The terms of reference of the Committee include all matters indicated by Disclosure and Transparency Rule DTR 7.1 and the Code. New terms of reference, aligned with the 2018 Code, were approved in September 2019. The Committee's key responsibilities include:

- Monitoring the integrity of the Group's financial reporting
- Reviewing the Group's risk management and internal control systems
- Monitoring and reviewing the effectiveness of the Group's Internal Audit function
- Monitoring the relationship between the Group and the external auditor

It also provides a forum through which the Group's external and internal audit functions report to the non executive directors, and the effectiveness of these functions is assessed.

The Internal Audit Director reports to the Chair of the Committee. She attends all meetings of the Committee and also reports regularly to the Risk and Compliance Committee.

The Committee considers that, as a whole, it possesses the competence relevant to the sector in which the Group operates that the Code requires. Peter Hartill has competence in accounting and auditing while other committee members have experience in various aspects of the financial services industry.

The Committee meets at least four times a year and has an agenda linked to events in the Group's financial calendar. Meetings generally take place before the half year and year end reporting dates in March and September and before the approval of results in May and November. The Committee normally invites the Chair of the Board, the executive directors, Chief Risk Officer, Group Financial Controller, Internal Audit Director and a partner and other representatives from the external auditor to attend meetings of the Committee, although it reserves the right to request any of these individuals to withdraw.

For part of each meeting the Committee meets separately with representatives of the external auditor and with the Internal Audit Director without any other persons present.

The Committee approves and monitors progress against the Group's Internal Audit Plan. It assesses the adequacy of resources available to the Internal Audit function and it receives reports of internal audit reviews conducted across the Group.

From time to time, when there are major changes in the Group's accounting policies or audit arrangements in progress, the Chair of the Committee has held meetings with shareholders and is prepared to meet investors in the future to discuss such matters.

Details of the Committee members' attendance at meetings and the Board's evaluation of the Committee's effectiveness are given in Section B3.2.

B5.3 Significant issues addressed by the Committee in relation to the Financial Statements

The Committee considers whether the accounting policies adopted by the Group are suitable and whether significant estimates and judgements made by the management are appropriate. In evaluating the Group's financial statements for the year ended 30 September 2019 the Committee considered particularly:

- The calculation of interest income under the Effective Interest Rate ('EIR') method for both internally originated and purchased loan assets and the Group's borrowings
- The levels of impairment provision against loan assets and, in particular, the transition to the impairment requirements of IFRS 9 in the period
- The requirement for any impairment provision against the purchased goodwill carried in the Group's balance sheet
- The derecognition of the assets and liabilities of the Paragon Mortgages (No. 12) PLC ('PM12') securitisation
- The valuation of the deficit in the Group's defined benefit pension scheme
- The viability statement which the Group is required to make under the Code
- The Group's capital and funding position and the Group forecasts for future periods

The Committee also considered whether this Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy.

In each of these areas the Committee was provided with papers discussing the position shown in the accounts, the underlying market conditions and assumptions and the methodology adopted for any calculations. The papers also detailed any changes in approach from previous periods. These were reviewed in detail and discussed with the relevant Group employees and the results of this work were considered, together with the results of testing by the external auditor. There were no material or significant disagreements between the management and the external auditor.

Particular matters which the Committee focused on in each of these areas were:

Matter	Particular areas of focus
Interest income and expense recognition	As required by IFRS 9, the Group recognises income from loan balances on an EIR basis, which is intended to produce a constant yield throughout the behavioural life of the loan, taking account of such matters as costs of procuration, and initially fixed or discounted interest rates. The calculation therefore rests on assumptions about the future behaviour of the Group's customers. A similar approach is taken to assessing interest on borrowings, where redemption profiles and anticipated refinancing dates influence expense recognition. The Committee assessed the appropriateness of the assumptions made, considering performance of the portfolios against expectations and the impact of changes in product specifications. Redemption profiles used in the modelling of mortgage books and the availability of alternative offerings in the market were areas of particular focus. *Further information on these estimates can be found in note 65b to the accounts, and the interest income and expense recognised on this basis is shown in notes 4 and 5.*
Loan impairment	IFRS 9 requires that companies provide for expected future credit losses on any financial asset held on the balance sheet on the amortised cost basis. As a forward-looking measure, the determination of such provisions is heavily dependent on the use of judgement and estimation techniques to evaluate the likelihood of loss on accounts and the potential amount of any loss, should one occur. In order to satisfy itself that the process applied by the Group resulted in an appropriate level of provisioning in accordance with IFRS 9, the Committee considered particularly: • The methods used to estimate probabilities of loss and potential losses • The assumptions used as inputs in these calculations • The economic projections used in deriving future loss expectation • The definitions of significant increase in credit risk, credit impairment and default for expected credit loss ('ECL') purposes To substantiate these decisions, the Committee considered actual results in the year compared to those predicted by the impairment methodology and the continuing relevance of historical information used in the process based on present economic conditions, lending and account administration practices. Particular consideration was given to the Group's receiver of rent portfolios and the level to which their ultimate loss levels accorded with expectations. The Committee also reviewed the appropriateness and adequacy of additional provisions made for particular cases and factors not allowed for in the impairment process. *Further information on these estimates can be found in note 65a to the accounts, the impairment charge for the year and the movements in provision for impairment are shown in note 23.* *The Group's exposure to credit risk is discussed in note 57.*
Goodwill impairment	The Group is required to assess, at the end of the year, whether the carrying value of the acquired goodwill balance in its accounts, which is not subject to amortisation under IFRS, remains appropriate or whether any impairment has occurred. This includes both newly acquired goodwill and goodwill arising from previous acquisitions. In considering whether any impairment of goodwill had occurred the Committee considered particularly the Group's forecasts for the cash flows to be generated by the acquired businesses and their reasonableness in the light of current trading performance and the Group's strategy for these operations. *The potential impairment of goodwill is discussed in notes 65c and 29.*

Matter	Particular areas of focus
Derecognition of assets and liabilities	During the year, the Group disposed of its residual interest in the PM12 securitisation transaction. IFRS 9 requires the directors to consider whether the terms of this transaction meet the criteria set out in the Standard for derecognition of the assets and liabilities of the securitisation. The Committee considered the contractual terms of the transaction, the changes brought about in the Group's risk exposures and the detailed rules set out in the standard. They also took account of views expressed by external technical experts. *The nature of this judgement is discussed in note 64 and the financial effect of the transaction is discussed in note 7.*
Pension deficit	The deficit on the Group's defined benefit pension plan is valued in accordance with IAS 19, which requires an actuarial valuation of the plan liabilities. Such a valuation is based on assumptions including market interest rates, inflation and mortality rates in the Plan. In order to satisfy itself as to the appropriateness of these assumptions, the Committee considered their derivation and the market data underlying them. These were compared to market benchmarks and advice from the Group's actuarial advisers. The Committee also considered benchmarking data provided by the external auditor. *Further information on the Plan deficit, the basis of valuation and the assumptions underlying it can be found in note 41 to the accounts, along with an analysis of sensitivities to the more significant assumptions.*
Viability statement	The Board is required by the Code and the Listing Rules to make a viability statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made. The Committee considered aspects of the work of the Board and its various committees which addressed the Group's business model, risk profile, access to funds and future strategy. They also considered guidance issued by the FRC and stress testing which had been carried out in the year. *A fuller discussion of the directors' consideration of the viability statement is set out in Section A4.*
Capital and funding	The Board is required by the Code and the Listing Rules to make a going concern statement in the Annual Report. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made. The Committee considered the Group's detailed forecasts and the implicit cash and capital requirements. The Committee discussed availability of funding, potential stress events and the impact of the economic environment. *A fuller discussion of the directors' consideration of the going concern statement is set out in Section A4.*
Internal Control and Risk Management	The Board is required to make statements in the Annual Report and Accounts relating to the Group's systems of internal controls and risk management. The Committee considered an evaluation prepared by the Risk function, together with the findings of internal audit reports in the year and its own engagement with the management information of the Group and the executive directors. On the basis of these activities the Committee concluded that it could advise the Board that the statements were appropriate. *The Board statements on internal control and risk management are set out in Section B3.*
Fair, balanced and understandable	The Board is required by the Code to state whether, in its view, the Annual Report is fair, balanced and understandable. The Committee has been asked to express an opinion to the Board as to whether this statement could properly be made. The Committee considered the draft Annual Report for the financial year, as a whole, satisfying itself that the process for the preparation and review of its various sections, was appropriate. The Committee especially focussed on areas where disclosure requirements had changed or where new activities were to be reported on. Based on this exercise, and the Committee's own understanding of the business in the year, it determined whether the Annual Report, overall, portrayed the Group's activities, position and results properly.

The discussion of future accounting changes required by IAS 8 (note 62) is an output of the ongoing IFRS 16 implementation project which the Committee has considered during the period and the Committee reflected upon whether the disclosure made in the accounts was appropriate.

The Committee was able to reach satisfactory conclusions on all of these areas and therefore resolved to commend the Annual Report to the Board for approval, and to advise the Board that it can conclude that the Annual Report is fair, balanced and understandable.

Earlier in the year the Committee had considered each of these areas, where applicable, in the same manner in concluding that it could commend the Group's half-yearly financial report for the six months ended 31 March 2019 to the Board for approval.

The Committees consideration of the financial statements for the year ended 30 September 2018, which took place in the year under review, is discussed in the Audit Committee report for that year.

B5.4 Other financial reporting matters considered by the Committee

IFRS 9 Transition

On 20 March 2019, the Group published a report outlining the financial and capital impacts of its transition to IFRS 9 as at 1 October 2018. The Committee considered this report and the basis on which it was prepared, in the same way as detailed for the year end under 'Loan Impairment'. It also considered its communications with the external auditors on the subject of IFRS 9 to the date of approval. Following this consideration, the Committee was able to commend the transition report for Board approval as a fair representation of the impact of transition.

Pillar III report

The CRR requires that a firm's Pillar III report is subject to the same review processes as its annual report and accounts. The Committee therefore reviewed the Group's Pillar III report, considering whether it included all material matters required by the CRR and its supporting requirements, and whether it formed a fair representation of these matters.

Correspondence with FRC

During the year, the Group's financial statements were reviewed by the Conduct Committee of the FRC. Such reviews are based on the annual report and accounts alone, and do not benefit from detailed knowledge of the Group's business or individual transactions reported upon, but are carried out by FRC staff who have an understanding of the relevant legal and accounting frameworks. FRC reviews provide no assurance as to the correctness of accounts, they consider only compliance with reporting requirements and the FRC accepts no liability to the Group or third parties in respect of them.

The Group prepared a response to the FRC which was presented to the Committee together with appropriate supporting information. These were considered by the Committee who also consulted with the external auditor before the response was provided to the FRC.

Following receipt of the response, the FRC closed its enquiry. The FRC's observations have been considered in drafting the financial statements for the year ended 30 September 2019, particularly in the compilation of the new and extended disclosures under IFRS 7, required for the first time this year.

B5.5 External auditor

The Committee is responsible for assessing the effectiveness of the external audit process, for monitoring the independence and objectivity of the external auditor and for making recommendations to the Board in relation to the appointment and remuneration of external auditors. The Committee is also responsible for developing and implementing the Group's policy on the provision of non-audit services by the external auditor, which was reviewed in the year.

Audit tendering

On 24 September 2014, the Competition and Markets Authority finalised its investigation into the audit market and published The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 (the 'Order'). The provisions of the Order are consistent with requirements introduced by European legislation. The Order first applied to the Group from the beginning of the year ended 30 September 2016 and requires that only the Committee can agree the fees and terms of service of the external auditors, initiate and supervise a tendering process or recommend the appointment of an external auditor to the Board following a tender process. The Group has complied with the requirements of the Order during the year.

KPMG were appointed as auditors, following a competitive tender process, with effect from the year ended 30 September 2016 at the Annual General Meeting in February 2016. The financial year ended 30 September 2019 is the fourth reported on by KPMG. Simon Clark has served as engagement partner since the year ended 30 September 2018. He has been involved in the audit assignment since KPMG's appointment.

The Group is therefore not subject to a legal requirement to undertake an audit tender until ten years have elapsed, and will report to shareholders no later than after the completion of the fifth year (the year ending 30 September 2020), and in each subsequent year thereafter, its conclusions on whether a further tender is in the Group's interest at that time.

Other than the legal requirements of the Order and the general constraints imposed by the current structure of the UK audit market, the Committee has not identified any factors which might restrict its choice of external auditor.

Audit effectiveness

The Committee has considered the effectiveness of the external audit for the year ended 30 September 2019 and the Group's relationship with the external auditor, KPMG, on an on-going basis, and has conducted a formal review of the effectiveness of the annual audit before commending this Annual Report to the Board. This review consisted of the following steps:

- A list of relevant questions was considered by senior management who submitted their responses in writing to the Committee in advance of the meeting convened to consider the Annual Report
- The Committee members considered their experience of the audit process in advance of that meeting
- At the meeting the Committee discussed the results of the exercise with the senior financial management of the Group, without the external auditor present
- The Committee then addressed the evaluation, as appropriate, with the external auditors

The Committee was able to conclude, on the basis of this exercise and its experience over the year, that the external audit process remained effective and that the auditor was independent and objective, up to the signing date of this report. A further review will be carried out following the completion of audit procedures on all Group companies and reported on in next year's Annual Report.

The effectiveness review addressing the conduct of the 2018 audit, undertaken at the time of approval of the 2018 Group accounts was updated once the external audit process for all Group companies had been completed and affirmed the original conclusion, that the external audit was independent and objective and that the audit process was effective for that financial year.

In conjunction with the effectiveness review, before recommending the re-appointment of the External Auditor, the Committee must consider whether they are able to provide the required service to the appropriate standard and are independent of the Group. To this end, the Committee considered whether KPMG's understanding of the Group's business, their access to appropriate financial services and regulatory specialists within their firm, both locally and nationally, and their understanding of the sectors in which the Group operates were appropriate to the Group's needs.

As part of this exercise the Committee also considered the transparency report presented by the external auditor and the FRC's most recent audit inspection review on KPMG, published in July 2019. In this report the FRC noted that while results at KPMG had improved year-on-year, the firm remained subject to increased regulatory scrutiny. The Committee received a presentation from the external auditor which described the steps being taken by the firm to enhance audit quality and discussed this and the FRC findings with the audit partner and other representatives.

As a result of these exercises the Committee concluded that it would recommend to the Board that a resolution to reappoint KPMG as external auditor for the year ending 30 September 2020 should be proposed at the forthcoming AGM.

Independence policy

Both the Committee and the external auditor have safeguards in place to avoid any compromise of the independence and objectivity of the external auditor. The Committee considers the independence of the external auditor annually and the Group has a formal policy for the engagement of its external auditor to supply non-audit services, reviewed, most recently, in September 2019. The policy is designed to ensure that neither the nature of the service to be provided nor the level of reliance placed on the services could impact the objectivity of the external auditor's opinion on the Group's financial statements.

The policy precludes the appointment of the external auditor to provide any service where there is involvement in management functions or decision making, or any service on which management might place primary reliance in determining the adequacy of internal controls, financial systems or financial reporting. It also precludes the external auditor from providing tax or remuneration advice. Internal audit services may not be provided by the external auditor. The Committee must approve any engagement of the external auditor for non-audit work, except where the fee involved is clearly trivial. The policy sets out rules for the employment of former employees of the external auditor and procedures for monitoring such persons within the organisation.

The Committee reviews, on a regular basis, the levels of fees paid to all major accounting firms to identify any matters which might impact on those firms' ability to tender for the group audit at any future date.

Fees paid to the external auditor

Fees paid to the external auditor are shown in note 13 to the accounts. No services other than services required to be provided by external auditors by legislation or regulation, such as the review of half-yearly financial information and profit verification for regulatory purposes, were provided by KPMG.

Audit fees of Group entities for the year have increased by 16.4% to £1,352,000 (2018: £1,161,000). This was a result of an increase in scope as a result of acquisitions and additional work related to the introduction of IFRS 9.

No fees were paid to KPMG, the Group's external auditor, for non-audit services during the year (2018: £68,000, excluding VAT).

The EU Audit Regulation (which is directly applicable in the UK for the time being) contains a 70% cap on non-audit fees for services provided to EEA Public Interest Entities ('PIEs') including audit-related services other than those services required by EU or national law. The calculation applies for the first year commencing after June 2019 which means that this restriction applies from the Group's year ending 30 September 2020. Non-audit fees paid to the auditor for the year ending 30 September 2020 should be no more than 70% of the average of the audit fees for 2017, 2018 and 2019, expected to be approximately £750,000.

The Group actively considers other providers for the type of non-audit services typically provided by accounting firms. It maintains on-going relationships relating to tax, remuneration and regulatory advice with firms other than the external auditor's firm and considers discrete projects on a case-by-case basis. The Group has engaged with a number of firms, including some outside the 'big four' largest audit firms for assignments during the year, assessing each firm's appropriateness for the particular assignment before an appointment was made. Fees paid to audit firms (excluding VAT), excluding the Group audit and related fees, can be analysed as shown below:

	2019	2018
	£000	£000
Auditors – KPMG	**-**	68
Other big four firms	**2,393**	926
Other firms	**6**	3
	2,399	997

The Group maintains relationships with all of the major accounting firms and considers a variety of providers for this type of assignment.

B5.6 Internal Audit

The Committee is responsible for considering and approving the remit of the internal audit function, approving the internal audit plan, and ensuring it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee also ensures that the internal audit function has adequate standing and is free from management or other restrictions which may impair its independence.

Operations

During the year, the Committee considered and approved the annual internal audit plan, which is based on an assessment of the key risks faced by the Group. Progress in respect of the plan is monitored throughout the year and the Committee assesses, on an ongoing basis, whether the internal audit function has sufficient and appropriate skilled resources to complete the plan. With the approval of the Committee, the audit plan and the related resource requirement may be revised during the year, based on the ongoing assessment of the key risks or in response to the requirements of the Group.

The Internal Audit Director met regularly throughout the year with the Chair of the Committee to discuss progress against plan, outstanding agreed actions, and departmental resourcing. Ahead of finalisation of the audit plan for the year ending 30 September 2020, the Chair of the Committee met with the Internal Audit Director to discuss audit planning priorities, key business risks and assess current resourcing.

During the year, the appointment process for the Group's new Internal Audit Director was finalised and she took up her appointment in November 2018. Following her appointment, she underwent a thorough programme of familiarisation with the Internal Audit function and the Group's activities and, following this, considered potential enhancements to the Internal Audit approach.

At the request of the PRA, as part of a market-wide review, during the year ended 30 September 2019, internal audit has undertaken specific review work to assess the adequacy of management information provided to the Board to measure and monitor operational resilience against risk appetite. This review was co-sourced under an agreement with a third-party accounting firm on a subject matter expertise basis. Certain other technical or specialist reviews of the first and second line have also been undertaken including an element of co-sourced input where it was deemed by the Internal Audit Director that such skills would complement and develop those of the internal team.

All internal audit reports are circulated to the Board. Significant findings of internal audit reports are discussed at meetings of the Committee throughout the year. Overdue actions graded medium or above are reviewed and challenged at both the Committee and the Risk and Compliance Committee.

Effectiveness

The Committee assesses the effectiveness of the Internal Audit function by reference to standards published by the Chartered Institute of Internal Auditors. In 2019, the Committee considered the output of an internal quality assessment prepared on this basis and concluded that the function was satisfactory.

An external quality assessment ('EQA') was last commissioned in 2018 to benchmark internal audit activities against best practice and peers. Progress on the EQA actions arising from this review has been reported to and monitored by the Committee in the year to ensure they are being properly addressed.

As a matter of policy, the Committee intends to commission an EQA at least every five years.

B5.7 Whistleblowing

The Group has an established procedure whereby employees can make disclosures regarding malpractice within the Group on a confidential basis, in accordance with the Public Interest Disclosure Act 1998 ('PIDA'). The policy also makes provision to ensure that no employee making such a disclosure suffers any detriment by doing so. A whistleblowing service is operated for the Group, at arm's length, by a third-party charity, Protect. This process was supervised by the Committee during the year and any amendments to the policy required the approval of the Chair of the Committee.

During September 2019, responsibility for receiving and acting on whistleblowing reports was transferred from the Committee to the Board, in accordance with the requirements of the 2018 Code. The Committee will retain responsibility for reviewing the operation of the process.

There is a right of appeal, currently to the Chair of the Committee, where the employee is dissatisfied with the outcome and his decision is final in all cases.

To ensure that the policy is embedded in the operations of the Group all employees received training on the requirements of PIDA and the Group's policy during the year and were tested to ensure their understanding. There were also internal publicity campaigns promoting the whistleblowing procedures.

During the year ended 30 September 2019, a small number of whistleblowing incidents were investigated. Each matter was fully reviewed by the Whistleblowing Committee and subsequently considered by the Committee. The investigation found that none of the incidents were material in nature. Whilst actions did arise following the investigations, these were minor.

B6
Remuneration report

This report covers the activities of the Remuneration Committee for the year ended 30 September 2019 and sets out the remuneration details for the executive and non-executive directors of the Company. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended, and the principles of the Code.

This report consists of the Statement by the Chair of the Committee (B6.1), the Annual Report on Remuneration (B6.2) and the full Remuneration Policy (B6.3) proposed to apply from the close of the Annual General Meeting to be held on 13 February 2020.

B6.1 Statement by the Chair of the Remuneration Committee

Dear Shareholder

The philosophy underpinning the Group's remuneration policy remains unchanged and continues to be adopted throughout the organisation; seeking to recognise fairly and equitably the contributions of all employees within the Group. For executive directors, the aim is to ensure that their rewards are aligned with the interests of shareholders through the achievement of both the Group's shorter term and strategic objectives, whilst meeting the core objective of being motivating and retentive. The Committee listened to the feedback at the 2019 AGM and recognised the need to alter the approach to determining short term incentive awards, in particular to remove the scalar in the year ended 30 September 2019 for the executive directors. The results of this are set out in the Annual Report on Remuneration.

Hugo Tudor, Chair of the Remuneration Committee

The philosophy underpinning the Group's remuneration policy remains unchanged... seeking to recognise fairly and equitably the contributions of all employees within the Group...

Business performance

The year saw growth in the Group's loan books, with new lending up 8.5% to £2,532.4 million which contributed to an increase in underlying profit by 5.0% to £164.4 million. Profit before tax on the statutory basis fell by 12.4% to £159.0 million following a £28.0 million gain on Idem Capital assets in 2018. This led to underlying EPS increasing by 6.0% to 51.1 pence (2018: 48.2 pence) and statutory EPS decreasing to 49.4 pence (2018: 55.9 pence).

Funding was enhanced with the continued growth of the Group's savings deposit base to £6.4 billion from £5.3 billion a year earlier, whilst continuing to access the capital markets through the latest securitisation. The Group's capital position remains strong, with a regulatory CET1 ratio of 13.7% (2018: 13.8%), representing a more efficient capital position enhanced by the sale of a legacy residual securitisation investment and accompanying share buy-back.

Variable pay earned in the year

Reflecting on shareholder feedback, during the year the Committee made some changes to the operation of the annual bonus. These changes reflect current best practice and support the introduction of the new policy set out below. The personal scalar element has been removed from the bonus framework and the assessment of performance has transitioned to a scorecard of performance metrics: 30% financial performance, 30% strategic and future value, 20% risk management, 20% personal performance.

The Committee has reflected the strong performance in the year when applying the existing remuneration policy and changes made to the operation of the bonus following shareholder feedback at the 2019 AGM. Performance bonuses of 89.4% of maximum for Mr N S Terrington, Mr R J Woodman and Mr J A Heron have been awarded. In reaching its decision the Committee has reviewed performance against a number of financial and risk-based targets, as well as taking individual performance into account.

This year's bonus awards reflect the executive directors' excellent performance in achieving an increase in underlying profit, RoTE, NIM progression and new lending (details of which are noted further in the report) within a turbulent and uncertain external environment and replacing income lost through the amortisation of the Idem Capital portfolio. The objectives are detailed in section B6.2.2, including disclosure of the target range for the year ended 30 September 2019, as well as retrospective disclosure for the year ended 30 September 2018. This year's target range is being disclosed immediately following the financial year for the first time in response to shareholder feedback.

Long term incentive awards under the Paragon Performance Share Plan ('PSP') which were granted in December 2016 are due to mature in December 2019. These awards are subject to performance conditions related to a Total Shareholder Return ('TSR') performance condition, measured against a bespoke comparator group of listed financial services entities (50% of the award), EPS growth (25% of the award) and for the first time a risk condition based on factors including regulatory, customer, conduct, operational, credit, capital and liquidity risks (25% of the award).

The performance of the business over the three-year performance period was very strong, leading to the TSR element vesting in full, and the EPS (22.94% out of a possible 25.00%) and risk (22.50% out of a possible 25.00%) elements vesting at near maximum. The outcome of the risk condition has been independently assessed by the Committee, supported by the Chair of the Risk and Compliance Committee and the Group's Chief Risk Officer. The Committee has considered the financial underpin for these awards, which for the 2016 award was different for Bank employees at the time prior to vesting, and agreed that based on this evaluation, 95.44% of these awards will vest on 1 December 2019.

Shareholder engagement and key changes to the remuneration structure for 2020

The current remuneration policy was approved by shareholders at the 2017 AGM to apply for a period of three years. Therefore, the Group's remuneration policy must be put to the shareholders again at the 2020 AGM and, consequently, the Committee undertook a full and comprehensive review of the policy during the year. Since the 2019 AGM, an active dialogue with the majority of the Group's major shareholders has been maintained and a series of productive and helpful consultations have taken place with me, the Chair of the Board and the Company Secretary. A total of 18 shareholders took part in these consultations, equating to approximately 69% of total voting rights (based on the Company's total voting rights as at 30 September 2019) and I am extremely grateful for their constructive feedback. These meetings were positive in tone whilst appropriately challenging and, importantly, have helped to shape the Committee's thinking in the design of the new policy.

Continued strong and sustainable growth for the Group will mean it is likely to be subject to increased financial services specific remuneration requirements during the lifetime of the new policy. As a result, the Committee is proposing a significant restructuring of the balance between fixed and variable pay for the executive directors, as well as potentially longer time horizons on pay in due course, and the key changes are set out below.

The policy is intended to apply for the three years following the 2020 AGM, in line with the legal requirement. In developing the new policy, the Committee had four key objectives:

- Responding to shareholder feedback

  Defining a balanced set of metrics which reward fairly, drive the Group's strategy, align to the Group's values, promote a strong culture and are supported by shareholders

- Addressing regulatory requirements over the lifetime of the new policy

  The Committee anticipates the Group, during the policy lifetime, becoming subject to increased levels of remuneration regulation as a larger firm (known as a Level 2 CRD IV firm). Consequently it needs to rebalance pay to ensure compliance with the 2:1 variable pay cap in readiness for this change now, so that shareholders have full visibility of the remuneration changes ahead

- Delivering alignment with the 2018 Code

  Develop policies which will be compliant going forward including improving alignment on pension provision

- Meeting the Committee's remuneration philosophy

  Apply the same reward principles throughout the Group to motivate and retain senior management and key roles critical to the delivery of the Group's strategy, rewarding fairly for strong performance and delivering a balanced package of fixed and variable pay, short and long term incentives with a focus on using equity

To reflect the objectives and to meet the requirements of CRD IV the Committee is proposing to:

- Introduce a cap on variable remuneration of twice fixed remuneration
- Increase the base salary of the CEO and CFO by 19% to support in rebalancing remuneration
- Introduce a fixed role-based allowance, paid in shares and released in five equal annual tranches
- Reduce pension contributions from 45% of salary to 20% of salary for incumbent executive directors to align with average contributions made to the wider workforce. For new external hires, pension contributions to be 10% of salary
- Reduce the maximum annual bonus opportunity from 200% of salary to 150% of salary
- Reduce the maximum annual PSP opportunity from 200% of salary to 180% of salary
- Reduce weighting on relative TSR under the PSP with awards granted under the new policy assessed against a broader scorecard of metrics: 25% relative TSR, 25% EPS, 25% risk, 25% customer and people metrics
- Introduce a two year holding period post vesting for the PSP
- Introduce a formal post-employment shareholding requirement to align executive directors' interests further with those of shareholders
- Extend malus and clawback provisions to ensure the Committee has the appropriate authority to reduce remuneration in the appropriate scenarios
- Introduce significantly extended deferral and retention variable pay requirements once the Group becomes a PRA Level 2 remuneration firm to align with regulatory rules and expectations for Senior Managers

The impact of all of these changes is for the cash paid to executive directors to be slightly lower but with the addition of the role-based allowance the non-variable element of the package increases by approximately 18%. At maximum the total package increases by about 3.5% reflecting an inflationary increase for the year. We considered carefully the argument to reduce this, reflecting the greater certainty from a higher non-variable package, but, in light of the significant deferrals that arise from CRD IV, we believe that this would be unreasonable.

Overall, variable pay will continue to be a key component of reward but is rebalanced to address the fact the Group is on the cusp of Level 2 status. Pension is significantly reduced to bring closer alignment with provision for the average of the workforce and variable pay will be more heavily geared to long term and equity incentives. The role-based allowance will deliver further value in equity and extending this allowance over five years will drive shareholder alignment.

The most important challenge for the Committee will be to continue to ensure that the remuneration policy remains appropriately structured to retain and motivate the executive directors, whilst providing alignment with shareholders and, critically, directly linking to the achievement of the Group's strategy.

I commend this report to shareholders and ask you to support the resolutions to approve the Company's Directors' Remuneration Report and the new remuneration policy set out in Section B6.3.

Hugo Tudor

Chair of the Remuneration Committee

26 November 2019

B6.2 Annual report on remuneration

Remuneration summary

The information provided in this section is not subject to audit

Aligning our pay principles to our strategy during the year ended 30 September 2019:

The success factors on which the Group's strategic priorities are based	Translation into reward principles and structure	
	Bonus	**Performance share plan**
Credit quality	Risk measures and future value of new business	Risk assessment
Loan pricing	Future value of new business and financial performance	EPS growth and TSR
Funding	Risk measure and financial performance	EPS growth, TSR and risk assessment
Strong financial foundations	Financial performance	Relative TSR, EPS and risk assessment
Efficient utilisation of the Group's capital base	Risk measures	Relative TSR and risk assessment
Cost control	Profit measures and personal objectives	EPS growth
A customer focused culture	Personal objectives	Risk assessment includes customer engagement measures
These success factors deliver enhancement of shareholder value and align with the Group's reward structure		

At a glance summary of remuneration during the year ended 30 September 2019:

	Salary increase	Salary	Bonus earned as % of maximum	PSP vesting
		£000		
N S Terrington	**3%**	**503**	**89.4%**	**95.44%**
R J Woodman	**3%**	**317**	**89.4%**	**95.44%**
J A Heron	**3%**	**268**	**89.4%**	**95.44%**

The annual report on remuneration includes:

- The Remuneration Committee, its key responsibilities and advisers (B6.2.1)
- The remuneration of the directors for the year ended 30 September 2019 (B6.2.2)
- How the remuneration policy will be applied to the directors in the year ending 30 September 2020 (B6.2.3)
- Other disclosures required by the Regulations (B6.2.4)
- Policy for executive and non-executive directors for approval at the AGM in 2020 (B6.3)

B6.2.1 The Remuneration Committee, key responsibilities and advisers

The information provided in this section is not subject to audit

Committee membership during the year ended 30 September 2019

The members of the Committee during the year were:

Hugo Tudor	Chair
Fiona Clutterbuck	Member all year
Peter Hartill	Member all year
Graeme Yorston	From 24 January 2019
Patrick Newberry	Until 31 December 2018

None of the non-executive directors who sit on the Committee has any personal financial interest (other than as a shareholder) or conflict of interest arising from cross-directorships or day-to-day involvement in running the business.

Key responsibilities

The Committee determines the Company's policy on executive remuneration, including pension rights and compensation payments of the executive directors. It sets the remuneration for each of the executive directors, the Chair of the Board, the Company Secretary, all Senior Management and Certification Regime personnel under the rules of the PRA/FCA which includes the Director of Internal Audit and the Chief Risk Officer.

The Committee will also review workplace remuneration and related policies and the alignment of incentives and rewards with culture; and when setting the policy for executive director remuneration, take into account those matters.

It will also consider the Group remuneration policy for all employees (excluding executive directors) and review and approve the Group's schedule of Material Risk Takers, under financial services regulatory remuneration rules.

No director contributes to any decision about his or her own remuneration.

The terms of reference for the Committee are available on the Group's website.

Attendees

The CEO, People Director, Chief Risk Officer, Company Secretary, other non-executive directors (including the Chair of the Risk and Compliance Committee) and external remuneration advisors attend by invitation.

Advisors

During the year, the Committee considered advice from:

- Deloitte LLP ('Deloitte') who were appointed as the Committee's independent advisor in February 2016 following a review process. Deloitte is a founder member of the Remuneration Consultants Group and as such voluntarily operates under its Code of Conduct in relation to executive remuneration in the UK. This supports the Committee's view that all advice received during the year was objective and independent

  The total fees paid to Deloitte for advice to the Committee during the year amounted to £160,000 (including VAT). Deloitte provided other professional services to the Group during the year including share scheme advice, regulatory support, customer contact support and co-sourced internal audit services

- The CEO, the Chair of the Risk and Compliance Committee, the People Director and Chief Risk Officer in determining remuneration for the year for executive directors and senior management

Statement of voting at Annual General Meeting

The table below sets out actual voting in respect of the resolutions to approve the Annual Report on Remuneration at the Company's AGM on 14 February 2019 and the Remuneration Policy at the AGM on 9 February 2017.

Resolution	Votes for	% for	Votes against	% against	Total votes cast	Votes withheld
Annual Report on Remuneration	170,875,932	86.36	26,986,282	13.64	197,862,214	6,557,937
Remuneration Policy	195,090,537	95.06	10,145,210	4.94	205,235,747	4,242

B6.2.2 Directors' remuneration for the year ended 30 September 2019

The information provided in this section has been audited

Single total figure of remuneration for executive directors

Year ended 30 September 2019	N S Terrington £000	R J Woodman £000	J A Heron £000	Total £000
Fixed remuneration				
Salaries and fees	**503**	**317**	**268**	**1,088**
Allowances and benefits[1]	**14**	**12**	**12**	**38**
Benefits in kind from the performance of duties[2]	**11**	**-**	**15**	**26**
Pension allowance	**226**	**143**	**121**	**490**
Variable remuneration				
Cash bonus	**687**	**437**	**372**	**1,496**
Deferred bonus	**212**	**129**	**107**	**448**
Dividend on vested deferred bonus[3]	**-**	**-**	**25**	**25**
Share awards	**1,222**	**769**	**651**	**2,642**
Total	**2,875**	**1,807**	**1,571**	**6,253**

Year ended 30 September 2018	N S Terrington £000	R J Woodman £000	J A Heron £000	Total £000
Fixed remuneration				
Salaries and fees	489	308	260	1,057
Allowances and benefits[1]	14	12	12	38
Benefits in kind from the performance of duties[2]	7	-	20	27
Pension allowance	220	138	117	475
Variable remuneration				
Cash bonus	672	428	364	1,464
Deferred bonus	207	126	105	438
Dividend on vested deferred bonus[3]	-	16	-	16
Share awards[4]	817	515	436	1,768
Total	2,426	1,543	1,314	5,283

1. "Allowances and benefits" includes private health cover, fuel benefit and company car provision or company car allowance (£10,000 to £12,000).

2 "Benefits in kind from the performance of duties" – the Company reimburses executive directors in respect of certain travel costs incurred in connection with the performance of their duties. The Group has been advised that the reimbursement of some of these costs constitutes a taxable benefit in kind. The Group has agreed to provide an allowance to these directors to cover the tax liability. The amounts shown represent the payments HMRC treats as taxable together with an allowance to cover the tax.

3. Dividend on vested bonus is the accrued dividends to the date of exercise paid on deferred bonuses which were exercised during the year. Under the policy which was adopted at the 2017 AGM, dividends will accrue to the point of vesting on deferred share awards made in respect of the year ended 30 September 2017 and thereafter.

4. The share awards value for the year ended 30 September 2018 has been restated to reflect the market value of the shares under the PSP that vested on 22 December 2018 as at that date.

Pension allowance and pension accruals

Nigel Terrington, Richard Woodman and John Heron were members of the Paragon Pension Plan ('the Plan'), the Group's defined benefit pension plan, until 30 September 2016. Following which time, they took a cash equivalent transfer of benefits in the Plan, receiving a lump sum value on a no gain, no loss basis and have no further entitlement.

The executive directors had previously ceased pension accrual under the Plan in return for a cash supplement calculated, as a percentage of salary, to equate to the cost of the Group's contributions towards future service benefits had each individual stayed within the Plan for their future service accrual. This supplement was assessed every three years and was last assessed by the Group's actuaries during 2017. Following this assessment, recognising the substantial cost to the Group of meeting these obligations, the Committee asked the executive directors to agree to fix this cash supplement at 45% of base salary so that the Group would have known costs associated with pension provision. For all three directors, the fixed percentage was a lower amount than their actual contractual entitlement based on the most recent figures presented by the Group's actuaries.

These contributions in respect of further pension provision for each of the directors are shown as 'pension allowance' in the single total figure of remuneration table. The change to 45% was made with effect from 1 April 2017, and no compensation was paid or payable to the executive directors in respect of this change.

Annual bonus

The annual bonus for the year ended 30 September 2019 was based on performance against business, financial and risk measures and personal strategic objectives. The personal element was altered part way through the year in response to shareholder feedback at the 2019 AGM with the scale factor removed and a broader range of financial measures considered by the Committee. Consequently, the bonus award allocation was as follows:

Balanced scorecard of objectives	Maximum award	Bonus outcome
Financial performance Operating profit Return on tangible equity Net Interest Margin ("NIM") progression Net loan increases	30%	23.6%
Future value and strategic development Development activities Pipeline Embedded value Liability management	30%	25.8%
Risk management Operation within levels for risk tolerance metrics agreed by the Board	20%	20.0%
Personal performance Delivery against personal objectives	20%	20.0%
Total	**100%**	**89.4%**

Balanced scorecard assessment

Performance for the year and the resulting award levels in respect of the business element were as follows:

Measure	Weighting	Threshold	Target	Stretch	Actual	Outcome	Overall
Financial performance	**30%**						
Underlying profit	45%	£160.0m	£164.0m	£170.0m	£164.4m	24.1	
Underlying RoTE	40%	14.0%	14.25%	14.50%	14.60%	40.0	
Underlying NIM progression	10%	0.02%	0.05%	0.08%	0.08%	10.0	
Net loan increases	5%	3.0%	5.0%	7.5%	7.0%	4.5	
						78.6	23.6%
Future value & strategy	**30%**	Qualitative assessment by the Committee of:					
Development activities	25%	Development activities during the year PM12 disposal Expanded savings addressable market			PM12 disposal at premium to book value with enhancement to capital ratios Retail funding now exceeds £6.4bn	20.0	
Pipeline	25%	The pipeline and its support for the delivery of the following year's strategy assessed by reference to mix, trends, yield and quality considerations			Underlying NIM at 2.29% and underlying RoTE at 14.6%	23.0	
Embedded value	25%	New originations during the year assessed by reference to diversification strategy, credit standards and yield considerations			Specialist buy-to-let lending 88.8% of total at £1,315.2m, including a high proportion of five-year products at good margin. Total non-buy-to-let lending at £1,057.9m	20.0	
Liability management	25%	Qualitative assessment by the Committee of achievements during the year			First SONIA securitisation Savings addressable market expanded from £130bn to £225bn through proposition development	23.0	
						86.0	25.8%
Risk	**20%**						
• Strong capital ratio • Strong liquidity ratios with proactive management to counter potential Brexit threats • Best in class credit risk management • Total number of complaints and operational losses remained well within appetite • Conduct Risk framework further embedded with increased quality assurance focus • Progress in operational resilience risk management						20.0	20.0%
Personal performance	**20%**						
As detailed in the directors' individual performance below						20.0	20.0%

Individual performance assessments

The following overarching objectives were applicable to all executive directors:

- Provide strategic leadership to deliver the business plan aligned to the Group's strategy
- Deliver the planned financial performance within the parameters of the Group's risk appetite
- Safeguard fair outcomes for customers to ensure they are central to the Group's operations
- Ensure secure and stable platforms are in place to deliver longer term strategic goals
- Embed the restructure across processes, systems and ways of working to maximise value
- Ensure the Group meets all risk, compliance and regulatory requirements
- Comply with the Senior Managers and Certification Regime and ensure it is embedded
- Protect the Group's strong culture with capable and motivated employees

The directors' individual objectives, in addition to those above, and the assessments made are set out below:

Executive director	Individual targets	Actual performance
N S Terrington	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything the Group does and extending the Paragon brand and all within the Group's risk management framework, the following annual personal objectives were agreed:	
	Broaden the Group's presence as a leading UK specialist lender	Specialist buy-to-let lending 88.8% of total at £1,315.2m (2018: £1,185.5m)
	Deliver strong organic new business generation	Total non-buy-to-let lending £1,051.9m (2018: £837.7m)
	Actively assess M&A opportunities to broaden the Group's diversification strategy	Continued proactive assessment of a number of potential opportunities to diversify the Group's strategy
	Drive the business towards the optimisation of RoTE on a sustainable basis over the medium term	Volume and margin management and financial risk management has positioned the Group for future growth with underlying NIM at 2.29% and underlying RoTE at 14.6%
	Develop an increased awareness of conduct risk to appropriately control and monitor inherent and residual risks	Conduct risk increasingly embedded with enhanced QA and improved complaints monitoring
	Build a succession plan pipeline for Executive Committee roles	Implementation of senior leadership development programme with a cohort of 21 internal high potential individuals

Executive director	Individual targets	Actual performance
R J Woodman	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do and extending the Paragon brand and all within the Group's risk management framework, the following annual personal objectives were agreed:	
	Optimise the Group's funding costs to support lending activities	Retail funding from customers' deposits now exceeds £6.4bn Paragon Mortgages (No. 12) PLC executed providing enhancement to capital ratios
	Continue to advance the Group's application for IRB authorisation	IFRS 9 first full year delivered without any issues Considerable increase in activity to the point the application is ready for submission, including the creation of a bespoke stress testing framework
	Ensure actions progress to support the Group's diversity targets	Women in Finance Charter target achieved 16 months ahead of original plan
	Continue to provide oversight of the funding required and liquidity management	Strong performance during a particularly busy year for transactions, system changes and pricing Further strong progress in reducing Group encumbrance levels towards sector norms
	Continue to provide oversight and management of the investor relations programme including equity analysts	Strong engagement with analyst community

Executive director	Individual targets	Actual performance
J A Heron	In addition to strong leadership, delivery of the Group's business plan and financial performance, upholding our corporate values, ensuring our customers are at the heart of everything we do, management of all buy-to-let activities, lending controls and customer engagement, all within the Group's risk management framework, the following annual personal objectives were agreed:	
	Achieve £1,612.4m of buy-to-let and second charge mortgage originations	Lending in line with the levels indicated to the market with a strong pipeline and an outstanding credit performance
	Enhance the customer and intermediary experience through redefined processes	NPS averaging +65 compared to +45 for the sector, strong and successful launch of an intermediary portal
	Develop bespoke commercial underwriting offering with individual terms and pricing	Yields and NIM maintained notwithstanding industry wide pressures, leading to a more favourable business mix than originally planned

Annual bonus outcome

The resulting bonuses for the year ended 30 September 2019 were as follows:

Executive director	Financial performance	Future value and strategy	Risk	Personal performance	Total	Total	Cash	Share value
						£000	£000	£000
N S Terrington	23.6%	25.8%	20.0%	20.0%	89.4%	899	687	212
R J Woodman	23.6%	25.8%	20.0%	20.0%	89.4%	566	437	129
J A Heron	23.6%	25.8%	20.0%	20.0%	89.4%	479	372	107

25% of amounts awarded in excess of £50,000 are deferred into nil cost options under the Deferred Share Bonus Plan ('DSBP') which can be exercised after three years. No further performance conditions apply to the deferred shares.

Retrospective disclosure of business element targets for the year ended 30 September 2018

The threshold and maximum performance targets in relation to the business element performance conditions for the financial year ended 30 September 2018 are no longer considered commercially sensitive and are therefore disclosed below. Actual performance has also been provided for reference.

Measure	Threshold performance	Target	Maximum	Actual
Financial performance				
Adjusted operating profit	£148.9m	£156.8m	£164.6m	£156.5m
Future value of new business				
Lending	£2,221.8m	£2,338.7m	£2,455.6m	£2,333.2m
Debt purchase investments	£54.0m	£60.0m	£66.0m	£83.4m
Risk	The future value of new business was written in line with the Group's required return and risk appetite. The Group operated within the risk tolerance levels set by the Board for capital ratios, liquidity positions, new business and operational and regulatory risk. It also developed its plan to mitigate longer term strategic risk.			

Performance Share Plan

Awards vesting in respect of the year ended 30 September 2019

Awards granted in December 2016 under the Group's PSP are subject to performance conditions measured over the three financial years ended 30 September 2019.

Performance condition	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting	Actual performance	Vesting outcome
Relative TSR*	50%	Median performance	Upper quartile performance	Above upper quartile	100.00%
EPS growth	25%	RPI plus 3% p.a.	RPI plus 7% p.a.	RPI plus 6.56% p.a.	91.74%
Risk	25%	n/a	n/a	90%	90.00%
Total as a % of maximum award					**95.44%**
Total as a % of salary at grant					**190.88%**

* The comparator group for TSR purposes agreed at the time of grant was: Aldermore Group PLC, Arrow Global Group PLC, Barclays PLC, Close Brothers Group PLC, CYBG PLC, Lloyds Banking Group PLC, Metro Bank PLC, OneSavings Bank PLC, Provident Financial PLC, Royal Bank of Scotland Group PLC, Shawbrook Group PLC, Secure Trust Bank PLC and Virgin Money Holdings (UK) PLC.

There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions and no reward below threshold performance. The risk metric measures the Group's performance against six equally weighted risk categories - material regulatory breaches, customer service, management of liquidity and capital risk, credit losses against risk appetite, management of conduct risk, material risk events over the performance period. The performance of the Group against these metrics was independently assessed by the Committee, supported by the Chair of the Risk and Compliance Committee and the Group's Chief Risk Officer, and the outcome reflects the strong level of performance over this period.

Vesting was also subject to the Committee's determination, in respect of the financial underpin, whether the level of vesting reflected the overall financial performance of the Group.

The vesting percentage has been reviewed by the Committee and details of the shares which will vest on 1 December 2019 are set out below.

	Total shares granted	Vesting outcome	Total shares awarded[1]	Share price[2]	PSP value
				£	£000
N S Terrington	262,114	95.44%	250,161	4.3706	1,222
R J Woodman	165,074	95.44%	157,546	4.3706	769
J A Heron	139,753	95.44%	133,380	4.3706	651

1. In accordance with the rules of the PSP, participants are entitled on exercise to additional value equal to the dividends that would have been paid on vested shares in respect of dividend record dates between the grant date and vesting date. Accordingly, the share award values also include £0.5130 per vested share in respect of such dividends.

2. The PSP value has been estimated using the average closing share price for the three months ended 30 September 2019. The actual value of the awards will not be known until the awards vest in December 2019, as it will be based on closing share price at that date.

Awards granted during the year ended 30 September 2019

On 14 December 2018 the following awards were granted under the PSP with a face value of 200% of salary.

Executive director	Salary	Percentage grant	Face value of grant	Share price[1]	Number of shares
	£000		£000	£	
N S Terrington	503	200%	1,006	4.4300	227,156
R J Woodman	317	200%	634	4.4300	143,059
J A Heron	268	200%	537	4.4300	121,117

1. Based on the average closing mid-market price of the Company's shares on each of the five dealing days following the announcement of the Company's results for the financial year ended 30 September 2018, being the price used to determine the number of shares in accordance with the Directors' Remuneration Policy.

The PSP awards are subject to the following performance conditions, with a performance period of the three years ending 30 September 2021:

Performance measure	Weighting	Threshold vesting for 25% of maximum award	Maximum vesting
Relative TSR	50%	Median performance	Upper quartile performance
EPS	25%	Basic EPS of 60 pence	Basic EPS of 68 pence or more
Risk	25%	Based on an assessment of a balanced scorecard of risk and compliance factors (see below)	

There is straight-line vesting between the threshold and maximum for the TSR and EPS conditions and no reward below threshold performance.

In addition, prior to any awards vesting under any element, the Committee must be satisfied that the individual's performance and the underlying financial performance of the Company are satisfactory given the level of vesting.

Reflecting the Group's evolution and growth, the Committee determined that achievement of absolute EPS targets would be more appropriate than measuring EPS growth relative to RPI as was indicated in the Directors' Remuneration Report last year (particularly given the external economic climate). The Committee is satisfied that these absolute EPS targets are no less stretching than the relative growth targets originally proposed but are more relevant and transparent for all stakeholders.

Relative TSR measure

The comparator group for the purposes of the relative TSR condition is:

Amigo Holdings PLC	Arrow Global Group PLC	Barclays PLC	Charter Court Financial Services Group PLC
Close Brothers Group PLC	Funding Circle Holdings PLC	Lloyds Banking Group PLC	Metro Bank PLC
OneSavings Bank PLC	Provident Financial PLC	Royal Bank of Scotland Group PLC	Secure Trust Bank PLC
S&U PLC	Virgin Money UK PLC		

Risk measure

The risk management performance condition is assessed by reference to risk management performance and the application of a strong risk culture across the Group taking into account:

Material regulatory breaches	Customer service	Management of liquidity and capital risk
Credit losses against risk appetite	Management of conduct risk	Material risk events over the performance period

Disclosure of assessment against performance of the risk element will be made in the Annual Report on Remuneration for the year of vesting.

Chairman and non-executive director fees

	Year ended 30 September 2019			Year ended 30 September 2018		
	Fees	**Benefits**	**Total**	Fees	Benefits	Total
	£000	**£000**	**£000**	£000	£000	£000
Chair of the Board						
F J Clutterbuck	**255**	**14**	**269**	159	5	164
Non-executive directors						
A K Fletcher[1]	**16**	**-**	**16**	65	-	65
P J N Hartill	**95**	**-**	**95**	88	-	88
P J Newberry[2]	**16**	**-**	**16**	65	-	65
B A Ridpath	**65**	**-**	**65**	65	-	65
H R Tudor	**85**	**-**	**85**	70	-	70
F F Williamson	**85**	**-**	**85**	85	-	85
G H Yorston	**65**	**-**	**65**	65	-	65
Total	**682**	**14**	**696**	662	5	667

1. Resigned from the Board on 31 December 2018. In addition to the fees earned as a non-executive director, Mr A K Fletcher served as a director of the Corporate Trustee of the Plan and received £4,000 (2018: £15,000) during the year in respect of that appointment from Paragon Finance PLC, the sponsoring company of the Plan and a subsidiary of the Group, while serving as a director of the Company.

2. Resigned from the Board on 31 December 2018.

Directors' share interests

The interests of the executive directors in the shares of the Company at 30 September 2019 (including those held by their connected persons) were:

	N S Terrington Number	R J Woodman Number	J A Heron Number
Unvested awards subject to performance conditions			
PSP[1 2]	**432,348**	**272,286**	**230,518**
Unvested awards not subject to performance conditions			
DSBP	**138,897**	**84,059**	**63,503**
Sharesave	**12,026**	**12,026**	**-**
Total unvested awards	**583,271**	**368,371**	**294,021**
Vested but unexercised awards			
PSP[2]	**542,090**	**437,218**	**133,380**
DSBP	**168,232**	**63,482**	**-**
Total vested but unexercised awards	**710,322**	**500,700**	**133,380**
Shares beneficially held	**781,269**	**226,051**	**274,723**
Total interest in shares	**2,074,862**	**1,095,122**	**702,124**
Awards exercised in the year[3]			
PSP	**-**	**-**	**100,440**
DSBP	**-**	**-**	**41,150**
Sharesave	**-**	**-**	**7,216**
Total awards exercised in the year	**-**	**-**	**148,806**

1. In addition to the unvested PSP awards in the table, each executive director holds a tax qualifying option under the Company Share Option Plan ('CSOP') over 6,279 shares at an exercise price of £4.7776 per share, as part of the awards granted on 8 December 2017. If a CSOP option is exercised at a gain, the number of shares the director will receive under the PSP will be reduced by the same value, to ensure that the total pre-tax benefit is not increased by the grant of the CSOP options. Therefore, the value of each award, in aggregate, is equivalent to that of a PSP award and the CSOP options may be disregarded in determining the value.

2. For the purposes of the table above the awards granted in December 2016 are assumed to be vested but unexercised in respect of the percentage which it is estimated will vest (95.44%) and to have lapsed in respect of the balance.

3. The PSP and DSBP awards were exercised on 27 June 2019, when the share price was £4.3446. The Sharesave awards were exercised on 5 August 2019 when the share price was £3.9240.

The interests of the Chairman and the non-executive directors at 30 September 2019, which consist entirely of ordinary shares, beneficially held, were as follows:

	2019
F J Clutterbuck	**8,372**
P J N Hartill	**7,000**
B A Ridpath	**2,358**
H R Tudor	**100,000**
F F Williamson	**3,000**
G H Yorston	**2,307**

As at 31 October 2019, the last practicable date prior to approving this Report, the Company has not been advised of any changes to the interests of the directors and their connected persons as set out in the tables above.

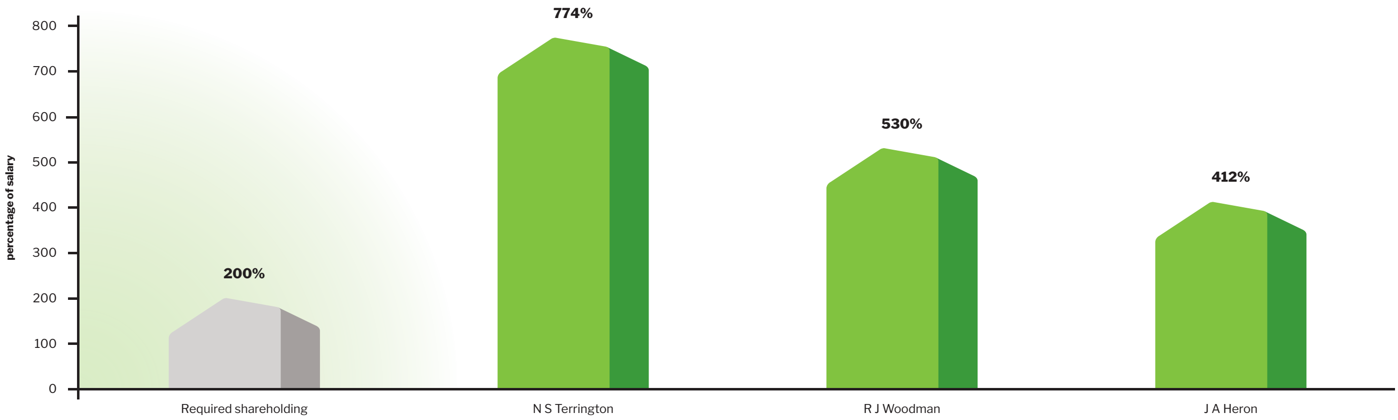
Share ownership guidelines

All executive directors are encouraged to hold a minimum number of shares in the Company with a value of 200% of their salary, calculated at 31 December each year. The valuation for shares held before 1 January 2017 is based on the average price of the Company's shares over a rolling three-year period. For shares acquired after that date the valuation is based on the market value of the shares at the date of acquisition. The value, net of income tax and national insurance, of vested but unexercised shares granted under the DSBP and under the PSP count towards the aggregate shares held by each director in respect of the policy.

The chart below compares the executive directors' holdings at 30 September 2019 to those required by the guidelines, expressed in value terms as a percentage of salary at 30 September 2019.

Directors' shareholding guidelines

30 September 2019



At 30 September 2019, all of the executive directors' holdings were in accordance with guideline levels.

B6.2.3 Application of remuneration policy for the year ending 30 September 2020

The information provided in this section of the Directors' Remuneration Report is not subject to audit. The details set out are subject to shareholder approval of the new policy at the 2020 AGM.

Executive directors

Base salary

To reflect the rebalancing of fixed and variable pay in readiness for Level 2 banking status during the life of the new policy, the salaries of Nigel Terrington and Richard Woodman will increase by 19%, backdated to 1 October 2019, subject to approval at the 2020 AGM.

The salary for John Heron was increased by 3% from 1 October 2019, in line with the level of increases for the Group's wider workforce. Mr Heron is retiring prior to the proposed policy for the year ending 30 September 2020 being put to shareholders for approval.

	Salary with effect from	
	1 October 2019	1 October 2018
	£	£
N S Terrington	**598,754**	503,150
R J Woodman	**377,087**	316,875
J A Heron	**276,350**	268,275

Allowances and benefits and pension contributions

Pension contributions will reduce from 45% of salary to 20% of salary for incumbent executive directors to align with average contributions made to the wider workforce. For new external hires pension contributions will be 10% of salary.

A fixed role-based pay allowance will be introduced, paid in shares over five years and released in five equal annual tranches. The allowance is structured to meet all fixed pay tests within the EBA guidelines. The allowance will be £140,000 p.a. for Mr N S Terrington and £90,000 p.a. for Mr R J Woodman. No role-based allowance will be payable to Mr J A Heron as he intends to retire from the Group prior to the Annual General Meeting in February 2020.

Allowances and benefits remain unchanged other than pension contributions and the introduction of a fixed role-based pay allowance to meet the requirements of CRD IV.

Annual bonus

The annual bonus structure is based on a revised scorecard of measurements; 30% on financial performance, 30% on future value of new business and strategic management, 20% on risk management and 20% on personal performance.

The Committee has chosen not to disclose, in advance, the performance targets for the forthcoming year as these are felt to be commercially sensitive. Retrospective disclosure of the targets and performance against them will be set out in next year's Annual Report on Remuneration except to the extent that any measure/target remains commercially sensitive.

The maximum award will reduce to 150% of salary (previously 200%). Executive directors will continue to be required to defer 25% of amounts awarded in excess of £50,000 in shares. The Committee may require higher levels of deferment or the executive may elect to defer a greater proportion. However, it is anticipated that deferral arrangements will remain unchanged until such point as the Group becomes a larger banking group and therefore subject to PRA level 2 remuneration requirements.

PSP awards

Award levels for executive directors is reduced to 180% (previously 200%) of base salary. The performance conditions and targets are summarised below:

Performance measure	**Weighting**	**Threshold vesting for 25% of maximum award**	**Maximum vesting**
Relative TSR	25%	Median performance	Upper quartile performance
Basic EPS	25%	60.0p	67.0p or more
Risk	25%	50% weighting on an assessment from the Chief Risk Officer of the six key elements of the Group's risk appetite: regulatory breaches, customer service, conduct, operational, capital and liquidity and credit losses 50% weighting on a strategic risk assessment to reflect the management of risk with regard to the delivery of the Group's medium term strategy	
Customer and people	25%	50% weighting on Customer elements which are not disclosed due to commercial sensitivity but will be on vesting. This element will be evaluated by the Chair of the Risk and Compliance Committee 50% weighting on People elements, which will consider employee engagement, voluntary attrition and diversity targets compared to industry averages	

There is straight-line vesting between threshold and maximum and no reward for below threshold performance.

In addition, prior to any awards vesting, the Committee must be satisfied that the individual performance and underlying financial performance of the Group are satisfactory given the level of vesting.

Relative TSR test

The comparator group for the purposes of the relative TSR test for the 2019/20 grant will be:

Amigo Holdings PLC	Arrow Global Group PLC	Barclays PLC	Close Brothers Group PLC
Funding Circle Holdings PLC	Lloyds Banking Group PLC	Metro Bank PLC	OneSavings Bank PLC
Provident Financial PLC	Royal Bank of Scotland Group PLC	Secure Trust Bank PLC	S&U PLC
Virgin Money UK PLC			

Chair of the Board's and non-executive directors' fees

	Fee with effect from	
	1 October 2019	1 October 2018
	£000	£000
Chair of the Board's fee	**255**	255
Base fee for non-executive directors	**65**	65
Additional fee for Senior Independent Director	**10**	10
Additional fee for chairs of committees[1]	**20**	20

1. The additional fee for chair of committees is currently payable to the Chairs of the Remuneration, Audit, and Risk and Compliance Committees, but would be payable for the chairing of such additional committees as might be authorised by the Board.

B6.2.4 Other information

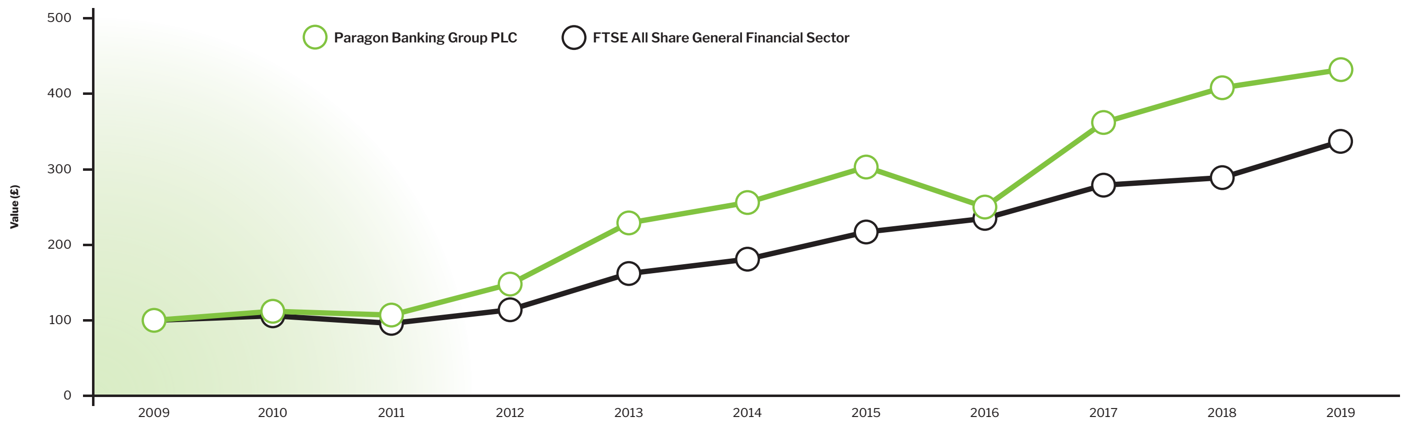
The information provided in this section of the Directors' Remuneration Report is not subject to audit

Performance graph and table

The following graph shows the Company's TSR performance compared with the performance of the FTSE All Share General Financial sector index. This graph shows the value, by 30 September 2019, of £100 invested in Paragon Banking Group PLC on 30 September 2009, compared with £100 invested in the FTSE General Financial sector index. The General Financial sector has been selected for this comparison because it is the sub-sector index that contains the Company's shares.

Ten-year return index for the FTSE All Share General Financial Sector

Ten years ended 30 September 2019



The following table shows the total remuneration, as included in the single figure table, and the amount vesting under short-term and long-term incentives as a percentage of the maximum that could have been achieved, in respect of the CEO, Mr N S Terrington, over the past ten years.

	Single figure of total remuneration	**Annual bonus earned against maximum opportunity**	**Long-term incentive vesting outcome against maximum opportunity**
	£000	**%**	**%**
2019	2,875	89.4	95.44
2018	2,426	90.0	72.47
2017	2,305	90.0	63.51
2016	1,956	75.0	50.00
2015	2,546	100.0	100.00
2014	3,113	100.0	100.00
2013	2,655	85.0	100.00
2012	2,565	87.5	100.00
2011	2,382	87.5	58.60 and 85.10
2010	1,209	75.0	58.60

Percentage change

The following table shows the change in certain aspects of the remuneration of the CEO, Mr N S Terrington:

Component	**2019**	2018	Change
	£000	£000	%
Salary	**503**	489	3
Benefits[1]	**14**	14	-
Benefits in kind in performance of duties[2]	**11**	7	57
Bonus	**899**	879	2

1. 'Benefits' includes private health cover, fuel benefit and company car provision or company car allowance.

2. 'Benefits in kind from the performance of duties' arise where the Group reimburses executive directors in respect of certain travel costs incurred in connection with the performance of their duties. The Group has been advised that the reimbursement of some of these costs constitutes a taxable benefit in kind. The Group has agreed to provide an allowance to Mr Terrington to cover the tax liability. The amount shown represents the payments HMRC treats as taxable together with an allowance to cover the tax.

The Group's pay review taking effect on 1 October 2018 awarded average percentage increases in wages and salaries to employees as a whole of 3.10% (1 October 2017: 3.21%).

The Group awarded average bonus levels for the year ended 30 September 2019 of 3.71% (2018: 2.98%).

The nature and level of benefits available to employees in the year ended 30 September 2019 was broadly similar to that in the previous year.

CEO pay ratio

The table below sets out the CEO pay ratio at the 25th, median and 75th percentile employees within the Group. The Group used Option A as defined in The Companies (Miscellaneous Reporting) Regulations 2018, as this calculation methodology was considered to be the most accurate method. The 25th, median and 75th percentile pay ratios were calculated using the full time equivalent remuneration (prepared in the same manner as those for the single figure table) for all UK employees during the financial year. Certain employees participate in discretionary bonus schemes and long term incentive schemes.

	Base salary	**Total remuneration**	**CEO pay ratio**
25th percentile	£21,000	£24,000	119:1
50th percentile	£29,000	£32,000	90:1
75th percentile	£53,000	£54,000	53:1

Base salaries shown above are the base salaries relating to the relevant identified employees.

The Group aims to provide a competitive remuneration package which is appropriate to promote the long-term success of the Group and to apply this policy fairly and consistently to attract and motivate staff.

Relative importance of spend on pay

Set out below is a summary of the Group's levels of expenditure on pay and other significant cash outflows.

	Note	**2019**	2018	Change
		£m	£m	£m
Wages and salaries	*10*	**62.6**	57.2	5.4
Dividend paid	*45*	**54.0**	43.1	10.9
Loan advances and investment in portfolios		**2,536.6**	2,416.6	120.0
Corporation tax paid	*46*	**39.4**	32.0	7.4

Loan advances and investment in portfolios is shown above as this is the principal application of cash used to generate income for the Group. Corporation tax is contributed out of profit to the UK Government.

Executive directors' share interests

The individual interests of the executive directors under the PSP are as follows:

	Award date	**Market price**	**At 1 October 2018**	**Awarded**	**Lapsed**	**Exercised**	**At 30 September 2019**	**Exercisable from**
			Number	**Number**	**Number**	**Number**	**Number**	
N S Terrington	18/12/2014	409.60p	103,548	-	-	-	103,548	18/12/2017
	22/12/2015	362.70p	188,381	-	-	-	188,381	22/12/2018
	01/12/2016†	369.40p	262,114	-	11,953	-	250,161	01/12/2019
	08/12/2017*	483.20p	205,192	-	-	-	205,192	08/12/2020
	14/12/2018	401.00p	-	227,156	-	-	227,156	14/12/2021
R J Woodman	10/12/2013	345.30p	69,525	-	-	-	69,525	10/12/2016
	18/12/2014	409.60p	91,508	-	-	-	91,508	18/12/2017
	22/12/2015	362.70p	118,639	-	-	-	118,639	22/12/2018
	01/12/2016†	369.40p	165,074	-	7,528	-	157,546	01/12/2019
	08/12/2017*	483.20p	129,227	-	-	-	129,227	08/12/2020
	14/12/2018	401.00p	-	143,059	-	-	143,059	14/12/2021
J A Heron	22/12/2015	362.70p	100,440	-	-	100,440	-	22/12/2018
	01/12/2016†	369.40p	139,753	-	6,373	-	133,380	01/12/2019
	08/12/2017*	483.20p	109,401	-	-	-	109,401	08/12/2020
	14/12/2018	401.00p	-	121,117	-	-	121,117	14/12/2021

† For the purpose of the table above, these awards are assumed to be vested in respect of the percentage which it is assumed will vest (95.44%) and to have lapsed in respect of the balance.

* On 8 December 2017 each executive director was granted CSOP options over 6,279 shares, at an exercise price of £4.7776 per share, as part of his PSP award. If a CSOP option is exercised at a gain, the number of shares that may be delivered under the PSP will be reduced at exercise by the same value to ensure that the total pre-tax benefit is not increased by the grant of the CSOP options.

The individual interests of the executive directors under the DSBP are as follows:

	Award date	Market price	At 1 October 2018	Awarded	Exercised	At 30 September 2019	Exercisable from
			Number	Number	Number	Number	
N S Terrington	10/12/2013	345.30p	55,302	-	-	55,302	10/12/2016
	18/12/2014	409.60p	52,888	-	-	52,888	18/12/2017
	22/12/2015	362.70p	60,042	-	-	60,042	22/12/2018
	01/12/2016	369.40p	44,493	-	-	44,493	01/12/2019
	08/12/2017	483.20p	42,055	-	-	42,055	08/12/2020
	14/12/2018	401.00p	-	52,349	-	52,349	14/12/2021
R J Woodman	18/12/2014	409.60p	26,965	-	-	26,965	18/12/2017
	22/12/2015	362.70p	36,517	-	-	36,517	22/12/2018
	01/12/2016	369.40p	26,742	-	-	26,742	01/12/2019
	08/12/2017	483.20p	25,517	-	-	25,517	08/12/2020
	14/12/2018	401.00p	-	31,800	-	31,800	14/12/2021
J A Heron	18/12/2014	409.60p	19,249	-	19,249	-	18/12/2017
	22/12/2015	362.70p	21,901	-	21,901	-	22/12/2018
	01/12/2016	369.40p	17,849	-	-	17,849	01/12/2019
	08/12/2017	483.20p	19,217	-	-	19,217	08/12/2020
	14/12/2018	401.00p	-	26,437	-	26,437	14/12/2021

The individual interests of the executive directors under the Sharesave Plan are as follows:

	Award date	Option price	At 1 October 2018	Awarded	Exercised	At 30 September 2019	Exercisable from
			Number	Number	Number	Number	
N S Terrington	20/06/2016	249.44p	12,026	-	-	12,026	01/08/2021
R J Woodman	20/06/2016	249.44p	12,026	-	-	12,026	01/08/2021
J A Heron	20/06/2016	249.44p	7,216	-	7,216	-	01/08/2019

B6.3 Policy report

The information provided in this part of the Directors' Remuneration Report is not subject to audit

Introduction

This part of the Directors' Remuneration Report sets out the directors' remuneration policy that is proposed to apply from the close of the Annual General Meeting to be held on 13 February 2020. The policy, once approved, will apply until the Annual General Meeting in 2023, unless revised by a vote of shareholders ahead of that time.

Summary of Proposed Changes

The Company's current directors' remuneration policy was approved at the 2017 AGM with over 95% votes in favour, and took effect from the date of that meeting.

As highlighted in the Remuneration Committee Chair's statement, in light of recent corporate governance developments and the Group likely to become subject to more stringent banking remuneration rules on the transition from a smaller Level 3 bank to a Level 2 CRD IV bank during the life of this policy, it was necessary to undertake a detailed review of the remuneration policy to ensure full compliance and alignment with market practice.

With this regulatory change in mind, the remuneration policy has been drafted with sufficient flexibility to ensure that we are able to remain compliant as the regulatory status of the bank changes. It is the Committee's intention that the revised remuneration policy will apply in two stages.

As a result of the revised 2018 Code the following changes are being proposed:

- **Pension** – reduction in the maximum pension contribution to 20% of salary for all incumbent executive directors to align with the average contributions made in respect of the wider workforce. New executive directors would receive a maximum pension contribution of 10% of salary
- **PSP** – introduction of a post-vesting holding period of two years for awards granted in respect of financial year 2019/20 and any subsequent year when the Group is not a Level 2 bank
- **Post-employment shareholding guidelines** – executive directors will now be required to retain an interest in the Company's shares for two years following cessation of employment
- **Malus and clawback** – extension of the provisions under which malus and clawback provisions can be applied to variable pay. We have also taken the opportunity to align with market practice and regulatory expectations
- **Discretion** – introduction of a discretion enabling the Committee to apply judgement to all variable pay outcomes

Additionally, in anticipation of the Group's transition from a Level 3 to a Level 2 bank, further changes are proposed to rebalance the remuneration package in light of the CRD IV bonus cap requirements and significantly extend the deferral and holding periods applicable to variable pay, as follows:

- **Role-based allowance** – introduction of a role-based allowance for all executive directors to reflect market practice for dealing with compliance with the bonus cap requirement. Each quarter the executive directors will receive shares which will be subject to release over a period of five years from the relevant payment date, with a proportion of the shares released in equal tranches on each anniversary
- **Bonus** – reduction in opportunity from 200% to 150% of salary. On transition to a Level 2 bank, bonuses will no longer ordinarily be deferred as a result of the significantly extended deferral and holding periods attached to PSP awards, however 50% of annual bonus awards will be paid in shares that will be subject to a one year holding period
- **PSP** – reduction in opportunity from 200% to 180% of salary. On transition to a Level 2 bank, vesting will occur in equal tranches between the third and seventh anniversary of grant. A further 12-month post-vesting holding period will apply to each tranche

Elements of the remuneration policy for executive directors

The executive directors receive a combination of fixed and performance-related elements of remuneration. Fixed remuneration consists of salary, benefits, pension scheme contributions or alternative retirement benefit provision and a role-based allowance. Performance-related remuneration consists of participation in the annual bonus plan (including deferral) and the award of shares under the PSP. The performance-related elements of remuneration are intended to represent an appropriate proportion of executive directors' potential total remuneration.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Base salary			
To provide a competitive, fixed cash component that reflects the scope of individual responsibilities and recognises sustained individual performance in the role.	Remunerate fairly for individual performance, having regard to the importance of motivation. Base salaries are typically reviewed annually, taking into account a number of factors including (but not limited to) the value of the individual, the scope of their role, their skills and experience and their performance. The Committee also takes into account pay and conditions of employees in the Group as a whole, business performance and prevailing market conditions.	While there is no maximum salary, if the Committee is satisfied with the individual's performance, increases will normally broadly follow those awarded for the rest of the organisation, in percentage of salary terms. Increases above the level awarded for the rest of the organisation may be awarded in appropriate circumstances which may include, but are not limited to: • Changes in the scope or responsibilities of a director's role; • Development or performance in role; • A change in the size and/or complexity of the business; • Change in market practice or a director's salary substantially falling behind a market competitive rate; and/or • External factors such as changes in regulatory requirements	Whilst no formal performance conditions apply, an individual's performance in role is taken into account in determining any salary increase.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Benefits			
To provide market levels of benefits on a cost-effective basis.	Private health cover for the executive and their family, life insurance cover of up to seven times' salary and company car or cash alternative. Other benefits may be offered from time to time taking into account individual circumstances.	Private health care benefits are provided through third party providers and therefore the cost to the company and the value to the director may vary from year to year. Whilst no absolute maximum level of benefits has been set, the level of benefits provided is determined taking into account individual circumstances, overall cost to the business and market practice.	None.
Retirement benefits			
To provide competitive post-retirement benefits.	Executive directors receive an annual contribution to the Company defined contribution pension scheme or a cash supplement in lieu of contribution (or a combination thereof).	Maximum 20% of salary for incumbent executive directors and 10% of salary for newly recruited executive directors.	None.
Fixed role-based allowance			
To maintain a competitive remuneration package with an appropriate balance of fixed and variable remuneration, with delivery in shares for shareholder alignment.	Annual allowance paid quarterly or at any other frequency that the Committee deems appropriate, on the basis that the after tax value is delivered in shares which are released to the executive director on a pro-rata basis over a five year period (or such other period as may be determined by the Committee from time to time). The role-based allowance is non-pensionable and is not taken into account for annual bonus and PSP purposes. The Committee retains the discretion to amend the retention period and/or pay the fixed role-based allowance in cash if required to do so to meet any regulatory requirements.	The fixed role-based allowances are determined based on the role, skills and responsibility of each individual and taking into account market competitiveness of total remuneration. The maximum role-based allowance is £140,000 p.a. for the CEO and £90,000 p.a. for the CFO. Any other executive director (including those appointed during the period for which this policy applies) may be eligible for a role-based allowance of up to 25% of salary. The fixed role-based allowance will be payable with effect from 1 October 2019, subject to approval of this policy at the forthcoming AGM.	None.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Annual bonus			
To incentivise executives to achieve specific, predetermined goals that drive delivery of the Company's operational objectives. To reward individual performance. To encourage retention and alignment with shareholders' interests through deferral of a proportion of bonus, awarded in shares.	Each executive director's annual bonus is based on a mix of financial and non-financial performance measures, measured over one year. The annual bonus is non-pensionable. Malus and clawback apply to the annual bonus as described in the notes to this table. A portion of the annual bonus may be deferred and/or may be paid in shares, dependent on the regulatory status of the bank and at the discretion of the Committee. Awards under the DSBP can take the form of a nil-cost option with a ten-year life, a conditional award of shares or an award of forfeitable shares. The use of this deferral is described below.	Maximum annual bonus potential is 150% of salary in respect of any given financial year. For target performance, a bonus of 75% of salary will be awarded, with additional amounts being awarded for exceptional performance. If a bonus is based on a strategic measure or personal objective, the Committee will determine the extent of vesting between 0% and 100% based on its assessment of the extent to which the measure or objective has been achieved. For performance below threshold, no bonus is payable.	The performance targets are set by the Committee at the start of the year with input, as appropriate, from the Chair of the Board and Chief Executive. Performance measures and their weightings are reviewed annually to maintain appropriateness and relevance. Performance is assessed against a range of measures, with at least 50% relating to financial metrics and any balance reflecting non-financial measures (including risk) and/or achievement of key personal and strategic measures.

Implementation in 2019/20 and any other year in which the Group is not a Level 2 bank:

25% of amounts awarded in excess of £50,000 will be deferred under the DSBP, to be satisfied in shares, over a deferral period of three years. Higher levels of deferral may be required by the Committee or, with the approval of the Committee may be elected for by the director. The Committee retains discretion to pay the whole of the bonus in cash in circumstances where the amount to be deferred would, in the opinion of the Committee, be so small as to make operation of the DSBP unduly administratively burdensome.

Awards may include the right to receive a number of shares determined by reference to dividends that would have been paid on shares in respect of dividend record dates between grant and vesting, which may assume the reinvestment of dividends.

Implementation as a Level 2 bank:

After the Group becomes a Level 2 bank for regulatory purposes, the PSP will be the primary vehicle for meeting the deferral requirements under the PRA remuneration requirements, although the Committee retains the right to defer such portion of an annual bonus award and over such deferral period as it determines to ensure that regulatory requirements are met.

50% of the bonus earned will be paid in cash, and 50% will be paid in shares. Any shares delivered will normally be immediately vested and may take the form of shares which must be retained for at least 12 months, or a right to acquire shares at the end of the holding period. In the former scenario, the executive director may sell shares to cover the tax liability arising on the award. In the latter scenario, the award may include the right to receive a dividend equivalent in respect of dividend record dates over the holding period. Where an award is subject to a deferral period and does not benefit from dividends or dividend equivalents to meet regulatory requirements, the number of shares to be awarded may be determined using a share price discounted for the expected dividend yield.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Performance Share Plan ('PSP')			
To incentivise executives to achieve enhanced returns for shareholders. To encourage long-term retention of key executives. To align the interests of executives and shareholders.	An annual award of shares subject to continued service and performance conditions assessed over a three-year performance period. The performance conditions used are reviewed on an annual basis to ensure they remain appropriate. Awards are structured as nil cost options with a ten-year life, a conditional award of shares or an award of forfeitable shares. Implementation of the vesting rules is described below the table. Malus and clawback apply to the PSP as described below this table.	Maximum award is 180% of salary in respect of any financial year. 25% of the awards will vest for threshold performance, with full vesting taking place for equalling or exceeding the maximum performance target. In determining the number of shares subject to an award, the market value of a share shall, unless the Committee determines otherwise, be assumed to be the average share price for the five days following the announcement of the Company's results for the previous financial year. Where awards do not receive dividends or dividend equivalents to meet regulatory requirements, the number of shares to be awarded may be determined using a share price discounted for the expected dividend yield.	The Committee will take into consideration prior performance when assessing the value of the PSP grant. Forward-looking performance is measured against a long-term scorecard of challenging performance measures that reflect the Company's strategic priorities. Performance conditions may include financial measures (e.g. adjusted EPS and/or relative TSR), and non-financial measures which may include risk-based, people and/or customer measures. Performance measures and their weightings, where multiple measures are used, are reviewed annually to maintain appropriateness and relevance.

Implementation in 2019/20 and in respect of any other year in which the Group is not a Level 2 bank:

Awards will normally vest at the end of the three year performance period and be subject to an additional two year holding period before they are released to the participant.

The holding period may be operated on the basis that the executive director is required to retain the after tax value of shares for the holding period, or that the award will only be "released", so that the executive director is entitled to acquire vested shares, at the end of that period.

Awards may include the right to receive a dividend equivalent in respect of dividend record dates between grant and release, which may assume the reinvestment of dividends.

Implementation as a Level 2 Bank:

When the Group becomes a Level 2 bank for regulatory purposes, at the end of the performance period, the performance outcome will be used to assess the percentage of the awards that will vest. These shares will then normally vest in five equal tranches, with the first vesting on or around the third anniversary of the grant date and the last instalment vesting on or around the seventh anniversary of the grant date, in accordance with the PRA remuneration rules.

Each vested tranche will be subject to an additional one year holding period, taking the form of shares which must be retained for at least the holding period, or a right to acquire shares at the end of the holding period. In the former scenario, the executive director may sell shares to cover the tax liability arising on award. In the latter scenario, the award may include the right to receive a dividend equivalent in respect of dividend record dates over the holding period.

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Sharesave Plan			
To provide all employees with the opportunity to become shareholders on similar terms.	Periodic invitations are made to participate in the Company's Sharesave Plan. A savings contract over three or five years with the funds used on maturity either to purchase shares by exercising options or returned to the participant. The option is granted at a discount to the share price at the time of grant of up to 20%. The Sharesave Plan provides tax benefits in the UK subject to satisfying certain HMRC requirements and is operated on an 'all employee' basis.	HMRC monthly savings limits apply.	None.

Malus and clawback

Annual bonus and PSP awards are subject to malus and clawback provisions in exceptional circumstances including the following:

- If a higher payment than would otherwise have been the case is paid as a result of a material misstatement of a group company's results
- Any error or inaccurate or misleading information or assumptions relating to a financial year
- If the participant is dismissed for misconduct
- If an individual was party to behaviour that resulted in serious reputational damage to a group company or a relevant business unit
- Occurrence of a material corporate failure in a group company or a relevant business unit
- If there is reasonable evidence of employee misbehaviour or material error
- A group company or relevant business unit suffers a material failure of risk management, taking account of the individual's proximity to and/or responsibility for the event

For up to three years following the payment of a cash bonus, the Committee may claw back any amount up to the gross amount of any cash bonus. DSBP and PSP awards may be reduced or cancelled before vesting or clawed back for up to two years after vesting. However, following the Company's transition to a Level 2 firm for regulatory purposes, any incentive awards may be reduced or cancelled before vesting or clawed back for a period of up to seven years from the grant date. This may be extended to ten years in the event of ongoing internal/regulatory investigation at the end of the seven-year period.

Shareholding guidelines

All executive directors are requested to hold a number of shares in the Company with a market value of 200% of their salary. The guideline must be met within a reasonable timeframe (typically expected to be within five years of appointment) and executive directors are normally required to retain 50% of the shares acquired on the vesting of fixed role-based allowance, annual bonus, PSP or DSBP awards (after sales to cover tax) until the guideline is met.

The number of shares, net of income tax and national insurance, subject to share-based awards that are no longer subject to further performance requirements granted under the fixed role-based allowance, annual bonus, DSBP and PSP count towards the aggregate shares held by each director for these purposes.

Reflecting best practice, the Committee has adopted a post-cessation shareholding requirement, effective from the adoption of this new policy. This requires that for two years following cessation, an executive director must retain such of his 'relevant' shares as have a value (as at cessation) equal to their shareholding guideline. If the executive director holds less than the required number of 'relevant' shares at any time, he must retain the 'relevant' shares he holds. Shares, which the executive director has purchased are not 'relevant' shares for these purposes.

Operation of share plans

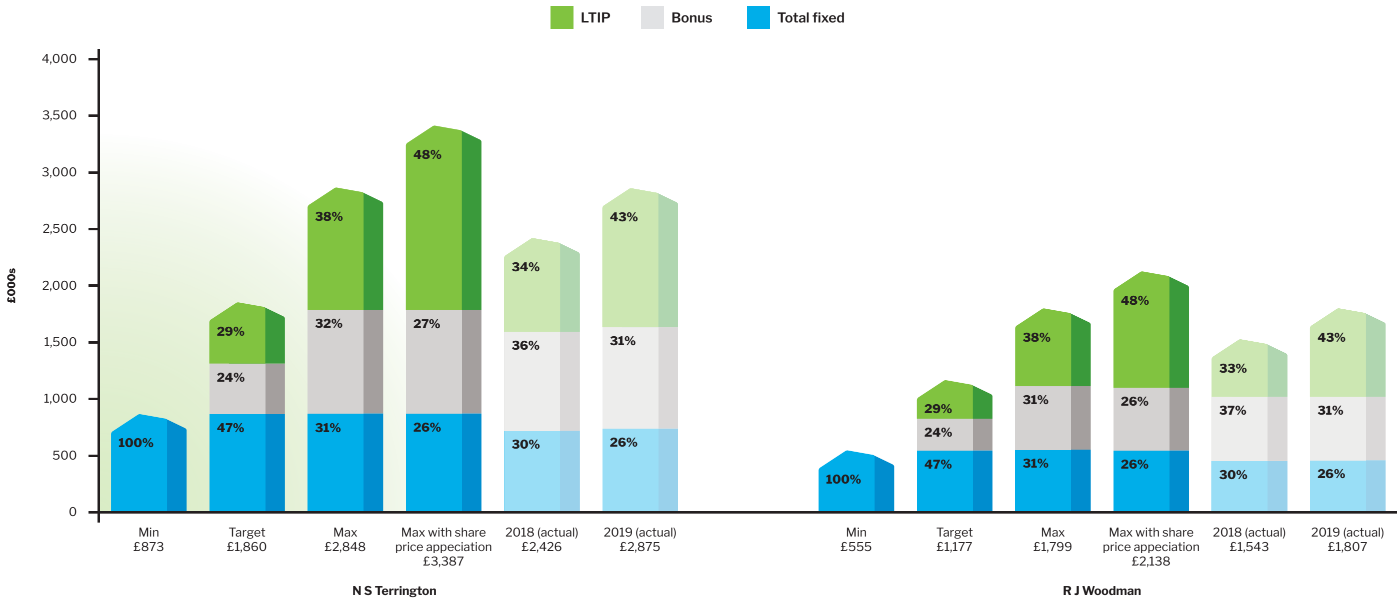
Awards under the Company's share plans (and any applicable performance conditions) may be adjusted in the event of any variation of the Company's share capital, demerger or special dividend.

Awards under the Company's share plans may vest early in the event of demerger, special dividend or other event which the Committee considers would affect the Company's share price, or in the event of a change of control. The extent to which PSP awards will vest will be determined taking into account the extent to which performance conditions have been satisfied (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed.

Awards granted over shares may be settled in cash, in whole or in part. The Company does not intend to settle awards, or dividend equivalents on awards, granted to executive directors in cash and would do so only where the particular circumstances make that appropriate, for example where there is a regulatory restriction on the delivery of shares or to enable the payment of tax liabilities relating to the award.

Illustrations of the application of the remuneration policy

The chart below illustrates the remuneration opportunity provided to each executive director at different levels of performance for the coming year, compared to their actual remuneration in the last two years:



Notes:

The basis of calculation for the above graphs and key assumptions used are as follows:

	Minimum	Target	Maximum	Maximum with 50% share price growth
Fixed elements of remuneration	• Total fixed pay is based on the latest salary and role-based allowance • Estimated cash cost to the company of benefits and pension contributions received under the remuneration policy			
Annual bonus (pay-out as % of maximum opportunity)	0%	50%	100%	100%
PSP (vesting as % of maximum opportunity)	0%	50%	100%	100% plus 50% share price growth

As Sharesave awards are provided on an all employee basis, they have not been included in the above analysis.

Elements of the remuneration policy for the Chair and non-executive directors

The Chair receives a fee, a company car or cash alternative and is eligible for private health cover on an individual or family basis in the same way as the executive directors. Non-executive directors are remunerated solely by fees. Neither the Chair nor the non-executive directors are eligible to participate in any of the Company's fixed role-based allowance, incentive or pension schemes and they are not entitled to receive compensation for early termination of their terms of engagement.

Benefits may also be provided to non-executive directors related to the performance of their duties (for example, travel and subsistence).

Purpose and link to strategy	Operation	Maximum opportunity	Performance conditions
Salary and fees			
To ensure that the Group can attract and retain the appropriate number and mix of non-executive directors with the correct experience to provide balance, oversight and challenge.	Non-executive director fees are reviewed on a periodic basis and are subject to the Articles of Association. The Chair's fee is set by the Committee, whilst the non-executive directors' fees are determined by the Board. The Board will exercise judgement in determining the extent to which non-executive directors' fees are altered in line with market practice, given the requirement to attract and retain the appropriate skills and given the expected time commitments. Non-executive directors are paid an annual base fee with additional fees for additional roles (for example, Senior Independent Director or chair of a board committee). Non-executive directors may be eligible to receive benefits such as travel and other reasonable expenses.	The Board will review fees periodically to assess whether they remain competitive and appropriate in light of changes in roles, responsibilities and/or time commitment of the non-executive directors. Increases above those awarded for the rest of the organisation may be made to reflect the periodic nature of any review. The Articles of Association of the Company contain a maximum level of fees that can be paid annually to non-executive directors (currently £2,000,000). This is reviewed by the Board from time to time. Where benefits are provided to non-executive directors, they will be provided at a level considered to be appropriate, taking into account individual circumstances.	None.

Choice of performance measures and approach to target setting

Annual bonus

The choice of the performance measures applicable to the annual bonus scheme reflects the Committee's belief that incentives should be appropriately challenging and tied to the achievement of financial and non-financial measures (including risk and other strategic measures) and key personal objectives.

The Committee reviews the measures each year and varies them as appropriate to reflect the priorities for the business in the year ahead. A sliding scale of targets is set for each measure to encourage continuous improvement and encourage the delivery of above-target performance.

PSP

The Committee will take into consideration prior Group and individual performance when assessing the value of the PSP grant level for executive directors.

Forward-looking performance is measured against a long-term scorecard of financial and non-financial performance measures that reflect the Company's strategic priorities.

Financial metrics could include EPS, which would measure long-term profitability, and/or TSR that considers shareholder value creation as a measure of market expectations of future performance. Other non-financial metrics could include risk or customer and people measures that would provide a focus on key measures of Company's long-term sustainability. Any risk metrics would be assessed across a range of quantitative and qualitative measures which are business critical.

Discretion

The Committee retains the flexibility to make adjustments to the formulaic vesting level of incentive awards in instances where the outcome would otherwise be unreflective of the wider shareholder experience and/or materially inappropriate in the context of unexpected or unforeseen circumstances relating to the Company.

Changes to performance conditions

If an event occurs which results in the annual bonus or PSP performance conditions and/or targets being deemed no longer appropriate (i.e. a material acquisition or divestment) then the Committee will have the ability to adjust the measures and/or targets and alter weightings so that the conditions achieve their original purpose.

Recruitment and conditions of service

Policy on recruitment and promotion

Salaries for newly recruited directors will be set to reflect their skills and experience, the Company's intended pay positioning and the market rate for the role. If it is considered appropriate to appoint a new director on a below market salary (for example, to allow the director to gain experience in the role) the individual's salary may be increased to a market level by way of a series of above inflation increases over such period as the Committee determines, subject to their performance and development in the role. A new appointment may also be offered a fixed role-based allowance that reflects the individual's role, skills and responsibilities, up to the permitted maximum set out in the policy table.

A new appointment would be offered benefits comparable to existing directors, other than, as described above, in respect of pension provision, as well as other reasonable expenses such as legal, tax equalisation and relocation costs (if necessary, on a net of tax basis).

The prevailing maximum bonus opportunity for existing directors will not be exceeded for any newly recruited director and would be pro-rated to reflect the proportion of the year worked. It may be necessary to set different performance measures and targets initially and/or to vary the proportion of the annual bonus that will be deferred and the deferral period, dependent on the timing of the appointment and the nature of the role taken up. Guaranteed bonuses will not be offered.

Long-term incentive awards will be granted in line with the policy outlined for existing directors, with the same maximum opportunity for any newly recruited director. Awards may be granted shortly after an appointment (subject to the Company not being in a prohibited period).

The maximum level of variable remuneration that may be awarded (excluding buyout awards as referred to below) is 330% of salary.

The Committee may make payments or grant awards to a newly recruited executive to buy out entitlements (for example, bonus and share awards) which will lapse on the executive's departure from a previous position. In doing so, the Committee will take into account relevant factors, including performance conditions attached to the lapsing arrangements and the time over which they would have vested. The approach to buy-out awards is intended to be in line with the PRA remuneration rules, which state that the terms of any replacement awards should be no more generous than the award forfeited on departure from the former employer.

In the event that an existing employee is promoted to the Board, any contractual commitments made to the employee prior to such promotion will continue to be honoured even if they would not otherwise be consistent with the policy prevailing when the commitment is fulfilled.

Notice periods and terms of engagement

The Chair and executive directors hold one year rolling contracts in line with current market practice and the Committee reviews the terms of these contracts regularly. The current service contracts for the executive directors are dated as follows:

	Contract Date
N S Terrington	1 September 1990 (as amended 7 January 1993, 16 February 1993, 30 October 2001 and 10 March 2010)
R J Woodman	8 February 1996 (amended 10 March 2010)
J A Heron	1 September 1990 (amended 14 January 1993, 8 February 1993 and 10 March 2010)

All new executive directors will have service contracts that are terminable by the Company on a maximum of twelve months' notice.

Chair and non-executive director appointments are for three years unless terminated earlier by, and at the discretion of, the director or the Company. The required notice period is one year for the Chair and three months for the non-executive directors.

Current terms of engagement for the Chair and non-executive directors apply for the following periods:

Director	Period of engagement
F J Clutterbuck	10 May 2018 to 9 May 2021
P J N Hartill	11 February 2017 to 10 February 2020
B A Ridpath	20 September 2017 to 19 September 2020
H R Tudor	24 November 2017 to 23 November 2020
F F Williamson	20 September 2017 to 19 September 2020
G H Yorston	20 September 2017 to 19 September 2020

Policy on termination payments

The Company has discretion to make a payment in lieu of notice in respect of all or part of the notice period. Any such payment would consist of salary, benefits and pension for the relevant part of the notice period. Specific change of control provisions or entitlements to enhanced redundancy payments are excluded.

Fixed Role-Based Allowance

Executive directors will be entitled to receive their fixed role-based allowance in respect of any notice period (or any notice period that would have applied but for the making of a payment in lieu of notice). Ordinarily the fixed role-based allowance will be paid at the usual time.

Shares subject to a fixed role-based allowance for the notice period and for previous fixed role-based allowance payments will be released over the originally anticipated period, although the Committee has discretion to release shares early in specific circumstances, for example, in the event of the death of an executive director.

Annual Bonus for the year of cessation

The payment of annual bonuses will be at the discretion of the Committee on an individual basis and the decision as to whether or not to award an annual bonus in full or in part will be dependent on a number of factors, including the circumstances of the individual's departure. For example, in certain good leaver situations (injury or disability, redundancy, employment transferred outside the Group, or any other reason the Committee decides) a bonus may be payable at the Committee's discretion, based on an assessment of performance. Any annual bonus award amounts paid will be pro-rated for time in service during the annual bonus period and will, subject to performance, be paid at the usual time and in the usual form (although the Committee retains discretion to pay the annual bonus award earlier in appropriate circumstances).

Unvested DSBP Awards

For awards granted under the DSBP, good leaver status would result in awards vesting at the usual time, unless the Committee determines they should vest earlier in appropriate circumstances. In other circumstances, DSBP awards will lapse.

Bonus awards subject to a holding period

If an individual leaves employment during a holding period, the default position will be for the holding period to continue for its originally anticipated length. The Committee may end the holding period early.

Unvested PSP Awards

The default treatment for outstanding unvested PSP awards will be that they lapse on cessation of employment. In good leaver circumstances (as described above), unvested awards will continue until the normal vesting date, vest subject to the satisfaction of the performance conditions, and be released at the end of the originally anticipated holding period. However, the Committee may permit the award to vest and be released at cessation subject to the satisfaction of the performance conditions (as assessed by the Committee) or vest and be released at the end of the performance period subject to the satisfaction of the performance conditions. In any such case, the extent of vesting will be reduced to reflect the proportion of the vesting period that has elapsed at the date of cessation, unless the Committee determines otherwise.

PSP Awards subject to a holding period

If an individual leaves employment during a holding period, the default position will be for the holding period to continue for its originally anticipated length. The Committee may permit the award to be released early, subject to any regulatory considerations. If the holding period is operated on the basis that the executive director is only entitled to acquire vested shares at the end of the holding period, the award will lapse if the executive director is dismissed for misconduct.

Other payments

The leaver provisions for any buyout award granted in connection with the recruitment of a director would be determined at the time of grant.

Any statutory entitlements or sums to settle or compromise claims in connection with the termination would be paid as necessary. In the appropriate circumstances, outplacement services, legal fees and relocation expenses may be provided at normal market rates for directors, along with payments in respect of accrued holiday.

There are no obligations in the non-executive directors' letter of appointment that could give rise to payments for loss of office.

Consideration of employment conditions elsewhere in the Group

There is no employee representative on the Committee. However, employees have the opportunity to make comments on any aspect of the Group's activities through employee forums and surveys and the views of employees are taken into account by Human Resources. One of the duties of the People Director is to brief the Board on employee views and, as a regular invitee to Committee meetings, this ensures that decisions are made with appropriate insight to employees' views. In addition, the People Forum will consider the relationship between executive remuneration and pay and reward across the Group on a regular basis.

Directors and senior executives participate in the annual bonus scheme, which is designed to incentivise executives to achieve specific, predetermined goals, reward individual performance and encourage retention through deferral of a proportion of the bonus. All employees whose performance has been exceptional are eligible for a discretionary bonus.

Directors and senior employees are eligible to participate in the PSP. The plan is in place to encourage the long-term retention of key executives who are considered to have the potential to influence shareholder value creation and awards are not offered to employees generally.

Employees below director and head of function level are eligible to participate in the Group's profit related pay scheme, which pays out a flat sum to all eligible staff based on a percentage of the Group's profits.

In determining pay levels for the employees as a whole, the Group annually considers externally provided benchmark levels for comparable jobs as well as individual development and performance. The general level of increase resulting from this review informs the Committee's deliberations on appropriate pay levels for the executive directors, together with external data specific to their roles which is used to ensure that the levels of remuneration are appropriate.

Consideration of shareholders' views

The Committee considers shareholder feedback received in relation to the AGM each year at a meeting shortly following the AGM. This feedback, plus any additional feedback received during any meetings from time to time, is then considered as part of the Company's annual review of remuneration policy.

In addition, the Chair of the Committee and the Chair of the Board regularly engage directly with major shareholders and their representative bodies and report their views back to the Committee, who take them into account when formulating any material changes to the remuneration policy. During the year under review, for the purposes of discussing this proposed policy, shareholders representing 69% of the Company's equity (based on the total voting rights as at 30 September 2019) were contacted and account was taken of their views in shaping the policy.

Details of votes cast for and against the resolution to approve last year's remuneration report and the resolution to approve the Directors' Remuneration Policy at the 2017 AGM along with any matters relating to remuneration discussed with shareholders during the year are set out in the Annual Report on Remuneration.

Legacy arrangements

The Committee retains discretion to make any remuneration payment or payment for loss of office outside the policy (including the exercising of any discretion available in respect of any such payment) outside of this Remuneration Policy:

- Where the terms of the payment were agreed before this Remuneration Policy came into effect, provided in the case of any payment whose terms were agreed after 2 February 2014 and before this Remuneration Policy became effective, the remuneration payment or payment for loss of office was permitted under the Company's relevant former Directors' Remuneration Policy
- Where the terms of the payment were agreed at a time when the relevant individual was not a director of the Company and, in the opinion of the Committee, the payment was not in consideration of the individual becoming a director of the Company

For these purposes, 'payment' includes the satisfaction of awards of variable remuneration and, in relation to an award over shares, the terms of the payment are agreed at the time the award is granted.

B6.4 Approval of Directors' Remuneration Report

The information provided in this part of the Directors' Remuneration Report is not subject to audit

This Directors' Remuneration Report, section B6 of the Annual Report and Accounts, including the Statement by the Chair of the Committee, the Annual Report on Remuneration and the Policy Report, has been prepared in accordance with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended and has been approved by the Board of Directors.

Signed on behalf of the Board of Directors

Hugo Tudor

Chair of the Remuneration Committee

26 November 2019

B7
Risk management

B7.1 Risk and Compliance Committee Chair's Report

Dear Shareholder

I am pleased to write to you again as Chair of the Risk and Compliance Committee to explain how we, as a committee, have discharged our responsibilities in the last year.

Our primary responsibility continues to be the maintenance of oversight of the effectiveness of the Group's risk management framework and of the Group's systems and controls for compliance with its statutory and regulatory obligations. The Committee also oversees the risk culture within the Group to ensure that this is adequately embedded and is supportive of the overall risk appetite set by the Board.

In discharging its responsibilities, the Committee relies on the support of the Group's Chief Risk Officer ('CRO'). Malcolm Hayes, who had held that position first with Paragon Bank then for the Group, since the Bank's licensing in 2014, informed me this year of his intention to retire. The Committee and I would like to thank him for his role in the development of the risk management system over that period and wish him well for the future.

During the year, the Committee supervised the search for a new CRO and an appointment is expected to be made shortly, subject to regulatory approval.

The Committee has maintained an agenda that has balanced standing review items with coverage of new or materially heightened risks and deeper dives into areas considered worthy of greater focus.

Standing items covered in each meeting have included:

- Reviews of the principal risks facing the Group
- Consideration of new or emerging risks and regulatory developments
- Consideration of the potential impact of key regulatory developments
- Consideration and challenge of management's rating of the various risk categories to which the Group is exposed
- Consideration of the root causes and impact of material risk events and the adequacy of actions undertaken by management to address them

In addition, during the last year, the Committee:

- Reviewed the Group's risk appetite to ensure it remained consistent with the delivery of the Group's strategic objectives, proposing any required changes to the Board
- Monitored and reviewed the potential impacts on the Group of the Brexit process, given the continuing uncertainty around the terms on which the UK might leave the EU

Finlay Williamson, Chair of the Risk and Compliance Committee

Our primary responsibility continues to be the maintenance of oversight of the effectiveness of the Group's risk management framework...

- Continued to monitor progress in respect of the Group's strategic decision to seek regulatory approval to enhance credit risk management by implementing an IRB approach
- Considered regular focussed reviews of key risk areas including credit risk, capital risk, liquidity and market risk, conduct risk and across the different categories of operational risk
- Considered reviews on specific areas of focus including cyber security and operational resilience. This included monitoring the progress of the Group in addressing the approach to operational resilience proposed in the regulatory discussion paper in 2018
- Reviewed, challenged and approved the Management Responsibilities Map
- Reviewed, challenged and approved the terms of reference of each of the executive risk committees
- Reviewed, challenged and approved the Compliance Monitoring Plan ('the Compliance Plan') and subsequent updates to the Compliance Plan
- Reviewed, challenged and approved the Money Laundering Reporting Officer's annual report
- Considered and challenged reports in relation to ICAAP, ILAAP and RP recommending approval to the Board
- Challenged and approved various key risk policies

During the coming year, the Committee's priorities will include:

- Completing the appointment of a new CRO and supervising their induction
- Reviewing the Group's risk appetite to ensure it remains consistent with delivery of the Group's strategic objectives and proposing any required changes in risk appetites to the Board
- Continuing to review the potential impacts on the Group of the political and economic consequences of UK's decision to withdraw from the EU as details of the terms of exit and the basis of the future relationship become clearer
- Reviewing and challenging the Group's submissions to the PRA, in relation to its strategic decision to seek regulatory approval to implement an IRB approach for credit risk
- Reviewing and challenging reports in relation to ICAAP, ILAAP and RP ahead of approval by the Board
- Continuing its focus on ensuring that customers receive fair outcomes, including monitoring the treatment of vulnerable customers, and ensuring that the management of conduct risk remains a key priority for the Group
- Overseeing a review of the Group's culture and any actions identified by it
- Monitoring the Group's adherence to the FCA and PRA requirements in relation to the Senior Managers and Certification Regimes as they are expanded across the financial services sector
- Providing continued oversight and review of the operational resilience strategy and capability in light of further requirements which may result following the expected publication of a regulatory consultation paper by the end of 2019
- Ensuring the Group is well prepared to face the increasing challenges posed by climate change and the impact this may have on the Group's risk profile
- Monitoring the impact on the Group of the scheduled withdrawal of LIBOR as the primary sterling interest rate benchmark and proposals to replace it using SONIA derived measures
- Undertaking deep dives in relation to specific risk categories and business areas on both a rolling and ad hoc basis

Overall, I am pleased to confirm that in the last year the Committee has again, in my view, met its key objectives and carried out its role effectively.

As I look to the year ahead, it is clear that the economic, political and regulatory environment within which the Group operates will remain challenging. In particular, the level of uncertainty surrounding the basis of the UK's departure from the EU remains high, with the status of its future trading relationships remaining extremely unclear. Whilst I remain confident that the Group has the skills and experience to manage the risks it is likely to encounter in the year ahead, we remain vigilant to the need to reinforce these should circumstances change materially.

Finlay Williamson

Chair of the Risk and Compliance Committee

26 November 2019

B7.2 Risk governance

The Risk and Compliance Committee assists the Board in fulfilling its responsibilities for risk management and comprises the independent non-executive directors and the Chair of the Board. Its terms of reference, which were reviewed and approved by the Board in October 2019, include all matters indicated by the 2018 Code.

The Committee's responsibilities include reviewing:

- The effectiveness of the Group's risk management framework and the extent to which risks inherent in the Group's business activities are controlled within the risk appetite established by the Board
- The effectiveness of the Group's systems and controls for compliance with statutory and regulatory obligations, as well as its obligations under significant contracts
- The appropriateness of the Group's risk culture, to ensure it supports the Group's stated risk appetite
- The effectiveness of the Group in addressing issues requiring remedial attention to ensure actions are completed in a timely manner and minimise the potential for risk appetite thresholds to be exceeded

The Risk and Compliance Committee provides oversight and challenge to the Group's enterprise-wide risk management arrangements. The Committee is supported by an executive level Asset and Liability Committee, Conduct and Compliance Committee, Credit Committee, Model Risk Committee and Operational Risk Committee.

The Committee meets at least four times a year and normally invites the executive directors, Chief Risk Officer ('CRO'), Chief Operating Officer and Internal Audit Director to attend its meetings. However, it reserves the right to request any of these individuals to withdraw or to request the attendance of any other Group employee. The Committee meets with the CRO at least once a year, without the presence of executive management, to discuss their remit and any issues arising from it.

The Committee also has the opportunity to meet with the Internal Audit Director and/or the external auditor without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.

Agenda items for regular meetings of the Committee include:

- Reviewing the Group's principal risks
- Receiving and considering reports relating to the Group's consolidated risk profile
- Receiving and considering reports relating to the Group's performance against the Board's risk appetite and the progress of any resulting management actions to restore performance within approved target ranges
- Reviewing and approving the Compliance Plan and the proposed management actions to address any adverse reports
- Reviewing any proposed material changes to the Group's risk appetite prior to approval by the Board
- Reviewing and approving the Group's Recovery Plan ('RP') prior to approval by the Board
- Receiving reports relating to key regulatory developments affecting the Group
- Reviewing the Group's conduct strategy and receiving reports from management on conduct risk
- Receiving reports from the Money Laundering Reporting Officer on compliance with anti-money laundering requirements
- Reviewing material operational risk events to assess the effectiveness of the Group risk and control assessment framework
- Reviewing the timeliness, effectiveness and progress of any executive management actions required to remediate issues identified
- Reviewing the Group's capital and liquidity adequacy assessments and stress testing analysis
- Considering the minutes of its executive sub-committees

The structure of the executive committees reporting to the Committee and their reporting lines is illustrated below:

Each of the executive committees operates within terms of reference formally approved by the Risk and Compliance Committee. The primary functions of each of these committees are described below.

Asset and Liability Committee ('ALCO')

ALCO comprises heads of relevant functions and is chaired by the CFO.

The principal purpose of ALCO is to monitor and review the financial risk management of the Group's balance sheet. As such, it is responsible for overseeing all aspects of market risk, liquidity risk and capital management as well as the treasury control framework. ALCO operates within clearly delegated authorities, monitoring exposures and providing recommendations on actions required. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to risk appetites to the Risk and Compliance Committee.

Conduct and Compliance Committee ('CCC')

The CCC comprises heads of relevant functions and is chaired by the Deputy CRO.

The CCC is responsible for overseeing the Group's conduct risk and compliance arrangements. The Committee considers conduct risk information such as details of conduct breaches; systems and procedures for delivering fair outcomes to customers; the product governance framework; monitoring reports; and employee incentive schemes. It also considers product reviews from a customer perspective. With respect to compliance, the CCC is responsible for overseeing the maintenance of effective systems and controls to meet conduct-related regulatory obligations. It is also responsible for reviewing the quality, adequacy, resources, scope and nature of the work of the Compliance function, including the annual Compliance Plan.

Credit Committee

The Credit Committee comprises senior managers from the risk, finance and collections functions and is chaired by the CRO.

The Credit Committee approves credit risk policies in respect of customer exposures and defines risk grading and underwriting criteria for the Group. It also provides guidance and makes recommendations in order to implement the Group's strategic plans for credit. The committee oversees the management of the credit portfolios, the post origination risk management processes and the management of past due or impaired credit accounts. It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the credit risk appetites to the Risk and Compliance Committee. The Committee also operates the Group's most senior lending mandate.

Model Risk Committee ('MRC')

The MRC comprises senior managers from risk, finance and the main business areas and is chaired by the CRO.

The role of the MRC is to review and make recommendations on all material aspects of the rating and estimation processes in relation to key credit and finance models. The MRC also acts as the 'Designated Committee' for IRB purposes, approving all material aspects of IRB rating systems.

Operational Risk Committee ('ORC')

The ORC comprises heads of relevant functions and is chaired by the CRO.

The ORC is responsible for overseeing the Group's operational risk and business risk management arrangements, including those systems and controls intended to counter the risk that the Group might be used to further financial crime. The Committee remit includes risks arising from personnel, technology, and environmental matters within the business. The Committee considers key operational risk information such as key risk indicators, themes within risk registers, emerging risks, loss events, control failures, and operational resilience measures.

It also monitors performance against appetite on an on-going basis and makes recommendations for revisions to the Risk and Compliance Committee.

B7.3 Risk management culture

The Board is committed to maintaining an effective risk management framework that is consistent and commensurate with the nature, complexity and risk profile of the business and is responsive to both internal and external events. The Group's inherently conservative risk appetite is expressed through the culture promoted by the Board and senior management. This has resulted in historically low levels of credit and operational losses and the absence of any material conduct issues affecting customers.

The following risk principles are designed to support and protect the Group's strategic goals:

- Risk management is used to protect the Group's customers, shareholders, creditors and its reputation
- The fair treatment of customers and the delivery of fair outcomes, particularly for those customers considered to be vulnerable, is central to the Group's risk management approach
- The Group encourages a risk culture that has robust risk management at the heart of all decision-making within an open and transparent environment
- The Group only carries out business where the potential risk to itself and its customers has been considered together with the potential reward and where the residual risk exposure is within its defined risk appetite
- The Group utilises appropriate risk management processes to ensure that risks are identified, assessed, prioritised and managed in a consistent way
- Appropriate, timely and accurate risk management information is maintained and developed to support business decisions and to ensure the Group operates within its agreed risk appetite

An independent Risk and Compliance function provides an effective second line oversight capability together with a source of specialist support and advice for business areas in relation to the management of risk.

B7.4 Risk management framework

Introduction

The Group's risk management framework is designed to enable management to identify and focus attention on the risks most significant to its objectives and to provide an early warning of events that put those objectives at risk. The framework includes:

- The Risk and Compliance Committee and its sub-committees as described in B7.2
- A suite of risk policies, which include policies addressing:
    - Conduct risk (including dealing with vulnerable customers and handling complaints)
    - Credit risk
    - Treasury risk
    - Operational risk
    - Data protection
    - Information security
    - Health and safety
    - Business continuity
    - Outsourcing and supplier risk
    - Anti-money laundering
    - Anti-bribery and corruption
    - Market abuse
    - Whistleblowing
    - Conflicts of interest

- Dedicated teams within the Risk and Compliance function covering particular risk areas, led by experienced specialists, as described below
- Risk Champions appointed within all business areas to support the embedding of an effective risk culture across the Group
- A well-established and experienced Internal Audit function, supported by ongoing co-source arrangements with external providers when specific specialist skills are required

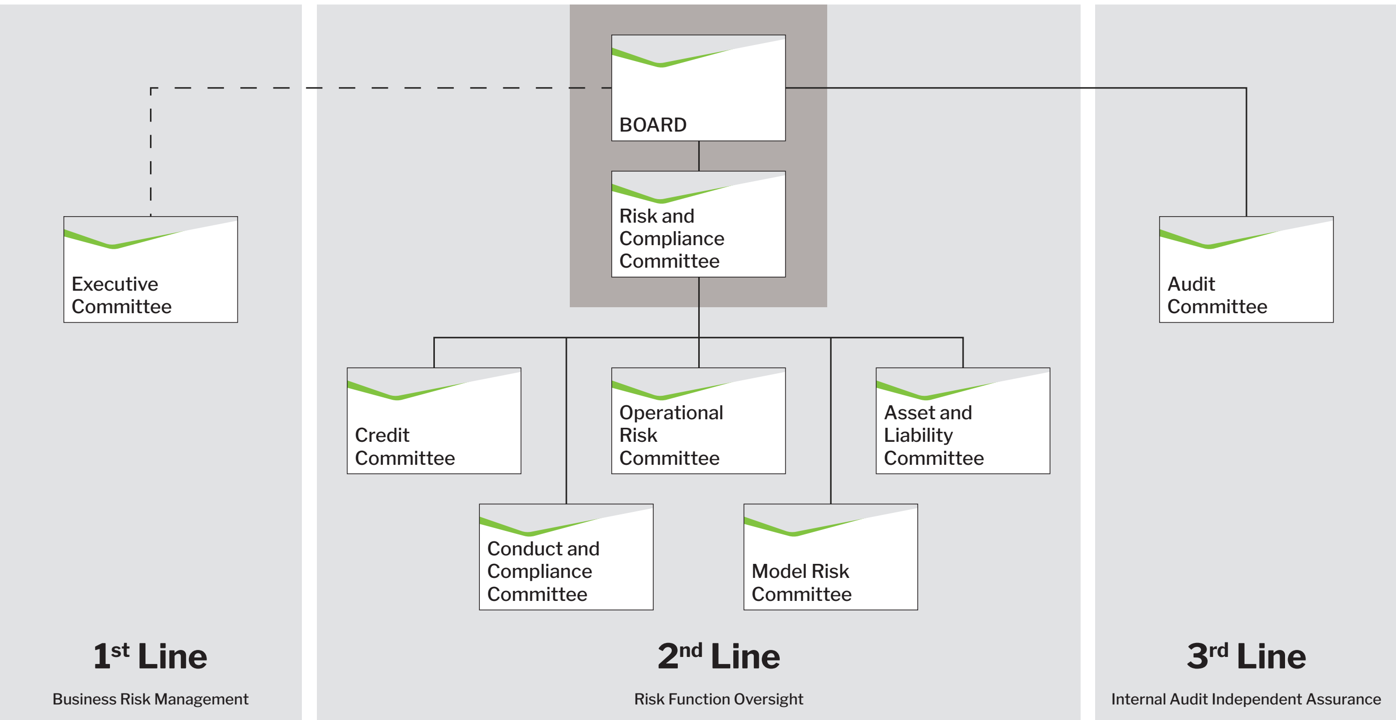
Three lines of defence model

The committee structures outlined above form the cornerstone for the governance of risk in a management framework organised within a three lines of defence model as follows:

- The *first line of defence*, comprising executive directors, together with managers and employees in operational and support areas, holds primary responsibility for designing, operating and monitoring risk management and control processes
- The *second line of defence* is provided by the Risk and Compliance function which is responsible for providing risk oversight and guidance to the first line, in addition to providing independent challenge and review. The function is overseen by the Risk and Compliance Committee and its supporting executive committees
- The *third line of defence* is provided by the Internal Audit function which is responsible for reviewing the effectiveness of the first and second lines of defence. This function is overseen by the Audit Committee

In addition, there are further external levels of control that complement the three internal layers, provided by the external audit process and the monitoring activities of regulatory bodies.

The way in which the three lines of defence model aligns with the wider governance framework is illustrated below:



The risk management framework is intended to provide a structured and disciplined approach to the management of risk within agreed appetites thereby supporting the achievement of the Group's strategic objectives. The key objectives of the risk management framework are to:

- Promote an appropriate risk culture across the Group ensuring risk is considered as part of key strategic and business decision making
- Establish standards for the consistent identification, measurement, monitoring, management and reporting of risk exposure and loss experience
- Outline the approach that will be taken in respect of setting and defining risk appetite and risk tolerances
- Promote risk management and the proactive reduction of the frequency and severity of risk events, driving control improvements where necessary
- Facilitate adherence to regulatory requirements, including threshold conditions, capital standards and to support the regulatory requirements associated with the ICAAP, ILAAP and RP
- Provide senior management and relevant committees with risk reporting that will be relevant and appropriate, enabling timely action to be taken in response to the information included within these reports

The Group publishes further information on its risk management system and risk profile in its Pillar III report, which can be found on the investor relations section of the Group's website at www.paragonbankinggroup.co.uk.

Risk management function

The Group's Risk and Compliance function is headed by the CRO, who reports directly to the CEO. The key responsibilities of the CRO are to:

- Develop and maintain the risk management framework covering all areas of the Group
- Develop and maintain risk policies within that framework, ensuring these are consistent with the Board's risk appetite
- Ensure that risks generated by the business are measured, monitored, controlled and reported on a timely basis
- Ensure compliance with all new and existing regulatory requirements
- Maintain open and constructive engagement with the regulatory authorities

The CRO is also responsible for the effective day-to-day running of the Risk and Compliance function and its relationship with the Board, its committees and senior management as well as for championing the Group's risk culture, providing support and advice to employees in the discharge of their risk responsibilities.

During the year there has been further recruitment at all levels within the Risk and Compliance function to bolster the division's strength and ensure that its size, structure and resources remain appropriate. This also allows the Group to benefit from the wider perspective provided by experienced external hires. The current function includes the following dedicated specialist second line areas which ultimately report to the CRO:

- Credit Risk
- Liquidity and Market Risk
- Conduct and Compliance Risk
- Operational Risk
- IT and Cyber Security Risk
- Data Protection
- Property Risk
- Financial Crime
- IRB Development

B7.5 Principal risks and mitigation

The Group is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. A summary of those risks and uncertainties which could prevent the achievement of the Group's strategic objectives, how the Group seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below. These risks are discussed in more granular detail in the Group's Pillar III report, published on the Group website.

This analysis represents the Group's gross risk position as presented to, and discussed by, the Risk and Compliance Committee as part of its ongoing monitoring of the Group's risk profile.

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

To identify and control the risks to which it is exposed, the Group employs a risk management framework. As part of this framework, principal risks are identified and assessed within the key categories of Business Risk, Credit Risk, Conduct Risk, Operational Risk, Liquidity and Capital Risk, Market Risk, and Pension Obligation Risk.

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

<table>
<tr><th colspan="3">BUSINESS RISK</th></tr>
<tr><th colspan="3">Economic risk</th></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The potential for a deterioration in the UK's economic conditions is harder to forecast given the continuing material uncertainties as to the terms on which the UK will leave the EU.

Given that its income is wholly derived from activities within the UK, the Group could be materially affected by a severe downturn in the UK economy, which could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.</td><td colspan="2">The Group closely monitors political and economic developments in the UK and overseas, with support from leading independent macro-economic and other advisors. This information supports the senior management's review of objectives each year and helps inform business plans for each of the Group's principal trading operations.

As a lender and acquirer of credit portfolios, exposure to any material deterioration in economic conditions is inevitable. The Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise.

The Group also uses stress testing to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. In addition to considering the credit implications of such economic stress, the Board also considers the operational and liquidity implications of such scenarios, which would include the potential to increase liquidity coverage ratios, access contingent liquidity and further strengthen key risk and servicing functions as and when required.</td></tr>
<tr><td>Change</td><td>Whilst UK economic performance has again been broadly stable in the last financial year, the near-term outlook has continued to remain uncertain given a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. This continuing uncertainty has led to the overall risk assessment being considered to have increased further in the last year.</td><td></td></tr>
</table>

BUSINESS RISK

Concentration risk

Description	Mitigation
Lending to customers investing in the UK private rented sector forms a substantial part of the Group's advances and assets. It is therefore exposed to any systemic deterioration in performance of the sector, which will be influenced by underlying factors such as house prices, supply of rental property, and demographic changes. The buy-to-let sector has been subject to a high level of fiscal and regulatory intervention in recent years. Where such changes make buy-to-let less attractive or viable to customers' businesses, the Group is exposed to adverse consequences. Concentration risks may also arise within other business lines, affecting their performance.	The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through several economic cycles together with regular independently conducted research commissioned over many years. The Group seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector. Given its specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond effectively to the various regulatory changes introduced in recent years in relation to buy-to-let lending. A suite of concentration risk metrics is monitored by the Bank's Credit Risk function and reported monthly through the Credit Committee on to the Risk and Compliance Committee. Potential areas of concentration relating not just to loan products but also covering borrower, asset, or large exposure risk for example, are therefore managed within defined limits. 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.

Change	The Group continues to have significant exposure to buy-to-let lending but, due to its specialist knowledge of the sector, it has been able to respond positively to regulatory changes in recent years. The Group's diversification strategy has also positioned it to reduce its reliance on this product line. In the longer term, changes to the UK taxation regime and greater regulatory intervention in the sector may reduce demand and availability of buy-to-let lending products. However, the Group continues to be confident in its ability to operate successfully in this evolving environment.	← →

Transition risk

Description	Mitigation
The Group has made a number of acquisitions in previous periods. While there have been no acquisitions in the current accounting period, any failure to manage effectively the transition and implementation risks resulting from previous material corporate acquisitions may impact adversely on the Group's financial performance and its reputation.	The Board's M&A strategy is that the Group will only consider acquisitions in areas of business that it understands, and which are complementary to its existing activities. Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors. Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board. Where necessary, enhancements are made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider Group.

Change	Ongoing integration activity has been successful and with no new acquisitions undertaken, transition risk has reduced.	↓

CREDIT RISK

Customer risk

Description	Mitigation
Failure to screen potential borrowers, underwrite new business, and manage repayments effectively could expose the Group to the risk of unexpected material losses. Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.	The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Credit policies incorporate limits for concentration risks arising from factors such as large exposures to counterparties, geographical areas or types of lending. The Group uses a range of sources to inform expectations of key external factors such as interest rate movements, house price inflation, property rental inflation and asset depreciation which are in turn used to guide policy and underwriting.

Change	The Group's arrears rate and cost of risk have remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration due to changing economic conditions, particularly given current uncertainties regarding the UK's future relationship with the EU, is being monitored closely across all Group portfolios. *The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in note 57 to the Group Accounts.*	

Counterparty risk

Description	Mitigation
The Group is exposed to the failure of counterparties with which it places deposits, or which provide hedging agreements to mitigate interest rate and foreign exchange risk.	The Group has a strictly controlled number of approved treasury counterparties. To be approved, counterparties must meet specific credit rating criteria. Exposure to approved counterparties is monitored intra-day by senior management within the Group's Treasury function with all trading performed within approved limits. The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO. Treasury counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, they must comply with criteria set out in the financing arrangements, which are monitored externally. Where a counterparty to the Group's cross-currency basis swaps fails to meet the required credit criteria they are obliged under the terms of the instruments to set aside a cash collateral deposit.

Change	The credit quality of the treasury counterparties with whom the Group transacts has been maintained during the year and this risk is therefore considered to have remained stable.	

CONDUCT RISK

Customer fair outcomes

Description	Mitigation
The Group provides a broad range of financial services products across a number of brands to consumers and small business customers. As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers. Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in profitability.	The Group has a formal Conduct Risk Management framework which includes a number of detailed policies and standards addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy, underpinned by additional policies and standards. This sets out the Group's overarching approach to the management of conduct risk as part of a framework within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites. The management of conduct risk within the Group is tailored to the specific product and customer type concerned. Business areas dealing with consumers have dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers. This may also include a dedicated customer support team to manage customers deemed to be vulnerable. The Conduct and Compliance Committee ('CCC') has a remit which includes overseeing the fair treatment of customers. The CCC also receives items for review and / or approval, such as product governance submissions, conduct risk related policies and standards, business area incentive schemes, compliance monitoring outputs and regulatory communications. The Compliance function has a formal monitoring plan which is focussed on conduct risk and the fair treatment of customers, particularly those that are defined as vulnerable, or in financial difficulty. The plan is reviewed and approved on at least an annual basis by the RCC. Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at the CCC, ORC and RCC. The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.

Change	The Group operates in areas which are highly regulated and where continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure. In response to this, the Group has continued to develop and embed its conduct risk management framework during the year.	

<table>
<tr><th colspan="3">OPERATIONAL RISK</th></tr>
<tr><th colspan="3">People risk</th></tr>
<tr><th colspan="2">Description</th><th>Mitigation</th></tr>
<tr><td colspan="2">The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels.

Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives.

This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be very difficult to replicate in the short term.</td><td>The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies.

External remuneration and reward structures are monitored to ensure the Group remains competitive and is able to recruit and retain key personnel.

A range of employee benefits are offered in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related pay scheme for most employees.

A Senior Leadership Development Programme and Manager and Team Leader Academies have been created to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business.

The Group has been accredited under the 'Investors in People' scheme since 1997 and has held Champion status in the scheme since May 2014. This accreditation is awarded to a very small proportion of organisations who are seen as pioneers in people management practices and role models in strategic leadership.</td></tr>
<tr><td>Change</td><td>A strong employment market and particularly buoyant demand for skilled financial services staff has again been a feature of the last financial year. This has led to continued strong competition to recruit and retain employees. Despite the increasingly competitive external environment, the Group remains confident in its ability to manage this risk.</td><td></td></tr>
</table>

OPERATIONAL RISK

Systems risk

Description	Mitigation
The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs. This includes the risk that the Group's processes fail to offer adequate protection against the threat of cyber-crime. Failure in Group IT systems, either in terms of capacity or security, however caused, could result in detriment to customers, regulatory censure and reputational damage, while failure to match market levels of functionality could have an adverse impact on business volumes. All of these factors could materially impact income and profitability. This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.	The Group has a formally agreed IT strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. It maintains an ongoing programme of investment in IT infrastructure and systems. The Group also employs a robust vendor management process to select and monitor third party IT suppliers. Over the last twelve months the Group has continued to invest in new technology and services to maintain and increase its defence in depth strategy to protect its operational capability. The implementation of a new Security Operations Centre service has added third party security expertise to support the Group's existing specialist resource. A formal Cyber Incident Response Plan is in place to ensure the Group is well placed to deal with any issues or events. This is regularly reviewed and approved by the RCC. There is ongoing focus on the information security management system (ISO27001:2005) to which the Group is certified, to ensure that controls, testing and user awareness are maintained and improved. Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.

Change	The Group has continued to invest significantly in order to further enhance its operational resilience. However, the Group recognises that while it continues to develop, and maintain a secure IT infrastructure, the increased sophistication of cyber-crime attacks continues to be a significant risk for the business in common with the rest of the financial services sector.	↑

Regulatory risk

Description	Mitigation
The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations. The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains some of its funding, have been subject to increasing legislative and regulatory intervention over recent years.	The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the RCC. All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes. The Compliance and Financial Crime functions maintain formal second line monitoring plans. Progress against the plan and the issues identified within individual reviews are reported to the CCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded, and any lessons learnt are applied across all relevant areas of the Group. Similarly, the Financial Crime function provides independent oversight of business areas' adherence to anti-money laundering and financial crime requirements. During 2018-19 key regulatory initiatives have included the focus on operational resilience and the impact of climate change. Work has commenced in both these areas and will develop during 2019-20 as further clarity is received around regulatory expectations.

Change	Whilst the Group considers that it continues to have robust arrangements in place, the increasing scope and complexity of regulatory regimes heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging ones.	↑

LIQUIDITY AND CAPITAL RISK

Funding risk

Description	Mitigation
The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines. Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity.	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. Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due. The Group, through Paragon Bank, is authorised to accept retail deposits. As such, it is subject to regulation by the PRA. The Group aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking. The Group has an experienced structured finance function who maintain relationships with major participants in the capital markets and who have been instrumental in many securitisation and debt issues. This gives it access to capital markets when required. The Company has a BBB investment grade credit rating from Fitch to support maintenance of its access to funding markets.

Change	The Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. It is well placed to access future funding from a wide range of sources to meet its future funding requirements. During the year, the Group demonstrated its ability to access the securitisation market for additional funding on an ongoing basis, and its Fitch rating was confirmed. Although there has been strong competition for retail deposits, the overall risk is considered to have remained stable.	← →

Capital risk

Description	Mitigation
The changes made in the Basel III capital regime by the BCBS regarding minimum capital requirements from 2021 could impact on the Group. The BCBS changes include increases in risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by the property, which may include certain categories of buy-to-let lending. The Group's capital requirements would, therefore, be increased to some extent.	In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB approach for credit risk. In support of this, the Group appointed an experienced director of IRB to lead this initiative. A formal IRB project has since been initiated with support from respected external specialist advisors to enable the Group to commence its application process with the relevant regulatory authorities during the first half of the new financial year. The Group's IRB plan is well progressed, however a consultation paper produced in September 2019 highlighted a need for aspirant firms to comply with certain future regulations and requirements where the authorisation process extends beyond 2020. Whilst only a consultation at this stage, the Board has decided to ensure its IRB models are fully compliant with this requirement before making its first submissions to the PRA. The timing of the application will reflect the requirements of the Policy Statement that will result from the consultation process.

Change	During the year, the UK and European authorities developed their approach to the implementation of the Basel III changes. The impacts of their decisions were considered, and the proposed changes have been incorporated within the Group's IRB project. These developments did not change the Group's assessment of the likely impact of these changes. *Further information on the Group's management of capital risk is given in note 55 to the Group Accounts.*	← →

MARKET RISK

Interest rate risk

Description	Mitigation
The Group is exposed to the risk that changes in interest rates may adversely affect its net income and profitability. In particular, the Group's profitability is determined by the difference between the interest rates at which it lends and those at which it borrows. Changes in market interest rates could therefore materially impact the Group's profits as a result of significant mismatches between its assets and liabilities.	This risk is managed through Board approved risk appetite limits with comprehensive treasury polices in place to ensure that the risk posed by changes and mismatches in interest rates are effectively managed. The Board's risk management framework for Interest Rate Risk in the Banking Book ('IRRBB') continues to evolve in line with updates in regulatory guidance on methods expected to be used by banks for controlling such risks. Day-to-day management of interest rate risk within Board approved limits is the responsibility of Treasury with control and oversight provided by ALCO which reports to the RCC. The Group seeks to match the structure of assets and liabilities by using appropriate financial instruments, such as interest rate swaps or cap agreements and fixed rate retail liabilities.

Change		
	The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. The approach to managing the risks has, however, been enhanced to reflect the EBA's guidelines. *Further information regarding the Group's management of interest rate risk is given in note 59 to the Group Accounts.*	

PENSION OBLIGATION RISK

Pension obligation risk

Description	Mitigation
The Group operates a defined benefit pension scheme and defined contribution pension schemes in the UK. There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates.	The Group's defined benefit scheme ('the Plan') was closed to new members with effect from February 2002. Since that time, new employees have been invited to join the Group's defined contribution pension scheme which carries no investment or mortality risk for the Group. To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the reviews also assist the Trustee in managing the volatility in the underlying investment performance and the risk of a significant increase in the scheme deficit by providing information used in investment strategy decisions. The Plan is subject to triennial formal valuation by the Plan actuary. The valuation process as at 31 March 2019 is currently in progress, and will include the agreement of a recovery plan between the Trustees and the Group which will aim to clear the deficit in the Plan. This is will be agreed during the year ending 30 September 2020.

Change		
	Despite short-term fluctuations caused by market instability in interest rates and asset prices, the Group considers the underlying long-term funding position for the Plan to be robust and sustainable. *Further details of the Group's exposure to the Plan are given in note 41 to the Group Accounts.*	

B8
Directors' report

The directors of Paragon Banking Group PLC (registered number 2336032) submit their Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ('Schedule 7'), which also includes additional disclosures made in accordance with the requirements of the UK Listing Authority.

Directors and their interests

The directors of the Company during the year were:

F J Clutterbuck
N S Terrington
R J Woodman
J A Heron
A K Fletcher* (resigned 31 December 2018)
P J N Hartill*
H R Tudor*
P J Newberry* (resigned 31 December 2018)
B A Ridpath*
F F Williamson*
G H Yorston*

* Non-executive directors throughout the year.

The directors' interests in the shares of the Company are disclosed in the Directors' Remuneration Report in Section B6. There have been no changes in the directors' interests in the share capital of the Company since 30 September 2019.

During the year, Mr H R Tudor sold all of his interest in the Company's 6.00% sterling denominated notes due 2020 (2018: £300,000 held).

Other than as stated above, the directors had no interests in securities issued by the Company. The directors have no interests in the shares or debentures of the Company's subsidiary companies.

The appointment and replacement of the Company's directors is governed by the Articles of Association of the Company (the 'Articles'), the Code, the Companies Act 2006 and related legislation, and the individual service contracts and terms of appointment of the directors. The powers of the directors, and their service contracts and terms of appointment, are described in the Corporate Governance section, in Sections B3 and B6. The Articles may only be amended by the Company's shareholders in general meeting.

Under Article 161 of the Articles, the Company has qualifying third party indemnity provisions for the benefit of its directors, 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.

Under Article 85 of the Articles certain directors are required to submit themselves for reappointment. In accordance with the Code, however, the Board has decided that it is appropriate for all directors to submit themselves for reappointment on an annual basis. Accordingly, all current directors, other than Mr Hartill and Mr Heron, who have announced their intention to step down from the Board before the meeting, will retire and seek reappointment at the AGM.

None of the directors has a service contract with the Company requiring more than 12 months' notice of termination to be given.

A director has a statutory duty to avoid a situation in which he or she has, or can have, an interest that conflicts or possibly may conflict with the interests of the Company. A director will not be in breach of that duty if the relevant matter has been authorised in accordance with the Articles by the other directors. The Articles include the relevant authorisation for directors to approve such conflicts.

None of the directors had, either during or at the end of the year, any material interest in any contract of significance with the Company or its subsidiaries.

Capital structure

Details of the issued share capital of the Company, together with details of movements in its issued share capital in the year, are given in note 42 to the accounts. The Company has one class of ordinary shares which carries no right to fixed income. Each ordinary share carries the right to one vote at general meetings of the Company. The rights and obligations attaching to ordinary shares are set out in the Articles.

There are no specific restrictions on the size of a member's holding or on the transfer of shares. Both of these matters are governed by the general provisions of the Articles and prevailing legislation. The Articles may be amended by special resolution of the shareholders. The directors are not aware of any agreements between holders of the Company's shares in respect of voting rights or which might result in restrictions on the transfer of securities.

Details of employee share schemes are set out in note 12 to the accounts. Votes attaching to shares held by the Group's employee benefit trust are not exercised at general meetings of the Company.

The Company presently has the authority to issue ordinary shares up to a value of £86.8 million and to make market purchases of up to 26.0 million £1 ordinary shares, granted at the AGM on 14 February 2019. These authorities expire at the conclusion of the forthcoming AGM on 13 February 2020 and resolutions will be put to that meeting proposing that they be renewed.

Purchase of own shares

On 27 June 2019, the Group announced a share buy-back programme of £30.0 million. During the year, 6,048,852 £1 ordinary shares (2018: 5,106,641) having an aggregate nominal value of £6,048,852 (2018: £5,106,641), were purchased under this programme. The reasons for this purchase were set out in an announcement published on the regulatory news service of the London Stock Exchange at that time. Total consideration paid in the year was £26.7 million, including costs (2018: £25.2 million).

All of the shares acquired under this programme were held initially as treasury shares.

On 31 July 2019, 21,630,434 of the treasury shares acquired under these programmes were cancelled. These shares had a nominal value of £21,630,434 and represented 8.32% of the issued share capital excluding treasury shares at that time.

The number of treasury shares held at 30 September 2019 was 5,218,702 (2018: 20,800,284), representing 2.04% of the issued share capital excluding treasury shares (2018: 7.98%). The maximum holding of treasury shares during the year was 21,769,034 (2018: 20,800,284) representing 8.37% of the issued share capital excluding treasury shares at that time (2018: 7.98%).

Dividends

The directors recommend a final dividend of 14.2p per share (2018: 13.9p per share) which, taken with the interim dividend of 7.0p per share (2018: 5.5p per share) paid on 26 July 2019, would give a total dividend for the year of 21.2p per share (2018: 19.4p per share).

Major shareholdings

Notifications of the following major voting interests in the Company's ordinary share capital, notifiable in accordance with Chapter 5 of the FCA's Disclosure and Transparency Rules or section 793 of the Companies Act 2006, had been received by the Company as at 30 September 2019 and at 31 October 2019, being a date not more than one month before the date of the notice convening the forthcoming AGM.

	31 October 2019		30 September 2018	
Shareholder	**Ordinary Shares**	**% Held**	**Ordinary Shares**	**% Held**
Royal London Asset Management Limited	**18,020,262**	**7.03%**	18,020,262	7.03%
Prudential PLC Group of Companies*	**-**	**-**	18,012,554	7.03%
M&G PLC*	**16,933,305**	**6.60%**	-	-
Franklin Templeton Fund Management Limited	**13,061,935**	**5.01%**	13,061,935	5.10%
Dimensional Fund Advisors LP	**13,033,648**	**5.08%**	13,033,648	5.08%
Norges Bank	**11,007,893**	**4.29%**	11,007,893	4.29%

*Following the demerger of Prudential plc and M&G PLC, the holding previously held by the Prudential PLC Group of Companies is now held by M&G PLC.

Percentage holdings are calculated based on the total voting rights at the relevant date.

Significant agreements

The Company is not party to any significant agreements that would take effect, alter or terminate following a change of control of the company.

The Company does not have any agreements with any director or employee that would provide compensation for loss of office or employment resulting from a takeover of the Company, except that provisions of the Company's share based remuneration arrangements may cause awards granted to employees under such plans to vest in such circumstances.

Research and development

During the year, the Group 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 in 2010. Claims in respect of these activities were made in the Group's tax returns. The amounts involved were modest in the context of the Group accounts.

Political expenditure

Company law requires the disclosure of political donations and political expenditure by any Group company. During the year ended 30 September 2019 no such payments were made (2018: £nil).

Auditors

The directors have taken all reasonable steps to make themselves and the Company's auditors, KPMG LLP ('KPMG'), 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 auditors are unaware.

The directors, having considered the requirements for rotation of auditors, the length of service of KPMG and the conduct of the audit concluded there was no present need to retender the audit. Therefore, a resolution for the reappointment of KPMG, who have expressed their willingness to continue in office, as the auditors of the Company is to be proposed at the forthcoming AGM. The evaluation process is described more fully in the Audit Committee Section B5.

Annual General Meeting

The Annual General Meeting of the Company will take place on 13 February 2020 in London. A notice convening the AGM is being circulated to shareholders with this Annual Report and Accounts.

Listing Rule LR9.8.4

There are no matters which the Company is required to report under Listing Rule LR9.8.4, other than the fact that the trustees of its employee share ownership trust (note 44) have waived their right to receive dividends on any shares held from time to time. As these shares are held on the consolidated balance sheet, this has no effect on the amounts reported by the Group.

Information presented in other sections

Certain information required to be included in a directors' report by Schedule 7 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 Group is included in the Strategic Report (Section A)
- A description of the Group's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 56 to the accounts and related notes
- Information concerning directors' contractual arrangements and entitlements under share based remuneration arrangements is given in Section B6, the Directors' Remuneration Report
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in Section A5.2 – 'People'
- Disclosures concerning greenhouse gas emissions are given in Section A5.3 – 'Environmental Issues'
- Disclosures concerning events taking place after the balance sheet date are set out in note 32 to the accounts.

Rule DTR7.2.1 of the Disclosure Guidance and Transparency Rules requires the Group's disclosures on Corporate Governance to be included in the Directors' Report. This information is presented in Sections B3, B4, B5, B6 and B7 and the information in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

Rule DTR4.1.5 of the Disclosure Guidance and Transparency Rules requires that the annual report of a listed company contains a management report containing certain prescribed information. This Directors' Report, including the other sections of the Annual Report incorporated by reference, comprises a management report for the Group for the year ended 30 September 2019, for the purposes of the Disclosure Guidance and Transparency Rules.

Section B8 of this Annual Report, together with the other sections of the Annual Report incorporated by reference, comprise a directors' report for the Company which has been drawn up and presented in accordance with, and in reliance upon, applicable English company law and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

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

Pandora Sharp

Company Secretary

26 November 2019

B9

Statement of directors' responsibilities

in respect of financial statements

The directors are responsible for preparing this Annual Report, including the consolidated and company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare consolidated financial statements for the Group and separate financial statements for the Company in respect of each financial year. In respect of the financial statements for the year ended 30 September 2019, that law includes the Companies Act 2006 ('the Act') and Article 4 of the IAS Regulation. That law requires the directors to prepare the consolidated financial statements in accordance with IFRS as adopted by the EU and they have also elected to prepare the financial statements of the Company in accordance with IFRS as adopted by the EU.

International Accounting Standard 1 – 'Presentation of Financial Statements' requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's ('IASB') 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

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 Group and Company and the Group's profit or loss for the year. In preparing each of the consolidated and Company financial statements the directors are also required to:

- Select suitable accounting policies and apply them consistently
- Make judgements and estimates that are reasonable, relevant and reliable
- State whether the consolidated financial statements have been prepared in accordance with IFRS as adopted by the EU and whether the company financial statements have been prepared in accordance with the Act
- Assess the ability of the Group and the Company to continue as a going concern, disclosing, as applicable, matters related to going concern
- Use the going concern basis of accounting unless they intend to liquidate the Company and / or the Group or to cease operation or they have no realistic alternative to doing so
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping adequate accounting records for the Company which are sufficient to record and explain its transactions, disclose with reasonable accuracy at any time its financial position and enable them to ensure that its financial statements comply with the requirements of the Act.

They are responsible for the implementation of such internal control processes as they deem necessary to enable the preparation of financial statements which are free from material misstatements, 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 Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations the directors are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement which comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website (www.paragonbankinggroup.co.uk). Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Confirmation by the Board of Directors

Each of the current directors confirms that, to the best of their knowledge:

- The financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and of the Group taken as a whole
- The Directors' Report, including those other sections of the Annual Report incorporated by reference, comprises a management report for the purposes of the Disclosure Guidance and Transparency Rules, and includes a fair review of the development and performance of the business and the consolidated position of the Group taken as a whole, together with a description of the principal risks and uncertainties that it faces
- The Annual Report (including the consolidated and company financial statements), taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy

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

Pandora Sharp

Company Secretary

26 November 2019