THE ACCOUNTS

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

D1
Primary Financial Statements

D1.1 Consolidated Income Statement

For the year ended 30 September 2019

	Note	**2019**	**2019**	2018	2018
		IFRS 9	**IFRS 9**	IAS 39	IAS 39
		£m	**£m**	£m	£m
Interest receivable	*4*		**505.7**		451.9
Interest payable and similar charges	*5*		**(227.3)**		(197.3)
Net interest income			**278.4**		254.6
Other leasing income	*6*	**18.3**		16.3	
Related costs	*6*	**(14.5)**		(12.5)	
Net leasing income		**3.8**		3.8	
Gain on derecognition of financial assets	*7*	**9.7**		28.0	
Other income	*8*	**15.4**		15.5	
Other operating income			**28.9**		47.3
Total operating income			**307.3**		301.9
Operating expenses	*9*		**(125.2)**		(114.2)
Provisions for losses	*23*		**(8.0)**		(7.4)
Operating profit before fair value items			**174.1**		180.3
Fair value net gains / (losses)	*14*		**(15.1)**		1.2
Operating profit being profit on ordinary activities before taxation			**159.0**		181.5
Tax charge on profit on ordinary activities	*15*		**(31.6)**		(35.7)
Profit on ordinary activities after taxation for the financial year			**127.4**		145.8

	Note	**2019**	2018
Earnings per share			
- basic	*17*	**49.4p**	55.9p
- diluted	*17*	**48.2p**	54.2p

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

D1.2 Consolidated Statement of Comprehensive Income

For the year ended 30 September 2019

	Note	**2019 IFRS 9 £m**	**2019 IFRS 9 £m**	2018 IAS 39 £m	2018 IAS 39 £m
Profit for the year			**127.4**		145.8
Other comprehensive income					
Items that will not be reclassified subsequently to profit or loss					
Actuarial (loss) / gain on pension scheme	*41*	**(16.5)**		8.9	
Tax thereon		**2.4**		(1.7)	
			(14.1)		7.2
Items that may be reclassified subsequently to profit or loss					
Cash flow hedge gains taken to equity	*24*	**0.5**		1.0	
Tax thereon		**(0.1)**		(0.2)	
Reclassification on derecognition	*7*	**(0.9)**		-	
Tax thereon		**0.2**		-	
			(0.3)		0.8
Other comprehensive income for the year net of tax			**(14.4)**		8.0
Total comprehensive income for the year			**113.0**		153.8

D1.3 Consolidated Balance Sheet

For the year ended 30 September 2019

	Note	**2019**	2018	2018	2017
		IFRS 9	IFRS 9	IAS 39	IAS 39
		£m	£m	£m	£m
Assets					
Cash – central banks	*18*	**816.4**	895.9	895.9	615.0
Cash – retail banks	*18*	**409.0**	414.7	414.7	881.9
Short term investments	*19*	**-**	-	-	-
Loans to customers	*20*	**12,250.3**	12,076.5	12,103.7	11,115.4
Derivative financial assets	*24*	**592.4**	855.7	855.7	906.6
Sundry assets	*25*	**92.8**	19.0	19.0	12.7
Deferred tax assets	*26*	**6.2**	-	-	-
Property, plant and equipment	*27*	**57.3**	56.8	56.8	46.2
Intangible assets	*28*	**171.1**	169.3	169.3	104.4
Total assets		**14,395.5**	14,487.9	14,515.1	13,682.2
Liabilities					
Short term bank borrowings		**1.0**	1.1	1.1	0.6
Retail deposits	*31*	**6,395.8**	5,292.4	5,292.4	3,611.9
Derivative financial liabilities	*24*	**80.5**	4.7	4.7	7.1
Asset backed loan notes	*32*	**4,419.4**	5,554.7	5,554.7	6,475.8
Secured bank borrowings	*33*	**787.5**	935.6	935.6	1,306.0
Retail bond issuance	*34*	**296.5**	296.1	296.1	295.7
Corporate bond issuance	*35*	**149.6**	149.3	149.3	149.1
Central bank facilities	*36*	**994.4**	1,024.4	1,024.4	700.0
Sundry liabilities	*37*	**112.7**	114.4	114.4	74.6
Current tax liabilities	*40*	**15.2**	21.4	21.4	17.4
Deferred tax liabilities	*26*	**-**	0.8	5.6	4.8
Retirement benefit obligations	*41*	**34.5**	19.5	19.5	29.8
Total liabilities		**13,287.1**	13,414.4	13,419.2	12,672.8
Called up share capital	*42*	**261.6**	281.6	281.6	281.5
Reserves	*43*	**887.3**	895.9	918.3	811.0
Own shares	*44*	**(40.5)**	(104.0)	(104.0)	(83.1)
Total equity		**1,108.4**	1,073.5	1,095.9	1,009.4
Total liabilities and equity		**14,395.5**	14,487.9	14,515.1	13,682.2

Approved by the Board of Directors on 26 November 2019.
Signed of behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.4 Company Balance Sheet

For the year ended 30 September 2019

	Note	2019 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Assets				
Cash – retail banks	*18*	**14.1**	24.9	277.6
Sundry assets	*25*	**107.3**	217.0	40.1
Current tax assets	*40*	**2.8**	-	-
Property, plant and equipment	*27*	**-**	-	18.6
Investment in subsidiary undertakings	*30*	**940.7**	984.4	819.1
Total assets		**1,064.9**	1,226.3	1,155.4
Liabilities				
Retail bond issuance	*34*	**296.5**	296.1	295.7
Corporate bond issuance	*35*	**149.6**	149.3	149.1
Sundry liabilities	*37*	**27.4**	128.5	39.4
Deferred tax liabilities	*26*	**1.6**	1.8	1.8
Total liabilities		**475.1**	575.7	486.0
Called up share capital	*42*	**261.6**	281.6	281.5
Reserves	*43*	**351.2**	460.8	454.5
Own shares	*44*	**(23.0)**	(91.8)	(66.6)
Total equity		**589.8**	650.6	669.4
		1,064.9	1,226.3	1,155.4

Approved by the Board of Directors on 26 November 2019.
Signed of behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

D1.5 Consolidated Cash Flow Statement

For the year ended 30 September 2019

	Note	2019	2018
		£m	£m
Net cash generated by operating activities	46	**397.9**	1,074.4
Net cash generated / (utilised) by investing activities	47	**8.3**	(282.8)
Net cash (utilised) by financing activities	48	**(491.3)**	(978.4)
Net (decrease) in cash and cash equivalents		**(85.1)**	(186.8)
Opening cash and cash equivalents		**1,309.5**	1,496.3
Closing cash and cash equivalents		**1,224.4**	1,309.5
Represented by balances within:			
Cash	18	**1,225.4**	1,310.6
Short-term bank borrowings		**(1.0)**	(1.1)
		1,224.4	1,309.5

D1.6 Company Cash Flow Statement

For the year ended 30 September 2019

	Note	2019	2018
		£m	**£m**
Net cash generated / (utilised) by operating activities	46	**170.9**	(30.5)
Net cash (utilised) by investing activities	47	**(105.1)**	(154.3)
Net cash (utilised) by financing activities	48	**(76.6)**	(67.9)
Net (decrease) in cash and cash equivalents		**(10.8)**	(252.7)
Opening cash and cash equivalents		**24.9**	277.6
Closing cash and cash equivalents		**14.1**	24.9
Represented by balances within:			
Cash	18	**14.1**	24.9
Short-term bank borrowings		**-**	-
		14.1	24.9

D1.7 Consolidated Statement of Movements in Equity

For the year ended 30 September 2019 (IFRS 9)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	127.4	-	127.4
Other comprehensive income	-	-	-	-	(0.3)	(14.1)	-	(14.4)
Total comprehensive income	-	-	-	-	(0.3)	113.3	-	113.0
Transactions with owners								
Dividends paid (note 45)	-	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	-	(34.3)	(34.3)
Exercise of share awards	1.6	2.5	-	-	-	(2.5)	2.3	3.9
Charge for share based remuneration (note 10)	-	-	-	-	-	5.9	-	5.9
Tax on share based remuneration	-	-	-	-	-	0.4	-	0.4
Net movement in equity in the year	(20.0)	2.5	21.6	-	(0.3)	(32.4)	63.5	34.9
Opening equity								
As previously reported	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9
Change of accounting policy (note 62)	-	-	-	-	-	(22.4)	-	(22.4)
As restated	281.6	65.8	28.7	(70.2)	3.3	868.3	(104.0)	1,073.5
Closing equity	261.6	68.3	50.3	(70.2)	3.0	835.9	(40.5)	1,108.4

For the year ended 30 September 2018 (IAS 39)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	145.8	-	145.8
Other comprehensive income	-	-	-	-	0.8	7.2	-	8.0
Total comprehensive income	-	-	-	-	0.8	153.0	-	153.8
Transactions with owners								
Dividends paid (note 45)	-	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(31.4)	(31.4)
Exercise of share awards	0.1	0.3	-	-	-	(10.9)	10.5	-
Charge for share based remuneration (note 10)	-	-	-	-	-	6.1	-	6.1
Tax on share based remuneration	-	-	-	-	-	1.1	-	1.1
Net movement in equity in the year	0.1	0.3	-	-	0.8	106.2	(20.9)	86.5
Opening equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4
Closing equity	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9

D1.8 Company Statement of Movements in Equity

For the year ended 30 September 2019 (IFRS 9)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	9.9	-	9.9
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	9.9	-	9.9
Transactions with owners							
Dividends paid (note 45)	-	-	-	-	(54.0)	-	(54.0)
Shares cancelled	(21.6)	-	21.6	-	(95.5)	95.5	-
Own shares purchased	-	-	-	-	-	(26.7)	(26.7)
Exercise of share awards	1.6	2.5	-	-	-	-	4.1
Charge for share based remuneration (note 10)	-	-	-	-	5.9	-	5.9
Net movement in equity in the year	(20.0)	2.5	21.6	-	(133.7)	68.8	(60.8)
Opening equity	281.6	65.8	28.7	(23.7)	390.0	(91.8)	650.6
Closing equity	261.6	68.3	50.3	(23.7)	256.3	(23.0)	589.8

For the year ended 30 September 2018 (IAS 39)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	43.0	-	43.0
Other comprehensive income	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	43.0	-	43.0
Transactions with owners							
Dividends paid (note 45)	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	(25.2)	(25.2)
Exercise of share awards	0.1	0.3	-	-	-	-	0.4
Charge for share based remuneration (note 10)	-	-	-	-	6.1	-	6.1
Net movement in equity in the year	0.1	0.3	-	-	6.0	(25.2)	(18.8)
Opening equity	281.5	65.5	28.7	(23.7)	384.0	(66.6)	669.4
Closing equity	281.6	65.8	28.7	(23.7)	390.0	(91.8)	650.6

D2
Notes to the accounts

For the year ended 30 September 2019

1. GENERAL INFORMATION

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

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

The remaining notes to the accounts are organised in to three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Capital and Financial Risk Management – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the financial statements

D2.1 NOTES TO THE ACCOUNTS – ANALYSIS

For the year ended 30 September 2019

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

2. SEGMENTAL INFORMATION

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

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

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

Gains on derecognition of financial assets have not been allocated to segment results, nor have the costs arising in the year ended 30 September 2018 from the Iceberg and Titlestone acquisitions of £2.2m as those are not directly related to customer facing activity.

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

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

Other assets and liabilities are not allocated between segments.

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

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

Year ended 30 September 2019 (IFRS 9)

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

Year ended 30 September 2018 (IAS 39)

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total Segments
	£m	£m	£m	£m	£m
Interest receivable	299.1	50.1	97.9	4.8	451.9
Interest payable	(141.5)	(17.9)	(10.1)	(27.8)	(197.3)
Net interest income	157.6	32.2	87.8	(23.0)	254.6
Other operating income	7.6	10.9	0.7	28.1	47.3
Total operating income	165.2	43.1	88.5	5.1	301.9
Direct costs	(14.9)	(21.2)	(10.4)	(67.7)	(114.2)
Provisions for losses	(5.5)	(2.0)	0.1	-	(7.4)
	144.8	19.9	78.2	(62.6)	180.3

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

	2019	2018
	£m	£m
Results shown above	**174.1**	180.3
Fair value items	**(15.1)**	1.2
Operating profit	**159.0**	181.5

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

	Note	**Mortgages**	**Commercial Lending**	**Idem Capital**	**Total Segments**
		£m	**£m**	**£m**	**£m**
30 September 2019 (IFRS 9)					
Segment assets					
Loans to customers	20	**10,344.1**	**1,452.1**	**389.9**	**12,186.1**
Operating lease assets	27	**-**	**36.3**	**-**	**36.3**
Cross-currency basis swaps	24	**582.7**	**-**	**-**	**582.7**
Securitisation cash	18	**353.1**	**-**	**-**	**353.1**
		11,279.9	**1,488.4**	**389.9**	**13,158.2**
Segment liabilities					
Allocated deposits		**5,367.2**	**1,822.5**	**303.1**	**7,492.8**
Securitisation funding		**5,206.9**	**-**	**-**	**5,206.9**
		10,574.1	**1,822.5**	**303.1**	**12,699.7**

	Note	Mortgages	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
1 October 2018 (IFRS 9)					
Segment assets					
Loans to customers	20	10,449.5	1,131.3	519.8	12,100.6
Operating lease assets	27	-	35.4	-	35.4
Cross-currency basis swaps	24	829.7	-	-	829.7
Securitisation cash	18	319.0	-	19.8	338.8
		11,598.2	1,166.7	539.6	13,304.5
Segment liabilities					
Allocated deposits		4,702.4	1,443.5	411.0	6,556.9
Securitisation funding		6,457.2	-	33.1	6,490.3
		11,159.6	1,443.5	444.1	13,047.2

	Note	Mortgages	Commercial Lending	Idem Capital	Total Segments
		£m	£m	£m	£m
30 September 2018 (IAS 39)					
Segment assets					
Loans to customers	20	10,473.5	1,133.2	521.1	12,127.8
Operating lease assets	27	-	35.4	-	35.4
Cross-currency basis swaps	24	829.7	-	-	829.7
Securitisation cash	18	319.0	-	19.8	338.8
		11,622.2	1,168.6	540.9	13,331.7
Segment liabilities					
Allocated deposits		4,702.4	1,443.5	411.0	6,556.9
Securitisation funding		6,457.2	-	33.1	6,490.3
		11,159.6	1,443.5	444.1	13,047.2

An analysis of the Group's financial assets by type and segment is shown in note 20. All of the assets shown above were located in the UK.

The additions to non-current assets, excluding financial assets, in the year which are included in segmental assets above are investments of £11.6m (2018: £19.3m) in assets held for leasing under operating leases, included in the Commercial Lending segment. No other fixed asset additions were allocated to segments.

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

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Total segment assets	**13,158.2**	13,304.5	13,331.7
Unallocated assets			
Central cash and investments	**872.3**	971.8	971.8
Unallocated derivatives	**9.7**	26.0	26.0
Operational property, plant and equipment	**21.0**	21.4	21.4
Intangible assets	**171.1**	169.3	169.3
Other	**163.2**	(5.1)	(5.1)
Total assets	**14,395.5**	14,487.9	14,515.1

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
Total segment liabilities	**12,699.7**	13,047.2	13,047.2
Unallocated liabilities			
Unallocated retail deposits	**(1,100.9)**	(1,260.3)	(1,260.3)
Derivative financial instruments	**80.5**	4.7	4.7
Central bank borrowings	**1,441.5**	1,470.9	1,470.9
Tax liabilities	**15.2**	22.2	27.0
Retirement benefit obligations	**34.5**	19.5	19.5
Other	**116.6**	110.2	110.2
Total liabilities	**13,287.1**	13,414.4	13,419.2

3. REVENUE

	Note	2019 IFRS 9 £m	2018 IAS 39 £m
Interest receivable	*4*	**505.7**	451.9
Operating lease income	*6*	**18.3**	16.3
Gain on disposal of financial assets	*7*	**9.7**	28.0
Other income	*8*	**15.4**	15.5
Total revenue		**549.1**	511.7
Arising from:			
Mortgages		**348.9**	306.7
Commercial Lending		**121.2**	73.5
Idem Capital		**62.7**	98.6
Total revenue from segments		**532.8**	478.8
Unallocated revenue		**16.3**	32.9
Total revenue		**549.1**	511.7

4. INTEREST RECEIVABLE

	2019 IFRS 9 £m	2018 IAS 39 £m
Interest receivable in respect of		
Loan accounts	**449.3**	408.9
Finance leases	**44.5**	34.4
Factoring income	**3.1**	2.2
Interest on loans to customers	**496.9**	445.5
Other interest receivable	**8.8**	6.4
Total interest on financial assets	**505.7**	451.9

The above interest arises from:

	2019 IFRS 9 £m	2018 IAS 39 £m
Financial assets held at amortised cost	**461.2**	417.5
Finance leases	**44.5**	34.4
	505.7	451.9

In 2018, under the requirements of IAS 39, interest receivable on loans to customers included £2.3m charged on accounts where an impairment provision had been made.

5. INTEREST PAYABLE AND SIMILAR CHARGES

	Note	2019 £m	2018 £m
On retail deposits		**114.2**	83.1
On asset backed loan notes		**63.4**	60.3
On bank loans and overdrafts		**9.6**	16.5
On corporate bonds		**10.9**	10.9
On retail bonds		**18.6**	18.6
On central bank facilities		**8.0**	5.2
Total interest on financial liabilities		**224.7**	194.6
On pension scheme deficit	*41*	**0.5**	0.8
Discounting on contingent consideration	*38*	**0.5**	0.5
Other finance costs		**1.6**	1.4
		227.3	197.3

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

6. NET OPERATING LEASE INCOME

	Note	2019	2018
		£m	£m
Income			
Operating lease rentals		**14.0**	11.4
Maintenance income		**4.3**	4.9
Total operating lease income		**18.3**	16.3
Costs			
Depreciation of lease assets	*27*	**(7.6)**	(5.9)
Maintenance salaries	*10*	**(1.9)**	(1.5)
Other maintenance costs		**(5.0)**	(5.1)
Total operating lease costs		**(14.5)**	(12.5)
Net operating lease income		**3.8**	3.8

7. GAIN ON DISPOSAL OF FINANCIAL ASSETS

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

The assets and liabilities derecognised in this transaction are set out below.

	£m
Cash	**37.7**
Loans to customers	**695.8**
Derivative financial assets	**93.6**
Other financial assets	**-**
	827.1
Asset backed loan notes	**784.1**
Tax liabilities	**1.9**
Other financial liabilities	**1.7**
	787.7
Net assets derecognised	**39.4**

Cash consideration received	**49.8**
Net assets derecognised	**(39.4)**
Transaction costs	**(0.7)**
Net gain on derecognition	**9.7**

The cash flow hedge relationship, including the derivatives and asset backed loan notes ceased on their derecognition and consequently an amount of £0.9m, less related tax of £0.2m, was recycled to profit and loss, and is included in other comprehensive income.

During the year ended 30 September 2018, the Group realised a gain of £28.0m on the disposal of second charge mortgages and unsecured consumer loans held in its Idem Capital division. The loans were originally acquired from various third parties as part of a number of portfolio purchases over time.

8. OTHER INCOME

	2019 £m	2018 £m
Loan account fee income	**7.2**	9.0
Broker commissions	**2.2**	2.1
Third party servicing	**5.0**	3.4
Other income	**1.0**	1.0
	15.4	15.5

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

9. OPERATING EXPENSES

	Note	2019 £m	2018 £m
Employment costs	*10*	**79.3**	73.3
Auditor remuneration	*13*	**1.8**	1.6
Amortisation of intangible assets	*28*	**2.4**	2.1
Depreciation of operational assets	*27*	**1.5**	1.9
Operating lease rentals payable	*51*	**2.9**	2.2
Other administrative costs		**37.3**	33.1
		125.2	114.2

10. EMPLOYEES

The average number of persons (including directors) employed by the Group during the year was 1,365 (2018: 1,349). The number of employees at the end of the year was 1,368 (2018: 1,367).

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

	2019 £m	2019 £m	2018 £m	2018 £m
Share based remuneration	**5.9**		6.1	
Other wages and salaries	**62.6**		57.2	
Total wages and salaries		**68.5**		63.3
National Insurance on share based remuneration	**1.0**		1.2	
Other social security costs	**7.7**		6.6	
Total social security costs		**8.7**		7.8
Defined benefit pension cost	**1.9**		1.8	
Other pension costs	**2.1**		1.9	
Total pension costs		**4.0**		3.7
Total employment costs		**81.2**		74.8
Of which				
Included in operating expenses (note 9)		**79.3**		73.3
Included in maintenance costs (note 6)		**1.9**		1.5
		81.2		74.8

Details of the pension schemes operated by the Group are given in note 41. The Company has no employees. Details of the directors' remuneration are given in note 11.

11. KEY MANAGEMENT REMUNERATION

The remuneration of the directors, who are the key management personnel of the Group and the Company, is set out below in aggregate in accordance with IAS 24 – 'Related Party Transactions'. Further information about the remuneration of individual directors is provided in the Annual Report on Remuneration in Section B6.2.2.

	2019	**2019**	2018	2018
	£m	**£m**	£m	£m
Salaries and fees	**1.8**		1.9	
Cash amount of bonus	**1.5**		1.5	
Social security costs	**0.5**		0.5	
Short-term employee benefits		**3.8**		3.9
Post-employment benefits		**0.5**		0.5
IFRS 2 cost in respect of directors	**2.1**		2.2	
National Insurance thereon	**0.4**		0.5	
Share based payment		**2.5**		2.7
		6.8		7.1

Post-employment benefits shown above are shown as 'pension allowance' in Section B6.2.2. Costs in respect of share awards shown in the Annual Report on Remuneration are determined on a different basis to the IFRS 2 charge shown above.

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

12. SHARE BASED REMUNERATION

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

The effect of the share based payment arrangements on the Group's profit is shown in note 10.

Further details of share based payment arrangements are given in the Annual Report on Remuneration in Section B6.2.2.

A summary of the number of share awards outstanding under each scheme at 30 September 2019 and at 30 September 2018 is set out below.

	Number	Number
	2019	2018
(a) Sharesave Plan	**2,558,569**	3,265,788
(b) Performance Share Plan	**4,762,886**	4,297,809
(c) Company Share Option Plan	**730,816**	549,061
(d) Deferred Bonus Plan	**774,046**	496,762
(e) Restricted Stock Units	**134,827**	82,787
	8,961,144	8,692,207

(a) Sharesave plan

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

A reconciliation of movements in the number and weighted average exercise price of Sharesave options over £1 ordinary shares during the year ended 30 September 2019 and the year ended 30 September 2018 is shown below.

	2019	**2019**	2018	2018
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2018	**3,265,788**	**281.60**	3,113,587	275.56
Granted in the year	**1,147,016**	**360.16**	464,112	408.80
Exercised or surrendered in the year	**(1,606,849)**	**253.65**	(107,235)	335.74
Lapsed during the year	**(247,386)**	**361.53**	(204,676)	307.04
At 30 September 2019	**2,558,569**	**338.06**	3,265,788	281.60
Options exercisable	**119,846**	**249.44**	21,966	345.68

The weighted average remaining contractual life of options outstanding at 30 September 2019 was 26.1 months (2018: 19.7 months). The weighted average market price at exercise for share options exercised in the year was 400.88p (2018: 492.50p).

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

Grant date	**Period exercisable**	**Exercise price**	**Number 2019**	Number 2018
23/12/2013	01/02/2019 to 01/08/2019	276.32p	**-**	147,415
11/06/2015	01/08/2018 to 01/02/2019	345.68p	**-**	21,966
11/06/2015	01/08/2020 to 01/02/2021	345.68p	**9,977**	10,063
20/06/2016	01/08/2019 to 01/02/2020	249.44p	**119,846**	1,593,061
20/06/2016	01/08/2021 to 01/02/2022	249.44p	**439,425**	445,077
28/07/2017	01/09/2020 to 01/03/2021	341.76p	**493,841**	541,521
28/07/2017	01/09/2022 to 01/03/2023	341.76p	**44,667**	52,653
31/07/2018	01/09/2021 to 01/03/2022	408.80p	**278,873**	391,019
31/07/2018	01/09/2023 to 01/03/2024	408.80p	**38,581**	63,013
30/07/2019	01/09/2022 to 01/03/2023	360.16p	**1,049,338**	-
30/07/2019	01/09/2024 to 01/03/2025	360.16p	**84,021**	-
			2,558,569	3,265,788

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

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

The fair value of options granted is determined using a trinomial model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018, are shown below.

Grant date	30/07/19	30/07/19	31/07/18	31/07/18
Number of awards granted	**1,058,831**	**88,185**	401,099	63,013
Market price at date of grant	**422.0p**	**422.0p**	498.0p	498.0p
Contractual life (years)	**3.5**	**5.5**	3.5	5.5
Fair value per share at date of grant (£)	**0.51**	**0.53**	1.00	0.91
Inputs to valuation model				
Expected volatility	**22.58%**	**26.44%**	28.39%	26.47%
Expected life at grant date (years)	**3.48**	**5.47**	3.45	5.44
Risk-free interest rate	**0.36%**	**0.40%**	1.23%	1.39%
Expected dividend yield	**4.95%**	**4.95%**	3.31%	3.31%
Expected annual departures	**5.00%**	**5.00%**	5.00%	5.00%

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

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

Awards under this plan comprise a right to acquire ordinary shares in the Company for nil or nominal payment and will vest on the third anniversary of their granting, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

Awards are exercisable from the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied to the day before the tenth anniversary of the grant date. Clawback provisions apply to awards granted under the PSP as detailed in the remuneration policy.

The conditional entitlements outstanding under this scheme at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Number 2019	Number 2018
21/05/2009	21/05/2012 to 20/05/2019 †	-	15,000
04/01/2010	04/01/2013 to 03/01/2020 †	**18,702**	33,664
17/12/2010	17/12/2013 to 16/12/2020 †	**12,424**	12,424
21/12/2011	21/12/2014 to 20/12/2021 †	**15,335**	15,335
28/02/2013	28/02/2016 to 27/02/2023 †	**6,981**	8,824
10/12/2013	10/12/2016 to 09/12/2023 †	**76,614**	77,717
18/12/2014	18/12/2017 to 17/12/2024 †	**233,550**	243,297
22/12/2015	22/12/2018 to 21/12/2025 ‡	**411,800**	1,384,246
01/12/2016	01/12/2019 to 30/11/2026 §	**1,339,409**	1,342,051
08/12/2017	08/12/2020 to 07/12/2027 §	**1,161,803**	1,165,251
14/12/2018	14/12/2018 to 13/12/2028 ◊	**1,486,268**	-
		4,762,866	4,297,809

† These awards, which were conditional on the achievement of performance based criteria, have now vested.

‡ 50% of these awards were subject to a TSR test and 50% were subject to an EPS test. The TSR test compared the rank of the Company's TSR against a comparator group of companies comprising the constituents of the FTSE-250. 25% of the TSR-tested awards vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance. The EPS test provided that 25% of EPS tested awards would vest where EPS growth was equal to the increase in the retail price index plus 3%, increasing on a straight line basis to full vesting for EPS growth equal to the increase in the retail price index plus 13% or more. For both tests the testing period was the three financial years commencing with the year of grant.

§ 50% of these awards are subject to a TSR test and 25% are subject to an EPS test as described at ‡ above, except that the comparator group for the TSR test is limited to a group of listed UK financial service entities rather than the entire FTSE-250. This group is determined at the point of each grant. In the EPS test, full vesting of the awards takes place if EPS growth is equal to the increase in the retail price index plus 7% or more.

The remaining 25% of these awards are subject to a risk performance condition which takes in to account factors deemed appropriate by the Remuneration Committee, who will ultimately decide the extent to which the risk condition has been satisfied.

Once the outcomes of these tests have been determined, the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below is equal to the gain from the gross PSP vesting.

◊ 50% of these awards are subject to a TSR test, 25% to an EPS test and 25% to a risk based test, similar to those described as § above, except that EPS at the end of the test period is compared to an absolute target, rather than RPI.

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

The fair value of awards granted under the PSP is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018 are shown below:

Grant date	14/12/18	08/12/17
Number of awards granted	**1,493,230**	1,177,290
Market price at date of grant	**401.00p**	483.20p
Fair value per share at date of grant	**307.32p**	338.66p
Inputs to valuation model		
Expected volatility	**28.86%**	28.25%
Risk-free interest rate	**1.20%**	0.94%

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

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

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

The PSP includes a tax advantaged element under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each member of staff may be granted up to a maximum total value of £30,000 of tax benefitted options.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2019 and the year ended 30 September 2018 is shown below.

	2019	**2019**	2018	2018
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
		p		p
Options outstanding				
At 1 October 2018	**549,061**	**399.16**	390,746	361.88
Granted in the year	**191,543**	**396.04**	179,722	477.76
Exercised or surrendered in the year	**-**	**-**	-	-
Lapsed during the year	**(9,788)**	**410.72**	(21,407)	378.59
At 30 September 2019	**730,816**	**398.19**	549,061	399.16
Options exercisable	-	-	-	-

The conditional entitlements outstanding under this scheme at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Exercise price	Number **2019**	Number 2018
01/12/2016	01/12/2019 to 30/11/2026 ◊	361.88p	**370,445**	372,426
08/12/2017	08/12/2020 to 07/12/2027 ◊	477.76p	**174,049**	176,635
14/12/2018	14/12/2021 to 13/12/2028 ◊	396.04p	**186,322**	-
			730,816	549,061

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

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

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

(d) Deferred Bonus awards

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Number 2019	Number 2018
10/12/2013	10/12/2016 to 09/12/2023	**55,302**	55,302
18/12/2014	18/12/2017 to 17/12/2024	**79,853**	99,102
22/12/2015	22/12/2018 to 21/12/2025	**96,559**	134,524
01/12/2016	01/12/2019 to 30/11/2026	**105,318**	105,318
08/12/2017	08/12/2020 to 07/12/2027	**102,516**	102,516
14/12/2018	14/12/2021 to 13/12/2028	**334,498**	-
		774,046	496,762

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

The Deferred Bonus shares granted in December 2016 and thereafter accrue dividends only over the vesting period, unlike earlier grants which accrued dividends until the point of exercise. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018 are shown below.

Grant date	14/12/18	08/12/17
Number of awards granted	**334,498**	102,516
Market price at date of grant	**401.00p**	483.20p
Fair value per share at date of grant	**401.00p**	483.20p

(e) Restricted Stock Units ('RSUs')

Since 2016, the Company has permitted certain employees to elect to receive RSU awards instead of PSP awards. RSU awards have vesting conditions based upon the grantee's personal performance (including a risk element) rather than conditions in the wider business. These conditions are determined to be met to the extent to which the Remuneration Committee deems that to be the case.

The conditional entitlements outstanding under this scheme at 30 September 2019 and 30 September 2018 were:

Grant date	Period exercisable	Number 2019	Number 2018
01/12/2016	01/12/2019 to 30/11/2026	**60,115**	60,115
08/12/2017	08/12/2020 to 07/12/2027	**22,672**	22,672
14/12/2018	14/12/2021 to 13/12/2028	**52,040**	-
		134,827	82,787

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2019 and the year ended 30 September 2018 are shown below.

Grant date	14/12/18	08/12/17
Number of awards granted	**52,040**	22,672
Market price at date of grant	**401.00p**	483.20p
Fair value per share at date of grant	**401.00p**	483.20p

13. AUDITOR REMUNERATION

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

	2019	2018
	£000	£000
Audit fee of the company	**462**	445
Other services		
Audit of subsidiary undertakings pursuant to legislation	**890**	716
Total audit fees	**1,352**	1,161
Audit related assurance services		
Interim review	**90**	62
Other	**22**	20
Other assurance services	**-**	68
Total fees	**1,464**	1,311
Irrecoverable VAT	**293**	262
Total cost to the Group (note 9)	**1,757**	1,573

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

14. FAIR VALUE NET (LOSSES) / GAINS

	2019	2018
	£m	£m
Ineffectiveness of fair value hedges (note 24)		
Portfolio hedges of interest rate risk		
Deposit hedge	**(0.2)**	0.2
Loan hedge	**(6.3)**	1.1
	(6.5)	1.3
Ineffectiveness of cash flow hedges	**-**	-
Other hedging movements	**(5.8)**	(0.5)
Net (losses) / gains on other derivatives	**(2.8)**	0.4
	(15.1)	1.2

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

15. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

(a) Analysis of charge in the year

	2019 £m	2018 £m
Current tax		
UK Corporation Tax on profits of the period	**36.3**	38.0
Adjustment in respect of prior periods	**(2.4)**	(1.1)
Total current tax	**33.9**	36.9
Deferred tax	**(2.3)**	(1.2)
Tax charge on profit on ordinary activities	**31.6**	35.7

The standard rate of corporation tax applicable to the Group for the year ended 30 September 2018 was 19.0%, the rate in the year ended 30 September 2019 was 19.0%, the rate in the year ending 30 September 2020 is expected to be 18.0% and the rate in subsequent years is expected to be 17.0%, based on currently enacted legislation.

The Bank Corporation Tax Surcharge was introduced with effect from 1 January 2016. This subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional 8.0% of tax to the extent these profits exceed £25.0m. The effect of the surcharge shown in note (c) below.

(b) Deferred tax credit for the year

The deferred tax credit in the income statement comprises the following temporary differences:

	2019 £m	2018 £m
Accelerated tax depreciation	**0.2**	(0.9)
Retirement benefit obligations	**0.3**	0.3
Impairment and other provisions	**(2.1)**	(0.8)
Utilisation of tax losses	**(0.2)**	-
Other timing differences	**(1.9)**	(0.7)
Deferred tax (credit) for the year	**(3.7)**	(2.1)
Prior period adjustment	**1.4**	0.9
Deferred tax (credit) (note 26)	**(2.3)**	(1.2)

The expected impact on deferred tax balances of the changes in the rate of Corporation Tax to 19.0% and 17.0% described above was initially accounted when the changes in rate were substantively enacted.

(c) Factors affecting tax charge for the year

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

The Group operates wholly in the UK and all but a nominal amount of the Group's income arises in UK resident companies. Consequently, it is appropriate to use the prevailing UK corporation tax rate as the comparator to the effective tax rate. As noted in (b) above, the UK Corporation tax rate applicable to the Group for the year was 19.0% (2018: 19.0%).

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

	2019	2018
	£m	£m
Profit on ordinary activities before taxation	**159.0**	181.5
Profit on ordinary activities multiplied by the UK standard rate of corporation tax	**30.2**	34.5
Effects of:		
Permanent differences		
- Disallowable acquisition costs	**-**	0.3
- Income from structured entities	**-**	(0.6)
- Recurring disallowable expenditure and similar items	**0.4**	0.1
Mismatch in timing differences	**0.3**	0.5
Change in rate of taxation on deferred tax assets and liabilities	**(0.6)**	0.2
Bank Corporation Tax Surcharge	**2.1**	0.9
Tax losses created with no corresponding deferred tax asset recognised	**0.1**	-
Prior year (credit)	**(0.9)**	(0.2)
Tax charge for the year	**31.6**	35.7

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

(d) Factors affecting future tax charges

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

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

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

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

16. PROFIT ATTRIBUTABLE TO MEMBERS OF PARAGON BANKING GROUP PLC

The Company's profit after tax for the financial year amounted to £9.9m (2018: £43.0m). A separate income statement has not been prepared for the Company under the provisions of Section 408 of the Companies Act 2006.

The Company has no other items of comprehensive income for the years ended 30 September 2019 or 30 September 2018.

17. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	2019	2018
Profit for the year (£m)	**127.4**	145.8
Basic weighted average number of ordinary shares ranking for dividend during the year (million)	**257.6**	260.8
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)	**6.7**	8.4
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)	**264.3**	269.2
Earnings per ordinary share		
- basic	**49.4p**	55.9p
- diluted	**48.2p**	54.2p

18. CASH AND CASH EQUIVALENTS

	2019	2018	2017
	£m	£m	£m
Deposits with the Bank of England	**816.4**	895.9	615.0
Balances with central banks	**816.4**	895.9	615.0
Deposits with other banks	**409.0**	393.1	758.8
Money Market Fund investments	**-**	21.6	123.1
Balances with other banks	**409.0**	414.7	881.9
Cash and cash equivalents	**1,225.4**	1,310.6	1,496.9

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements. This cash is shown as 'securitisation cash' below.

Balances with central banks form part of the liquidity buffer of Paragon Bank PLC and are therefore not available for the Group's general purposes. Free cash may also be deposited at the Bank of England.

Cash held by the Trustee of the Group's employee share ownership plan may only be used to invest in the shares of the Company, pursuant to the aims of that plan. This is shown as 'ESOP cash' below.

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

	2019	2018	2017
	£m	£m	£m
Free cash	**225.7**	238.0	305.5
Securitisation cash	**353.1**	338.8	574.0
Liquidity buffer	**646.4**	724.9	615.0
ESOP cash	**0.2**	8.9	2.4
	1,225.4	1,310.6	1,496.9

The 'Cash and Cash Equivalents' amount of £14.1m (2018: £24.9m; 2017: £277.6m) shown in the Company balance sheet is included in 'Free Cash'. This amount includes £nil of Money Market Fund investments (2018: £150.0m, 2017: £119.5m)

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England.

Cash and cash equivalents are allocated to Stage 1 assets. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

19. SHORT TERM INVESTMENTS

This amount represents fixed rate securities issued by the UK Government for which a liquid market exists, and which are held from time to time, as part of the liquidity requirement of Paragon Bank PLC.

No such securities were held at either 30 September 2019 or 30 September 2018, but the Group held this type of investment during the year.

20. LOANS TO CUSTOMERS

	Note	**2019**	2018	2018	2017
		IFRS 9	IFRS 9	IAS 39	IAS 39
		£m	£m	£m	£m
Loan accounts	*21*	**11,394.3**	11,381.5	11,407.4	10,636.1
Finance lease receivables	*22*	**791.8**	719.1	720.4	488.0
Loans to customers		**12,186.1**	12,100.6	12,127.8	11,124.1
Fair value adjustments from portfolio hedging	*24*	**64.2**	(24.1)	(24.1)	(8.7)
		12,250.3	12,076.5	12,103.7	11,115.4

The Group's loans to customers at 30 September 2019, analysed between the segments described in note 2 are as follows:

	Mortgages	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At 30 September 2019 (IFRS 9)				
First mortgages	**10,172.5**	**-**	**-**	**10,172.5**
Consumer loans	**171.6**	**-**	**352.3**	**523.9**
Motor finance	**-**	**281.3**	**37.6**	**318.9**
Asset finance	**-**	**492.2**	**-**	**492.2**
Development finance	**-**	**506.5**	**-**	**506.5**
Other loans	**-**	**172.1**	**-**	**172.1**
Loans to customers	**10,344.1**	**1,452.1**	**389.9**	**12,186.1**
At 1 October 2018 (IFRS 9)				
First mortgages	10,308.3	-	-	10,308.3
Consumer loans	141.2	-	447.0	588.2
Motor finance	-	256.4	72.8	329.2
Asset finance	-	402.3	-	402.3
Development finance	-	352.9	-	352.9
Other commercial loans	-	119.7	-	119.7
Loans to customers	10,449.5	1,131.3	519.8	12,100.6
At 30 September 2018 (IAS 39)				
First mortgages	10,332.2	-	-	10,332.2
Consumer loans	141.3	-	448.3	589.6
Motor finance	-	256.6	72.8	329.4
Asset finance	-	403.4	-	403.4
Development finance	-	352.8	-	352.8
Other loans	-	120.4	-	120.4
Loans to customers	10,473.5	1,133.2	521.1	12,127.8

The Group's purchased loan portfolios are analysed below.

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m
First mortgage loans	**15.7**	11.7	11.7
Consumer loans	**275.4**	352.0	352.5
Motor finance loans	**37.6**	72.8	72.8
	328.7	436.5	437.0

Information on the ERCs for first mortgages and consumer loans is given in note 57. All other loans above are internally generated or arise from acquired operations.

21. LOAN ACCOUNTS

Loan accounts at 30 September 2019, 1 October 2018, 30 September 2018 and 30 September 2017, which are all denominated and payable in sterling, were:

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
First mortgage loans	**10,172.5**	10,308.3	10,332.2	9,855.5
Second charge mortgage loans	**389.2**	414.4	415.9	490.7
Other unsecured consumer loans	**134.7**	173.8	173.7	219.1
Development finance loans	**506.5**	352.9	352.8	42.3
Other secured commercial lending	**125.9**	72.8	72.9	17.5
Other commercial loans	**65.5**	59.3	59.9	11.0
	11,394.3	11,381.5	11,407.4	10,636.1

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

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

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

The amounts of the loan assets above pledged as collateral under the central bank facilities described in note 36 or under the external funding arrangements described in notes 32 and 33 are shown below. The table also shows assets prepositioned with the Bank of England for use in future drawings.

	First Mortgages £m	Consumer Finance £m	Other £m	Total £m
30 September 2019 (IFRS 9)				
In respect of:				
Asset backed loan notes	**4,338.3**	**-**	**-**	**4,338.3**
Warehouse facilities	**948.1**	**-**	**-**	**948.1**
Central bank facilities	**1,734.4**	**-**	**-**	**1,734.4**
Total pledged as collateral	**7,020.8**	**-**	**-**	**7,020.8**
Prepositioned with Bank of England	**1,873.7**	**-**	**-**	**1,873.7**
Other assets not pledged as collateral	**1,278.0**	**523.9**	**697.9**	**2,499.8**
	10,172.5	**523.9**	**697.9**	**11,394.3**
1 October 2018 (IFRS 9)				
In respect of:				
Asset backed loan notes	5,037.8	40.4	-	5,078.2
Warehouse facilities	1,023.8	-	-	1,023.8
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,731.7	40.4	-	7,772.1
Prepositioned with Bank of England	1,171.0	-	-	1,171.0
Other assets not pledged as collateral	1,405.6	547.8	485.0	2,438.4
	10,308.3	588.2	485.0	11,381.5
30 September 2018 (IAS 39)				
In respect of:				
Asset backed loan notes	5,052.2	40.8	-	5,093.0
Warehouse facilities	1,030.2	-	-	1,030.2
Central bank facilities	1,670.1	-	-	1,670.1
Total pledged as collateral	7,752.5	40.8	-	7,793.3
Prepositioned with Bank of England	1,171.1	-	-	1,171.1
Other assets not pledged as collateral	1,408.6	548.8	485.6	2,443.0
	10,332.2	589.6	485.6	11,407.4

22. FINANCE LEASE RECEIVABLES

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

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Motor finance	**318.9**	329.2	329.4	163.0
Asset finance	**472.9**	389.9	391.0	325.0
Carrying value	**791.8**	719.1	720.4	488.0

The minimum lease payments due under these loan agreements are:

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Amounts receivable				
Within one year	**292.9**	258.5	259.5	174.9
Within two to five years	**566.7**	529.4	530.2	357.6
After five years	**40.2**	30.9	30.9	17.8
	897.8	818.8	820.6	550.3
Less: future finance income	**(101.4)**	(95.2)	(95.2)	(58.3)
Present value	**798.4**	723.6	725.4	492.0

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

	2019 IFRS 9 £m	2018 IFRS 9 £m	2018 IAS 39 £m	2017 IAS 39 £m
Amounts receivable				
Within one year	**255.8**	225.5	226.4	151.9
Within two to five years	**506.6**	470.8	471.7	323.8
After five years	**36.0**	27.3	27.3	16.3
Present value	**798.4**	723.6	725.4	492.0
Allowance for uncollectible amounts	**(6.6)**	(4.5)	(5.0)	(4.0)
Carrying value	**791.8**	719.1	720.4	488.0

None of the Group's finance lease receivables were pledged as collateral for liabilities at 30 September 2019 or 30 September 2018.

23. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Group's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 20, including both finance leases, accounted for under IAS 17, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

- Basis of provision
- Impairments by stage and division
- Movements in impairment provision in the period
- Impairments charged to income
- Economic inputs to provision calculations
- Sensitivity analysis

Basis of provision

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

Calculation of expected credit loss ('ECL')

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

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

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

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

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

Significant Increase in Credit Risk ('SICR')

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

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

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

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

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

Definitions of default

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

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

Credit Impaired loans

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

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

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

During the year the Group revised certain of its default definitions for regulatory purposes. Where appropriate, IFRS 9 definitions have been amended to harmonise with the new definition and hence the staging at 1 October 2018 set out below differs from that presented in the Group's transition report.

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

IFRS 9 Staging

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

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

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

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

Impairments by stage

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

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

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
1 October 2018					
Gross loan book					
Mortgages	9,961.6	369.9	142.4	11.7	10,485.6
Commercial Lending	1,106.4	8.2	5.8	17.5	1,137.9
Idem Capital	206.1	19.7	40.0	265.5	531.3
Total	11,274.1	397.8	188.2	294.7	12,154.8
Impairment provision					
Mortgages	(0.3)	(1.7)	(34.1)	-	(36.1)
Commercial Lending	(4.2)	(0.4)	(2.0)	-	(6.6)
Idem Capital	(0.4)	(0.5)	(10.6)	-	(11.5)
Total	(4.9)	(2.6)	(46.7)	-	(54.2)
Net loan book					
Mortgages	9,961.3	368.2	108.3	11.7	10,449.5
Commercial Lending	1,102.2	7.8	3.8	17.5	1,131.3
Idem Capital	205.7	19.2	29.4	265.5	519.8
Total	11,269.2	395.2	141.5	294.7	12,100.6
Coverage ratio					
Mortgages	-	0.46%	23.95%	-	0.34%
Commercial Lending	0.38%	4.88%	34.48%	-	0.58%
Idem Capital	0.19%	2.54%	26.50%	-	2.16%
Total	0.04%	0.65%	24.81%	-	0.45%

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

Finance leases included above, analysed by staging, were:

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
30 September 2019					
Gross loan book	**734.2**	**21.0**	**5.7**	**37.5**	**798.4**
Impairment provision	**(3.2)**	**(0.7)**	**(2.7)**	**-**	**(6.6)**
Net loan book	**731.0**	**20.3**	**3.0**	**37.5**	**791.8**
1 October 2018					
Gross loan book	637.5	8.2	5.1	72.8	723.6
Impairment provision	(2.6)	(0.3)	(1.6)	-	(4.5)
Net loan book	634.9	7.9	3.5	72.8	719.1

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

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above. Acquired portfolios which were largely non-performing at acquisition, and which were purchased at a deep discount to face value are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

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

Coverage for Stage 2 cases remains broadly similar year-on-year in both the Mortgages and Idem Capital divisions. Within the Commercial Lending division, the '<1 month' total in 2019 includes increased balances from the maturing structured lending and development finance portfolios, where security levels are high and hence provision requirements are generally lower than for other businesses within the division. The '>1 month <=3 months' total in Commercial Lending includes very few cases and hence the coverage ratio may vary depending on the cases currently in progress.

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

	< 1 month arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m
1 October 2018			
Gross loan book			
Mortgages	306.3	63.6	369.9
Commercial Lending	4.0	4.2	8.2
Idem Capital	8.8	10.9	19.7
Total	319.1	78.7	397.8
Impairment provision			
Mortgages	(0.8)	(0.9)	(1.7)
Commercial Lending	(0.1)	(0.3)	(0.4)
Idem Capital	(0.2)	(0.3)	(0.5)
Total	(1.1)	(1.5)	(2.6)
Net loan book			
Mortgages	305.5	62.7	368.2
Commercial Lending	3.9	3.9	7.8
Idem Capital	8.6	10.6	19.2
Total	318.0	77.2	395.2
Coverage ratio			
Mortgages	0.26%	1.42%	0.46%
Commercial Lending	2.50%	7.14%	4.88%
Idem Capital	2.27%	2.75%	2.54%
Total	0.34%	1.91%	0.65%

Analysis of Stage 3 loans

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

Coverage for Stage 3 Mortgages has reduced over the year as a number of heavily provided legacy receiver of rent cases have been resolved, as discussed further below. The coverage ratio for Commercial Lending is subject to large fluctuations, as the number and absolute value of Stage 3 cases are relatively low and hence the specific details of individual cases will influence the ratio. In Idem Capital, the principal impact on the values shown below was a major operational review of legacy balances during the year which resulted in a change in the collection strategy and a consequent writing off of a large proportion of the balances shown at 1 October 2018.

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

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
1 October 2018				
Gross loan book				
Mortgages	5.0	116.3	21.1	142.4
Commercial Lending	1.1	-	4.7	5.8
Idem Capital	29.0	-	11.0	40.0
Total	35.1	116.3	36.8	188.2
Impairment provision				
Mortgages	-	(26.8)	(7.3)	(34.1)
Commercial Lending	(0.4)	-	(1.6)	(2.0)
Idem Capital	(1.7)	-	(8.9)	(10.6)
Total	(2.1)	(26.8)	(17.8)	(46.7)
Net loan book				
Mortgages	5.0	89.5	13.8	108.3
Commercial Lending	0.7	-	3.1	3.8
Idem Capital	27.3	-	2.1	29.4
Total	33.0	89.5	19.0	141.5
Coverage ratio				
Mortgages	-	23.04%	34.60%	23.95%
Commercial Lending	36.36%	-	34.04%	34.48%
Idem Capital	5.86%	-	80.91%	26.50%
Total	5.98%	23.04%	48.37%	24.81%

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

	2019	2018
	IFRS 9	IFRS 9
	£m	£m
First mortgages	**65.7**	69.6
Second mortgages	**14.0**	17.4
Asset finance	**2.2**	1.0
Motor finance	**1.0**	0.9
	82.9	88.9

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

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

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

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

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

	30 September 2019		1 October 2018	
	No.	**£m**	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	**402**	**70.5**	464	83.0
2011 to 2013	**86**	**17.3**	107	21.8
2014 to 2016	**31**	**4.5**	40	5.9
2016 and later	**84**	**14.0**	44	5.6
Total managed accounts	**603**	**106.3**	655	116.3
Accounts in the process of realisation	**80**	**11.9**	115	16.9
	683	**118.2**	770	133.2

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

Movements in impairment provision by stage

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

	Mortgages	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At transition – 1 October 2018	36.1	6.6	11.5	54.2
Provided in period	1.2	7.2	0.3	8.7
Amounts written off	(6.5)	(3.1)	(7.4)	(17.0)
Assets derecognised	(4.0)	-	-	(4.0)
At 30 September 2019	**26.8**	**10.7**	**4.4**	**41.9**

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

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

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

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Loss allowance at 1 October 2018	4.9	2.6	46.7	-	54.2
New assets originated or purchased	4.4	-	-	-	4.4
Changes in loss allowance					
Transfer to stage 1	0.5	(0.5)	-	-	-
Transfer to stage 2	(0.3)	0.4	(0.1)	-	-
Transfer to stage 3	(0.5)	(0.4)	0.9	-	-
Changes due to credit risk	(3.1)	3.0	5.2	-	5.1
Write offs	-	-	(17.0)	-	(17.0)
Assets derecognised	(0.1)	(1.7)	(2.2)	-	(4.0)
Changes in models/parameters	0.2	0.3	(1.3)	-	(0.8)
Loss allowance at 30 September 2019	**6.0**	**3.7**	**32.2**	**-**	**41.9**

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

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

	Stage 1	Stage 2	Stage 3	POCI	Total
	£m	£m	£m	£m	£m
Balances at 1 October 2018	11,274.1	397.8	188.2	294.7	12,154.8
New assets originated or purchased	2,443.2	-	-	4.1	2,447.3
Changes in staging					
Transfer to stage 1	100.8	(97.5)	(3.3)	-	-
Transfer to stage 2	(240.0)	243.4	(3.4)	-	-
Transfer to stage 3	(27.1)	(18.6)	45.7	-	-
Redemptions and repayments	(1,586.1)	(30.0)	(29.6)	(110.1)	(1,755.8)
Goodwill adjustment (note 66)	-	-	-	(2.7)	(2.7)
Assets derecognised	(636.8)	(39.4)	(14.1)	(14.7)	(705.0)
Write offs	-	-	(17.0)	-	(17.0)
Other changes	54.5	2.8	1.4	47.7	106.4
Balance at 30 September 2019	11,382.6	458.5	167.9	219.0	12,228.0
Loss allowance	(6.0)	(3.7)	(32.2)	-	(41.9)
Carrying value	**11,376.6**	**454.8**	**135.7**	**219.0**	**12,186.1**

Other changes includes interest and similar charges

Impairments charged to income

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

	Mortgages	Commercial Lending	Idem Capital	2019 IFRS 9	2018 IAS 39
	£m	£m	£m	£m	£m
Provided in period	1.2	7.2	0.3	**8.7**	9.1
Recovery of written off amounts	(0.2)	-	(0.5)	**(0.7)**	(1.7)
	1.0	7.2	(0.2)	**8.0**	7.4
Of which					
Loan accounts	1.0	2.8	(0.2)	**3.6**	5.6
Finance leases	-	4.4	-	**4.4**	1.8
	1.0	7.2	(0.2)	**8.0**	7.4

Economic impacts

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations.

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

The outlook in the central scenario at 30 September 2019 is broadly similar to that a year earlier, although both the forecast level of bank rates and consumer lending growth are reduced, reflecting a more pessimistic economic outlook. However, the house price growth forecast over the five year period is a little stronger.

The central scenario is the economic forecast used within the Group for planning purposes and represents its expectation of the most likely outcome. The upside and downside scenarios are less likely variants developed from this base case. The final scenario represents a protracted slump and is derived from the Bank of England's annual stress testing scenarios. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be consistent.

The Group defines its upside and downside scenarios by reference to the central scenario. It is therefore necessary for management to consider the relative weightings that should apply to each of these scenarios when ECLs are calculated. At 30 September 2019, the directors considered the movements already reflected in the scenarios and the levels of uncertainty in the UK political and economic climate more generally and concluded that, while the central scenario still provided an appropriate basis for planning purposes, the downside risks had increased over the twelve months. The directors therefore determined that the weighting attributed to the downside scenario should be increased, and that to the upside scenario reduced.

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

30 September 2019

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	**40%**	**20%**	**35%**	**5%**
Economic driver				
Gross Domestic Product ('GDP') (increase)	**1.7%**	**2.2%**	**1.0%**	**(0.1)%**
House Price Index ('HPI') (increase)	**3.3%**	**5.5%**	**(0.1)%**	**(5.3)%**
Bank Base Rate ('BBR')	**0.8%**	**1.9%**	**0.5%**	**0.0%**
Consumer Price Inflation ('CPI')	**2.1%**	**1.8%**	**2.5%**	**3.1%**
Unemployment (rate)	**3.9%**	**3.5%**	**5.6%**	**8.0%**
Secured lending (annual change)	**3.6%**	**4.2%**	**2.7%**	**1.4%**
Consumer credit (annual change)	**6.1%**	**7.6%**	**3.8%**	**0.3%**

1 October 2018

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	40%	30%	25%	5%
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.6%	2.0%	0.9%	(0.1)%
House Price Index ('HPI') (increase)	3.0%	5.1%	(0.3)%	(5.2)%
Bank Base Rate ('BBR')	1.2%	1.7%	0.7%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.6%	3.3%
Unemployment (rate)	3.9%	3.6%	5.7%	8.3%
Secured lending (annual change)	3.2%	3.6%	2.5%	1.5%
Consumer credit (annual change)	8.6%	10.5%	5.3%	0.6%

Sensitivity

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

Economic conditions

If the weightings of the economic scenarios were altered to weight the upside scenario at 10%, the central scenario at 40%, the downside scenario at 45% and the severe downside at 5%, the effect would be to increase buy-to-let provisions, the most significant part of the impairment provision, by £0.9m, from £26.5m to £27.4m.

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs were increased by 10%, loans with a gross value of £25.8m would transfer from stage 1 to stage 2, and the total provision would increase by £0.6m from the effects of higher expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional stage 2 cases.

Value of security

The principal assumptions impacting on loss given default are the estimated security values. If the rate of growth in house prices assumed by the model were halved, ignoring any PD effects, then the provision for the Group's first and second mortgages assets under the central scenario would increase by £5.5m.

Receiver of rent

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

Superseded disclosures

Further information relating to comparative disclosures under IAS 39 which are no longer relevant under IFRS 9 is included in note 54(c).

24. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Introduction

The Group uses derivative financial instruments such as interest rate swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in notes 56 to 60) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

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

The Group's hedging arrangements can be analysed between:

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

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

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

The analysis below splits derivatives between those accounted for within portfolio fair value hedges, or as cash flow hedges and those which, despite representing an economic hedge, are not accounted for as hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2019 or the preceding year.

	2019 Assets £m	**2019 Liabilities £m**	2018 Assets £m	2018 Liabilities £m
Derivatives in accounting hedge relationships				
Fair value hedges				
Interest rate swaps				
Fixed to floating	**0.2**	**(78.3)**	22.0	(1.1)
Floating to fixed	**7.6**	**(0.2)**	1.9	(3.4)
	7.8	**(78.5)**	23.9	(4.5)
Cash flow hedges				
Cross-currency basis swaps				
Dollar-sterling	**274.6**	**-**	424.6	-
Euro-sterling	**308.1**	**-**	405.1	-
	582.7	**-**	829.7	-
Total derivatives in hedge accounting relationships	**590.5**	**(78.5)**	853.6	(4.5)
Other derivatives				
Interest rate swaps	**1.9**	**(2.0)**	2.1	(0.2)
Currency futures	**-**	**-**	-	-
Total recognised derivative assets/(liabilities)	**592.4**	**(80.5)**	855.7	(4.7)

The credit risk inherent in the derivative financial assets shown above is discussed in note 57.

a) Fair value hedges

Background and hedging objectives

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

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings, as in the Group's securitisation transactions, but may also arise where retail deposit funding is used. Where possible the Group takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing risk and controlled within limits under the Group's interest rate risk management process, described in note 59. In order to manage these exposures, they are hedged with financial derivatives and form part of the Group's portfolio hedging arrangements. Repricing risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

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

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

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

This policy creates two macro hedges:

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

The Group is in the process of changing the principal sterling reference rate used in its interest rate risk management framework from LIBOR to SONIA.

Where fixed rate assets or liabilities have been hedged with interest rate swaps, these currently mostly reference three-month LIBOR. During the year, the Group entered into SONIA swaps to hedge fixed rate assets funded in PM26, a SONIA-linked securitisation transaction. As the Group transitions away from LIBOR it is expected that all new hedging will eventually reference SONIA. For existing swaps referencing LIBOR that have a maturity beyond December 2021 (the date LIBOR is expected to become unavailable), the Group is closely following developments. The International Swaps and Derivative Association ('ISDA'), the trade organisation for derivatives, are consulting in developing fall backs and revisions to documentation that counterparties can sign to transition to SONIA. The proposals are expected to be finalised by calendar year-end, with implementation in 2020.

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

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

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

Ineffectiveness

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

- The maturity profile of the hedging instruments may not exactly match that of the hedged items, particularly where hedged items settle early
- The use of derivatives as a hedge of interest rate risk additionally exposes the Group to the derivative counterparties' credit risk, which is not matched in the hedged item. This risk is minimised by transacting only with high quality counterparties and through collateralisation arrangements (as described in note 57).
- The use of different discounting curves in measuring fair value changes in the hedged items and hedging instruments
- Difference in the timing of interest payments on the hedged items and settlements on the hedging instruments

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

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

Hedging Instruments

The hedging portfolios at 30 September 2019 and 30 September 2018 consist of a large number of sterling denominated swaps. Settlement on all swaps is generally quarterly where:

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

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

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

	2019		2018	
	Deposit Hedge	**Loan Hedge**	Deposit Hedge	Loan Hedge
Average fixed notional interest rate	**0.83%**	**1.04%**	0.75%	1.00%
Average notional margin over LIBOR	**-**	**-**	-	-
Average notional margin over SONIA	**-**	**-**	-	-
	£m	**£m**	£m	£m
Notional principal value				
LIBOR swaps	**1,619.0**	**4,304.5**	1,592.5	3,161.4
SONIA swaps	**-**	**486.8**	-	-
	1,619.0	**4,791.3**	1,592.5	3,161.4
Maturing				
Within one year	**805.5**	**465.4**	1,412.0	814.6
Between one and two years	**449.5**	**595.2**	80.5	218.8
Between two and five years	**364.0**	**3,554.7**	100.0	2,128.0
More than 5 years	**-**	**176.0**	-	-
	1,619.0	**4,791.3**	1,592.5	3,161.4
Fair value	**7.5**	**(78.2)**	(1.5)	20.9

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

Accounting impacts

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

	2019		2018	
	Deposit Hedge	**Loan Hedge**	Deposit Hedge	Loan Hedge
	£m	**£m**	£m	£m
Hedging instruments				
Interest rate swaps				
Included in derivative financial assets	**7.6**	**0.2**	1.9	22.0
Included in derivative financial liabilities	**(0.1)**	**(78.4)**	(3.4)	(1.1)
	7.5	**(78.2)**	(1.5)	20.9
Notional principal value	**1,619.0**	**4,791.3**	1,592.5	3,161.4
Change in fair value used in calculating hedge ineffectiveness	**7.9**	**(98.5)**	(0.4)	15.1
Hedged items				
Fixed rate deposits				
Monetary amount of risk relating to Retail Deposits	**1,473.7**	**-**	1,446.7	-
Fixed rate loans				
Monetary amount of risk relating to Loans to Customers	**-**	**4,834.8**	-	3,141.3
Accumulated amount of fair value hedge adjustments included on balance sheet (notes 20 and 31)*	**(3.9)**	**64.2**	4.2	(24.1)
Of which: amounts related to discontinued hedging relationships being amortised	**-**	**(8.8)**	-	(5.0)
Change in fair value used in recognising hedge ineffectiveness	**(8.1)**	**92.2**	0.6	(14.0)
Hedge ineffectiveness recognised				
Included in fair value (losses) / gains in the profit and loss account	**(0.2)**	**(6.3)**	0.2	1.1

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

b) Cash flow hedging

Background and hedging objectives

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

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

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

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

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

Hedging instruments

Under these swap agreements

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

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

	2019		2018	
	Swap currency		Swap currency	
	USD	**EUR**	USD	EUR
Average fixed exchange rate	**2.0**	1.5	1.9	1.5
Average margin over LIBOR on interest payable	**0.24%**	0.49%	0.25%	0.52%
Average margin over US dollar LIBOR / EURIBOR on interest receivable	**0.19%**	0.52%	0.21%	0.53%
Notional Principal value (£m)	**447.5**	1,007.4	897.3	1,320.6
Fair value (£m)	**274.6**	308.1	424.6	405.1
Average remaining term (years)	**21**	22	20	21

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

The absolute value of these swaps is relatively large as the majority of the instruments date from before the 2008 credit crisis, when a major dislocation in rates occurred, creating significant market value in the instruments. However, economically, this is offset by the corresponding increase in the carrying value of the currency denominated notes. Legacy assets, those with inception dates in 2008 or earlier, account for £582.1 million of the cross-currency basis swap balance at 30 September 2019 (2018: £819.5m), with post-2010 assets representing only £0.6 million (2018: £10.2m).

The decrease in notional principal related to the PM12 disposal, where the hedging arrangement ceased on the derecognition of both the hedged FRNs and the hedging instruments (note 7), and note repayments in the period.

Sources of potential ineffectiveness

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

In respect of credit risk the hedging instruments are partially collateralised, with additional collateral conditionally available, as described in note 57. This generates a small potential credit valuation adjustment associated with the derivative asset representing the credit risk of the receivable future cash flows that make up the derivative fair value. However, IAS 39 requires that Other Comprehensive Income ('OCI') is adjusted by the lower of the cumulative gain or loss on the derivative or the hedged item (as proxied by a hypothetical derivative). As the derivative bears credit risk of the counterparty (for the uncollateralised portion) it has a lower fair value than the hypothetical derivative. The result is that the full fair value of the derivative is taken to OCI as it is the lower of the two amounts and no ineffectiveness arises.

Accounting impacts

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

	2019		2018	
	Swap currency		Swap currency	
	USD	**EUR**	USD	EUR
Hedging Instruments				
Cross-currency basis swaps				
Included in derivative financial assets	**274.6**	308.1	424.6	405.1
Included in derivative financial liabilities	**-**	-	-	-
	274.6	308.1	424.6	405.1
Notional principal value	**447.5**	1,007.4	897.3	1,320.6
Change in fair value used in calculating hedge ineffectiveness	**71.3**	(21.2)	(55.7)	8.3
Hedged Items				
Floating rate notes				
Included in Asset Backed Loan Notes	**447.5**	1,007.4	897.3	1,320.6
Changes in fair value used in calculating hedge ineffectiveness	**71.3**	(21.2)	55.7	8.3
Cash flow hedging reserve (before tax)	**0.8**	2.8	0.9	3.1

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

	2019	2018
	£m	£m
Change of value in hedging instrument recognised in cash flow hedge reserve		
US Dollars swaps	**71.3**	55.7
Euro swaps	**(21.2)**	8.3
	50.1	64.0
Amount reclassified from cash flow hedge reserve to profit, recognised as foreign exchange differences and interest on asset backed loan notes both included within interest payable		
US Dollars swaps	**71.1**	55.5
Euro swaps	**(21.5)**	7.5
	49.6	63.0
Net amount recognised in Other Comprehensive Income before tax	**0.5**	1.0

All amounts reclassified to profit have been transferred because the hedged item has affected profit or loss, or in the case of the PM12 FRNs, has been derecognised (note 7).

c) Derivatives not in a hedge accounting relationship

The Group's other derivatives comprise:

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

The principal terms of these derivatives are set out below.

Interest rate swaps

	2019		2018	
	Pay fixed	**Pay floating**	Pay fixed	Pay floating
Average fixed notional interest rate	**0.75%**	**0.77%**	0.92%	0.80%
Average notional margin over LIBOR	**-**	**-**	-	-
Average notional margin over SONIA	**-**	**-**	-	-
	£m	**£m**	£m	£m
Notional principal value				
LIBOR swaps	**315.4**	**554.0**	441.7	362.0
SONIA swaps	**-**	**8.0**	-	8.0
	315.4	**562.0**	441.7	370.0
Maturing				
Within one year	**68.4**	**424.0**	215.0	359.0
Between one and two years	**43.5**	**95.0**	32.2	11.0
Between two and five years	**92.5**	**43.0**	189.0	-
More than 5 years	**111.0**	**-**	5.5	-
	315.4	**562.0**	441.7	370.0
Fair value	**1.9**	**(2.0)**	1.4	0.5

Currency futures

	2019	2018
US Dollar futures		
Average future exchange rate	**1.22**	1.32
	£m	£m
Notional principal value	**5.7**	5.8
Maturing		
Within one year	**5.7**	5.8
Between one and two years	**-**	-
Between two and five years	**-**	-
	5.7	5.8
Fair value	**-**	-

25. SUNDRY ASSETS

(a) The Group

	Note	2019	2018	2017
		£m	£m	£m
Current assets				
Accrued interest income		**0.4**	0.6	0.2
Trade receivables		**3.6**	2.2	4.2
CSA Assets		**72.2**	3.8	2.0
CRDs		**11.4**	6.2	1.6
Other receivables		**2.7**	2.5	1.7
Sundry financial assets	*67*	**90.3**	15.3	9.7
Prepayments		**2.1**	2.6	2.8
Other tax		**0.4**	1.1	0.2
		92.8	19.0	12.7

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

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

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

CRD, CSA and accrued interest are considered to be stage 1 assets for IFRS 9 impairment purposes. The probabilities of default of the obligor institutions (the Bank of England and major banks) has been assessed and is considered to be so low as to require no significant impairment provision.

(b) The Company

	2019	2018	2017
	£m	£m	£m
Current assets			
Amounts owed by Group companies	**106.6**	216.3	40.1
Accrued interest income	**0.7**	0.7	-
	107.3	217.0	40.1

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

26. DEFERRED TAX

(a) The Group

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

	Note	2019 £m	2018 £m	2017 £m
Net liability at 1 October 2018				
As previously reported		**(5.6)**	(4.8)	(2.0)
Change of accounting policy	62	**5.0**	-	-
Restated		**(0.6)**	(4.8)	(2.0)
Derecognition	7	**1.8**	-	-
Acquisitions	66	**0.5**	(0.3)	-
Income statement credit	15	**2.3**	1.2	2.8
Credit to equity		**2.2**	(1.7)	(5.6)
Net asset / (liability) at 30 September 2019		**6.2**	(5.6)	(4.8)

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

	2019 £m	2018 £m	2017 £m
Accelerated tax depreciation	**2.3**	4.1	4.0
Retirement benefit obligations	**5.9**	3.7	5.7
Impairment and other provisions	**(5.3)**	(14.0)	(14.9)
Tax (losses)	**0.4**	0.2	0.2
Other timing differences	**2.9**	0.4	0.2
Net deferred tax asset / (liability)	**6.2**	(5.6)	(4.8)

As stated in note 15 legislation has been introduced to reduce the standard rate of UK corporation tax to 17.0% from 1 April 2020. The temporary differences have been provided at the rate prevailing when the Group anticipates the temporary difference to reverse. In the event that the temporary differences actually reverse in different periods, a credit or charge will arise in a future period to reflect the difference. The timing of reversal of temporary differences will be affected by both matters within the Group's control (e.g. the timing and nature of the refinancing of certain portfolios) and matters outside the Group's control (e.g. the level of redemptions of finance leases).

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

In addition, the Group has tax losses of £2.3m (2018: £1.7m) in entities whose current taxable profits are insufficient to support the recognition of a deferred tax asset.

(b) The Company

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

	2019 £m	2018 £m	2017 £m
Net liability at 1 October 2018	**1.8**	1.8	1.9
Income statement (credit)	**(0.2)**	-	(0.1)
Net liability at 30 September 2019	**1.6**	1.8	1.8

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

	2019 £m	2018 £m	2017 £m
Other timing differences	**1.6**	1.8	1.8
Net deferred tax liability	**1.6**	1.8	1.8

27. PROPERTY, PLANT AND EQUIPMENT

(a) The Group

	Leased assets £m	Land and buildings £m	Plant and machinery £m	Total £m
Cost				
At 1 October 2017	30.0	22.8	10.9	63.7
Acquisitions	-	-	-	-
Additions	19.3	-	0.8	20.1
Disposals	(2.9)	-	(1.0)	(3.9)
At 30 September 2018	46.4	22.8	10.7	79.9
Acquisitions	-	-	-	-
Additions	11.6	-	1.1	12.7
Disposals	(5.3)	-	(1.2)	(6.5)
At 30 September 2019	**52.7**	**22.8**	**10.6**	**86.1**
Accumulated depreciation				
At 1 October 2017	6.6	3.0	7.9	17.5
Charge for the year	5.9	0.6	1.3	7.8
On disposals	(1.5)	-	(0.7)	(2.2)
At 30 September 2018	11.0	3.6	8.5	23.1
Charge for the year	7.6	0.5	1.0	9.1
On disposals	(2.2)	-	(1.2)	(3.4)
At 30 September 2019	**16.4**	**4.1**	**8.3**	**28.8**
Net book value				
At 30 September 2019	**36.3**	**18.7**	**2.3**	**57.3**
At 30 September 2018	35.4	19.2	2.2	56.8
At 30 September 2017	23.4	19.8	3.0	46.2

Plant and machinery shown above is used within the Group's business. Leased assets includes £25.6m in respect of assets leased under operating leases (2018: £25.7m) and £10.7m of assets available for hire (2018: £9.7m).

During the year ended 30 September 2018, the Group entered into a transaction with the Paragon Pension Plan, effectively granting a first charge over its freehold head office building as security for its agreed contributions under the recovery plan. The carrying value of the assets subject to this charge was £18.0m (2018: £18.3m).

(b) The Company

	Land and buildings £m
Cost	
At 1 October 2017	19.9
Disposals	(19.9)
At 30 September 2018	-
Disposals	-
At 30 September 2019	**-**
Accumulated depreciation	
At 1 October 2017	1.3
Charge for the year	0.2
On disposals	(1.5)
At 30 September 2018	-
Charge for the year	-
On disposals	-
At 30 September 2019	**-**
Net book value	
At 30 September 2019	**-**
At 30 September 2018	-
At 30 September 2017	18.6

During the year ended 30 September 2018, the Group's head office building was transferred to a subsidiary entity as part of the arrangements to establish the effective charge described above.

28. INTANGIBLE ASSETS

	Goodwill (note 29) £m	Computer software £m	Other intangible assets £m	Total £m
Cost				
At 1 October 2017	104.1	7.9	9.2	121.2
Acquisitions (note 66)	64.1	-	1.4	65.5
Additions	-	1.5	-	1.5
At 30 September 2018	168.2	9.4	10.6	188.2
Acquisitions (note 66)	2.2	-	-	2.2
Additions	-	2.0	-	2.0
At 30 September 2019	**170.4**	**11.4**	**10.6**	**192.4**
Accumulated amortisation and impairment				
At 1 October 2017	6.0	5.9	4.9	16.8
Amortisation charge for the year	-	1.4	0.7	2.1
At 30 September 2018	6.0	7.3	5.6	18.9
Amortisation charge for the year	-	1.7	0.7	2.4
At 30 September 2019	**6.0**	**9.0**	**6.3**	**21.3**
Net book value				
At 30 September 2019	**164.4**	**2.4**	**4.3**	**171.1**
At 30 September 2018	162.2	2.1	5.0	169.3
At 30 September 2017	98.1	2.0	4.3	104.4

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

29. GOODWILL

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

	2019 £m	2018 £m
Asset finance	**113.0**	113.0
Development finance	**49.8**	47.6
TBMC	**1.6**	1.6
	164.4	162.2

(a) Asset finance

The goodwill carried in the accounts relating to the asset finance cash generating unit was recognised on the acquisitions of PAF and Premier in the year ended 30 September 2016 and Iceberg in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2019 indicated that no write down was required.

The recoverable amount of the asset finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five-year period.

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

- Level of business activity, based on management expectations. The forecast assumes a compound annual growth rate ('CAGR') for new business over the five-year period of 12.0%, compared with 12.5% in the year ended 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.9% (2018: 2.2%) which does not exceed the long term average growth rates for the markets in which the business is active

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

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.2% (2018: 13.4%)

As an illustration of the sensitivity of this impairment test to movements in the key assumptions, the Group has calculated that a 24.0% reduction in profit levels coupled with a 370 basis point increase in the pre-tax discount rate would eliminate the headroom in the projection.

In the testing carried out at 30 September 2018, a 12.6% reduction in profit levels coupled with a 185 basis point increase in the pre-tax discount rate would have that effect.

(b) Development finance

The goodwill carried in the accounts relating to the development finance cash generating unit was recognised on the acquisition of Titlestone for the year ended 30 September 2018 and amended in the current year as described in note 66.

An impairment review undertaken at 30 September 2019 indicated that no write down was required.

The recoverable amount of the development finance cash generating unit used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five-year period.

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

- Level of business activity, based on management expectations. The forecast assumes a CAGR for new commitments over the five-year period of 18.3%, compared with 47.8% in the year ended 30 September 2019. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.9% (2018: 2.2%) which does not exceed the long-term average growth rate for the UK economy

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

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 13.2% (2018: 13.4%)

Management believes any reasonably possible change in the key assumptions above would not cause the recoverable amount of the development finance cash generating unit to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2018.

(c) TBMC

The goodwill carried in the accounts relating to the TBMC cash generating unit was recognised on the acquisition of The Business Mortgage Company Limited and its subsidiaries ('TBMC') in December 2008 and impaired by £6.0m in 2009.

An impairment review was undertaken at 30 September 2019 which indicated no further impairment. The recoverable amount of TBMC used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board covering a five year period. The pre-tax discount rate applied to the cash flow projection is 4.74% (2018: 5.66%) and cash flows beyond the five year budget are extrapolated using a 1.6% (2018: 2.0%) growth rate, being the average long term growth rate in the UK economy over a twenty year period.

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

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

- Discount rate, which is based on market rates of interest plus a margin appropriate to the risk profile of the TBMC business as an investment

The directors believe that no reasonably possible change in any of the key assumptions above would cause the carrying value of the unit to exceed its recoverable amount.

30. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Shares in group companies	Loans to group companies	Loans to ESOP Trusts	Total
	£m	£m	£m	£m
At 1 October 2017	**759.4**	**46.3**	**13.4**	**819.1**
Investments in subsidiaries	**12.5**	**-**	**-**	**12.5**
Loans advanced	**-**	**200.0**	**6.5**	**206.5**
Loans repaid	**-**	**(46.3)**	**-**	**(46.3)**
Provision movements	**(1.2)**	**-**	**(6.2)**	**(7.4)**
At 30 September 2018	**770.7**	**200.0**	**13.7**	**984.4**
Investments in subsidiaries	**-**	**-**	**-**	**-**
Capital distributions	**(130.0)**	**-**	**-**	**(130.0)**
Loans advanced	**-**	**100.0**	**5.1**	**105.1**
Loans repaid	**-**	**-**	**-**	**-**
Provision movements	**(0.2)**	**-**	**(18.6)**	**(18.8)**
At 30 September 2019	**640.5**	**300.0**	**0.2**	**940.7**

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

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

During the year ended 30 September 2019 the Company received £44.3m in dividend income from its subsidiaries (2018: £62.0m) and £15.1m of interest on loans to Group companies (2018: £12.6m).

The Company's subsidiaries, and the nature of its interest in them, are shown in note 68.

31. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	2019	2018	2017
	£m	£m	£m
Fixed rate	**4,154.4**	3,643.1	2,675.9
Variable rates	**2,237.5**	1,653.5	939.5
	6,391.9	5,296.6	3,615.4

The weighted average interest rate on retail deposits at 30 September 2019, analysed by charging method, was:

	2019	2018	2017
	%	%	%
Fixed rate	**2.02**	1.94	1.89
Variable rates	**1.43**	1.36	1.21
All deposits	**1.81**	1.76	1.71

The contractual maturity of these deposits is analysed below.

	2019	2018	2017
	£m	£m	£m
Amounts repayable			
In less than three months	**466.6**	256.8	211.4
In more than three months, but not more than one year	**2,088.4**	2,024.7	1,399.6
In more than one year, but not more than two years	**1,158.0**	1,010.6	770.0
In more than two years, but not more than five years	**900.9**	655.3	629.7
Total term deposits	**4,613.9**	3,947.4	3,010.7
Repayable on demand	**1,778.0**	1,349.2	604.7
	6,391.9	5,296.6	3,615.4
Fair value adjustments for portfolio hedging (note 24)	**3.9**	(4.2)	(3.5)
	6,395.8	5,292.4	3,611.9

32. ASSET BACKED LOAN NOTES

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

For its public issues, the Group has an additional option to repay all of the Notes at an earlier date (the 'call date'), at their outstanding principal amount.

Interest is payable at a fixed margin above;

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

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

All of the Notes are rated and publicly listed.

The notes outstanding at 30 September 2019 can be analysed as follows:

	2019	2018
	£m	£m
Secured on first mortgage assets	**4,419.4**	5,521.6
Secured on other assets	**-**	33.1
	4,419.4	5,554.7

The Group publishes detailed information on the performance of all of its listed note issues on the Bond Investor Reporting section of its website at www.paragonbankinggroup.co.uk. A more detailed description of the securitisation structure under which these Notes are issued is given in note 58.

On 3 July 2019, a Group company, Paragon Mortgages (No. 26) PLC, issued £364.3m of sterling mortgage backed floating rate notes to external investors at par. All of the notes were class A notes, rated AAA by Fitch and Aaa by Moody's. The interest rate above SONIA on the notes was 1.05%. The proceeds were used to refinance existing short-term liabilities. The Group retained £273.9m of notes of various classes meaning that its investment represented 43.0% of the issued notes.

Notes in issue at 30 September 2019 and 30 September 2018, net of any held by the Group, were:

Issuer	Maturity date	Call date	Principal outstanding		Average interest margin	
			2019	2018	**2019**	2018
Sterling notes			**£m**	£m	**%**	%
Interest based on LIBOR						
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	**95.2**	102.4	**0.38**	0.38
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	**155.7**	169.5	**0.52**	0.50
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	**237.7**	258.9	**0.15**	0.15
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	**-**	100.4	**-**	0.41
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	**443.7**	475.8	**0.27**	0.27
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	**423.8**	466.1	**0.23**	0.23
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	**117.7**	128.3	**0.30**	0.30
Paragon Mortgages (No. 21) PLC	15/06/42	15/12/18	**-**	55.2	**-**	1.13
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	**-**	48.3	**-**	1.15
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	**34.5**	55.9	**1.84**	1.56
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	**45.7**	71.5	**2.85**	2.36
Paragon Mortgages (No. 25) PLC	15/05/50	15/05/23	**423.6**	435.3	**0.72**	0.71
First Flexible No. 5 PLC	01/06/34	01/07/09	**-**	50.3	**-**	0.99
First Flexible No. 6 PLC	01/12/35	01/03/08	**47.7**	52.5	**1.27**	1.27
First Flexible (No. 7) PLC	15/09/33	15/03/11	**-**	12.4	**-**	0.30
Paragon Secured Finance (No. 1) PLC	15/11/35	15/11/08	**-**	33.1	**-**	0.98
Interest based on SONIA						
Paragon Mortgages (No. 26) PLC	15/05/45	15/08/24	**364.3**	-	**1.05**	-
US dollar notes			**$m**	$m	**%**	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	**15.5**	16.7	**0.36**	0.36
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	**-**	743.8	**-**	0.24
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	**143.4**	154.3	**0.18**	0.18
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	**166.1**	185.3	**0.20**	0.20
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	**552.9**	611.2	**0.19**	0.19
First Flexible No. 6 PLC	01/12/35	01/03/08	**7.5**	8.2	**0.56**	0.56
Euro notes			**€m**	€m	**%**	%
Paragon Mortgages (No. 9) PLC	15/05/41	15/05/09	**147.7**	158.9	**0.56**	0.56
Paragon Mortgages (No. 10) PLC	15/06/41	15/12/09	**247.0**	254.1	**0.39**	0.39
Paragon Mortgages (No. 11) PLC	15/10/41	15/04/10	**196.1**	213.6	**0.54**	0.54
Paragon Mortgages (No. 12) PLC	15/11/38	15/08/10	**-**	326.0	**-**	0.54
Paragon Mortgages (No. 13) PLC	15/01/39	15/10/10	**285.9**	303.8	**0.42**	0.42
Paragon Mortgages (No. 14) PLC	15/09/39	15/03/11	**326.4**	338.2	**0.48**	0.47
Paragon Mortgages (No. 15) PLC	15/12/39	15/06/11	**248.9**	254.5	**0.72**	0.71
Paragon Mortgages (No. 22) PLC	15/09/42	15/06/19	**-**	26.3	**-**	0.50
Paragon Mortgages (No. 23) PLC	15/01/43	15/10/19	**2.2**	14.1	**0.70**	0.70
Paragon Mortgages (No. 24) PLC	15/07/43	15/04/20	**0.6**	16.1	**1.10**	1.10
First Flexible No. 6 PLC	01/12/35	01/03/08	**26.8**	29.6	**1.05**	1.05

The details of the assets backing these securities are given in note 21.

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

- Paragon Secured Finance (No. 1) PLC on 15 November 2018
- First Flexible (No. 5) PLC on 3 December 2018
- Paragon Mortgages (No. 21) PLC on 17 December 2018
- Paragon Mortgages (No. 22) PLC on 17 June 2019
- First Flexible (No. 7) PLC on 17 June 2019

The underlying assets were subsequently funded by other Group companies.

On 25 September 2019, notice was given of the Group's intention to redeem all of the outstanding notes of Paragon Mortgages (No. 23) PLC at par, and this took place on 15 October 2019, after the year end.

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

33. BANK BORROWINGS

New first mortgage loans may be financed by a secured bank loan, referred to as a 'warehouse facility'. These facilities are drawn on the completion of a mortgage and repayment of the facilities is restricted to the principal cash received in respect of the funded mortgage. Loans originated in warehouse facilities are refinanced in the mortgage backed securitisation market when conditions are appropriate or through internal sales to access retail funding. More information on this process is given in note 58 and details of assets held within the warehouse facilities are given in note 21. Details of the Group's bank borrowings are set out below.

		2019			2018		
		Principal value	**Maximum available facility**	**Carrying value**	Principal value	Maximum available facility	Carrying value
		£m	**£m**	**£m**	£m	£m	£m
i)	Paragon Second Funding	**787.5**	**787.5**	**787.5**	935.6	935.6	935.6
ii)	Paragon Seventh Funding	**-**	**200.0**	**-**	-	-	-
		787.5	**987.5**	**787.5**	935.6	935.6	935.6

i) The Paragon Second Funding warehouse was available for further drawings until 29 February 2008 at which point it converted automatically to a term loan and no further drawings were allowed. This loan is a sterling facility provided to Paragon Second Funding Limited by a consortium of banks and is secured on all the assets of Paragon Second Funding Limited, Paragon Car Finance (1) Limited and Paragon Personal Finance (1) Limited. Its final repayment date is 28 February 2050, but it is likely that substantial repayments will be made within the next five years. Interest on this loan is payable monthly in sterling at 0.675% above LIBOR (2018: 0.675% above LIBOR).

ii) On 26 September 2015, a Group company, Paragon Seventh Funding Limited, entered into an additional £200.0m committed sterling facility with Bank of America Merrill Lynch International Limited. This facility was secured on all the assets of Paragon Seventh Funding Limited and was available for drawings and redrawings until 8 October 2017. This facility bore interest at a rate of three month LIBOR plus 1.30%. The facility was not renewed at the end of the commitment period and was repaid during the year ended 30 September 2018.

On 14 November 2018, a new £200.0m warehouse funding facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all of the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. Interest is payable at 0.95% over three month LIBOR.

The weighted average margin above LIBOR on bank borrowings at 30 September 2019 was 0.675% (2018: 0.675%).

34. RETAIL BONDS

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

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

Maturity date	Interest terms	Issue price	Currency	**2019**	2018
				£m	£m
5 December 2020	6.000% p.a. fixed	par	GBP	**60.0**	60.0
30 January 2022	6.125% p.a. fixed	par	GBP	**125.0**	125.0
28 August 2024	6.000% p.a. fixed	par	GBP	**112.5**	112.5
				297.5	297.5

The notes are unsubordinated unsecured liabilities of the Company and the amount included in the accounts of the Group and the Company in respect of these bonds is £296.5m (2018: £296.1m).

35. CORPORATE BONDS

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

The carrying value of these bonds in the accounts of the Group and the Company at 30 September 2019 was £149.6m (2018: £149.3m).

36. CENTRAL BANK FACILITIES

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

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

Drawings under the Indexed Long-Term Repo Scheme ('ILTR') have a maturity of six months and a rate of interest set in an auction process. At 30 September 2019 the average rate of interest on the Group's ILTR drawings was 0.90% (2018: 0.90%).

Drawings under the Term Funding Scheme ('TFS') have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 22 months (2018: 34 months). As these drawings are provided at rates below those available commercially, by a government agency, they are accounted for under IAS 20. The TFS is no longer available for new drawings.

The amounts drawn under these facilities are set out below.

	2019	2018
	£m	£m
TFS	**944.4**	944.4
ILTR	**50.0**	80.0
On balance sheet funding	**994.4**	1,024.4
FLS	**109.0**	108.7
Total central bank facilities	**1,103.4**	1,133.1

Further first mortgage assets of the Bank have been pre-positioned with the Bank of England for future use in such schemes. The assets pledged in support of these drawings are set out in note 21.

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

	2019	2018
	£m	£m
TFS at IAS 20 carrying value	**930.5**	923.5
Deferred government assistance	**13.9**	20.9
	944.4	944.4

37. SUNDRY LIABILITIES

(a) The Group

	2019	2018	2017
	£m	£m	£m
Current liabilities			
Accrued interest	**37.4**	27.5	23.6
Trade creditors	**0.9**	2.7	3.5
CSA liabilities (note 57)	**-**	10.3	-
Other accruals	**29.7**	29.7	21.0
Sundry financial liabilities at amortised cost	**68.0**	70.2	48.1
Contingent consideration (note 38)	**2.2**	-	-
Sundry financial liabilities	**70.2**	70.2	48.1
Deferred income	**1.3**	0.9	1.1
Conduct (note 39)	**-**	-	0.5
Other taxation and social security	**2.4**	2.5	1.4
	73.9	73.6	51.1
Non-current liabilities			
Accrued interest	**14.9**	12.4	7.2
Other accruals	**0.2**	0.2	0.2
Sundry financial liabilities at amortised cost	**15.1**	12.6	7.4
Contingent consideration (note 38)	**21.5**	25.7	14.0
Sundry financial liabilities	**36.6**	38.3	21.4
Deferred income	**2.2**	2.5	2.1
	38.8	40.8	23.5
Total sundry financial liabilities at amortised cost	**83.1**	82.8	55.5
Total sundry financial liabilities at fair value	**23.7**	25.7	14.0
Total other sundry liabilities	**5.9**	5.9	5.1
Total sundry liabilities	**112.7**	114.4	74.6

(b) The Company

	2019	2018	2017
	£m	£m	£m
Current liabilities			
Amounts owed to Group companies	**23.8**	125.7	36.5
Accrued interest	**3.6**	2.8	2.9
	27.4	128.5	39.4

All of the above balances represent financial liabilities carried at amortised cost.

38. CONTINGENT CONSIDERATION

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

	2019	2018
	£m	£m
At 1 October 2018	**25.7**	14.0
Acquisitions (note 66)	**-**	11.8
Payments	**(2.5)**	-
Revaluation of liability	**-**	(0.6)
Unwind of discounting (note 5)	**0.5**	0.5
At 30 September 2019 (note 37)	**23.7**	25.7

39. CONDUCT

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

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

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

40. CURRENT TAX LIABILITIES

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

41. RETIREMENT BENEFIT OBLIGATIONS

(a) Defined benefit plan - description

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

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

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

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

- **Interest risk** – A fall in corporate bond yields would reduce the discount rate used in valuing the Plan liabilities and increase the value of the Plan liabilities. The Plan assets would also be expected to increase, to the extent that bond assets are held, but this would not be expected to fully match the increase in liabilities, given the weighting towards equity assets and diversified growth funds noted above.

- **Inflation risk** – Pensions in payment are increased annually in line with the Retail Price Index ('RPI') or the Consumer Price Index ('CPI') for Guaranteed Minimum Pensions built up since 1988. Pensions built up since 5 April 2006 are capped at 2.5% and pensions built up before 6 April 2006 are capped at 5%. For employees who have left the Company but have deferred pensions, these also revalue over the period to retirement predominantly in line with RPI. Therefore, an increase in inflation would also increase the value of the pension liabilities. The Plan assets would also be expected to increase, to the extent that they are linked to inflation, but this may not fully match the increase in liabilities.

- **Longevity risk** – The value of the Plan deficit is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would increase the deficit in the Plan.
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on a premium over the expected rate of inflation. Should the salaries of Plan members increase at a higher rate, then the deficit will be higher.

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

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

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2016, by Aon Hewitt, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with Section 224 of the Pensions Act 2004 was £214.0m, with a shortfall against the assets of £118.4m. A full actuarial valuation, as at 31 March 2019, is currently in progress and will be reflected in the 2020 Group accounts.

Following the 2016 actuarial valuation, the Trustee put in place a revised recovery plan. The Trustee's recovery plan aims to meet the statutory funding objective within six years and ten months from the date of valuation, that is by 31 January 2023. As part of this recovery plan, the Group entered into a Pension Funding Partnership ('PFP') transaction effectively granting the Plan a first charge over its head office building as security for payments under the plan (note 27). No amount is included in the Plan assets in respect of the building, which remains within the Group's Property, Plant and Equipment balance (note 27) but it provides the Plan with additional security in a stress event.

(b) Defined benefit plan – financial impact

For accounting purposes, the valuation at 31 March 2016 was updated to 30 September 2019 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

The major categories of assets in the Plan at 30 September 2019, 30 September 2018 and 30 September 2017 and their fair values were:

	2019	2018	2017
	£m	£m	£m
Cash	**7.1**	0.6	0.9
Equity instruments	**60.7**	61.8	58.7
Debt instruments	**34.2**	28.4	28.9
Real estate	**10.8**	10.7	9.8
Total fair value of Plan assets	**112.8**	101.5	98.3
Present value of Plan liabilities	**(147.3)**	(121.0)	(128.1)
(Deficit) in the Plan	**(34.5)**	(19.5)	(29.8)

At 30 September 2019 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets. All investments of the Plan are in managed funds for which unit prices are quoted publicly by the fund managers, however they are not openly traded so are considered to be Level 2 financial instruments as defined by IFRS 13.

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

The effect of this ruling has been accounted for in the accounts of the Group for the year ended 30 September 2019. The Group's present expectation is that the ruling will result in an additional charge to profit of £0.3m before tax and this amount has been included as 'past service cost' below. However, this estimate is based on a preliminary interpretation of the ruling and a high-level calculation and therefore the actual amount posted may vary due to the Trustee's response to the ruling, idiosyncratic impacts on individual members and the development of a wider legal and accounting consensus on the proper interpretation of the courts requirements as the ruling is studied in more detail.

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

	2019	2018
	£m	£m
At 1 October 2018	**101.5**	98.3
Interest on Plan assets	**3.0**	2.6
Cash flows		
Contributions by Group	**4.6**	4.5
Contributions by Plan members	**0.2**	0.2
Benefits paid	**(2.4)**	(4.7)
Administration expenses paid	**(0.7)**	(0.5)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	**6.6**	1.1
At 30 September 2019	**112.8**	101.5

The actual return on Plan assets in the year ended 30 September 2019 was £9.6m (2018: £3.7m).

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

	2019	2018
	£m	£m
At 1 October 2018	**121.0**	128.1
Current service cost	**1.6**	1.8
Past service cost	**0.3**	-
Funding cost	**3.5**	3.4
Cash flows		
Contributions by Plan members	**0.2**	0.2
Benefits paid	**(2.4)**	(4.7)
Remeasurement loss / (gain)		
Arising from demographic assumptions	**(1.4)**	(1.8)
Arising from financial assumptions	**24.5**	(6.0)
Arising from experience adjustments	**-**	-
At 30 September 2019	**147.3**	121.0

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

	30 September 2019	30 September 2018	30 September 2017
In determining net pension cost for the year			
Discount rate	**2.95%**	2.70%	2.40%
Rate of compensation increase	**3.60%**	3.60%	3.50%
Rate of price inflation	**3.10%**	3.10%	3.00%
Rate of increase of pensions	**2.95%**	2.90%	2.95%
In determining benefit obligations			
Discount rate	**1.85%**	2.95%	2.70%
Rate of compensation increase	**3.20%**	3.60%	3.60%
Rate of price inflation	**2.70%**	3.10%	3.10%
Rate of increase of pensions	**2.65%**	2.95%	2.90%
Further life expectancy at age 60			
Male member aged 60	**28**	28	29
Female member aged 60	**29**	29	30
Male member aged 40	**30**	30	30
Female member aged 40	**31**	31	32

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

	Note	**2019**	2018
		£m	£m
Current service cost		**1.6**	1.8
Past service cost		**0.3**	-
Total service cost	*10*	**1.9**	1.8
Administration expenses		**0.7**	0.5
Included within operating expenses		**2.6**	2.3
Funding cost of Plan liabilities		**3.5**	3.4
Interest on Plan assets		**(3.0)**	(2.6)
Net interest expense	*5*	**0.5**	0.8
Components of defined benefit costs recognised in profit or loss		**3.1**	3.1

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

	2019	2018
	£m	£m
Return on Plan assets (excluding amounts included in interest)	**6.6**	1.1
Actuarial gains/(losses)		
Arising from demographic assumptions	**1.4**	1.8
Arising from financial assumptions	**(24.5)**	6.0
Arising from experience adjustments	**-**	-
Total actuarial (loss)/gain	**(16.5)**	8.9
Tax thereon	**2.4**	(1.7)
Net actuarial (loss)/gain	**(14.1)**	7.2

Of the remeasurement movements reflected above:

- The return on plan assets represents better than expected investment performance
- The change in demographic assumptions reflects the adoption of new mortality assumptions, using the most recent version of the tables adopted by the Trustee in the triennial valuation, which predict lower life expectancy among members than the previous versions
- The change in financial assumptions reflects principally the impact of increased inflation expectations on discount rates
- The discount rate assumptions reflect the announcement made by National Statistics in September 2019 regarding its future intention to rebase its definition of RPI

(c) Defined benefit plan – future cash flows

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2019, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

Assumption	**Increase in assumption**	**Impact on scheme liabilities**
Discount rate	0.1% p.a.	(2.3)%
Rate of inflation*	0.1% p.a.	0.4%
Rate of salary growth	0.1% p.a.	2.3%
Rates of mortality	1 year of life expectancy	2.9%

* maintaining a 0.5% assumption for real salary growth

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

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

The target asset allocations for the year ending 30 September 2020 are 60% growth assets (primarily equities), 30% bonds and 10% real estate.

The rate of employee contributions to the Plan is 5.0% of pensionable salaries. Since 1 April 2017, following the finalisation of the March 2016 valuation, the agreed rate of employer contributions has been 32.0% of gross salaries. Additional contributions of £2.5m per annum for deficit reduction, including amounts payable under the PFP, and £0.4m per annum in respect of costs, each payable monthly, were also agreed.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2020 is £4.5m.

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

	2019	2018
	Years	Years
Category of member		
Active members	**25**	24
Deferred pensioners	**24**	23
Current pensioners	**16**	15
All members	**24**	22

(d) Defined contribution arrangements

The Group sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Group successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme.

The PAF business also sponsors a number of defined contribution pension plans and makes contributions to these schemes in respect of employees.

The assets of these schemes are not Group assets and are held separately from those of the Group, under the control of independent trustees. Contributions made by the Group to these schemes in the year ended 30 September 2019, which represent the total cost charged against income, were £2.1m (2018: £1.9m) (note 10).

42. CALLED-UP SHARE CAPITAL

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

Movements in the issued share capital in the year were:

	2019	2018
	Number	Number
Ordinary shares		
At 1 October 2018	**281,596,936**	281,489,701
Shares issued	**1,606,849**	107,235
Shares cancelled	**(21,630,434)**	-
At 30 September 2019	**261,573,351**	281,596,936

During the year the Company issued 1,606,849 shares (2018: 107,235) to satisfy options granted under Sharesave schemes for a consideration of £4,075,843 (2018: £360,031).

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

43. RESERVES

(a) The Group

	2019	2018	2018	2017
	IFRS 9	IFRS 9	IAS 39	IAS 39
	£m	£m	£m	£m
Share premium account	**68.3**	65.8	65.8	65.5
Capital redemption reserve	**50.3**	28.7	28.7	28.7
Merger reserve	**(70.2)**	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve (note 24)	**3.0**	3.3	3.3	2.5
Profit and loss account	**835.9**	868.3	890.7	784.5
	887.3	895.9	918.3	811.0

(b) The Company

	2019	2018	2018	2017
	IFRS 9	IFRS 9	IAS 39	IAS 39
	£m	£m	£m	£m
Share premium account	**68.3**	65.8	65.8	65.5
Capital redemption reserve	**50.3**	28.7	28.7	28.7
Merger reserve	**(23.7)**	(23.7)	(23.7)	(23.7)
Profit and loss account	**256.3**	390.0	390.0	384.0
	351.2	460.8	460.8	454.5

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

44. OWN SHARES

	The Group		The Company	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Treasury shares				
At 1 October 2018	**91.8**	66.6	**91.8**	66.6
Shares purchased	**26.7**	25.2	**26.7**	25.2
Shares cancelled	**(95.5)**	-	**(95.5)**	-
At 30 September 2019	**23.0**	91.8	**23.0**	91.8
ESOP shares				
At 1 October 2018	**12.2**	16.5	**-**	-
Shares purchased	**7.6**	6.2	**-**	-
Options exercised	**(2.3)**	(10.5)	**-**	-
At 30 September 2019	**17.5**	12.2	**-**	-
Balance at 30 September 2019	**40.5**	104.0	**23.0**	91.8
Balance at 1 October 2018	**104.0**	83.1	**91.8**	66.6

At 30 September 2019 the number of the Company's own shares held in treasury was 5,218,702 (2018: 20,800,284). These shares had a nominal value of £5,218,702 (2018: £20,800,284). These shares do not qualify for dividends.

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

At 30 September 2019, the trust held 3,912,516 ordinary shares (2018: 2,874,825) with a nominal value of £3,912,516 (2018: £2,874,825) and a market value of £18,873,977 (2018: £13,764,662). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2019 (2018: all). The dividends on all of these shares have been waived (2018: all).

45. EQUITY DIVIDEND

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

	2019	2018	**2019**	2018
	Per share	Per share	**£m**	£m
Equity dividends on ordinary shares				
Final dividend for the year ended 30 September 2018	**13.9p**	11.0p	**35.9**	28.9
Interim dividend for the year ended 30 September 2019	**7.0p**	5.5p	**18.1**	14.2
	20.9p	16.5p	**54.0**	43.1

Amounts paid and proposed in respect of the year:

	2019	2018	**2019**	2018
	Per share	Per share	**£m**	£m
Interim dividend for the year ended 30 September 2019	**7.0p**	5.5p	**18.1**	14.2
Proposed final dividend for the year ended 30 September 2019	**14.2p**	13.9p	**35.8**	35.8
	21.2p	19.4p	**53.9**	50.0

The proposed final dividend for the year ended 30 September 2019 will be paid on 17 February 2020, subject to approval at the Annual General Meeting, with a record date of 10 January 2020. The dividend will be recognised in the accounts when it is paid.

46. NET CASH FLOW FROM OPERATING ACTIVITIES

(a) The Group

	2019	2018
	£m	£m
Profit before tax	**159.0**	181.5
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	**1.5**	1.9
Profit on disposal of operating property, plant and equipment	**-**	(0.2)
Amortisation of intangible assets	**2.4**	2.1
Foreign exchange movement on borrowings	**(124.8)**	(67.6)
Other non-cash movements on borrowings	**3.6**	6.0
Impairment losses on loans to customers	**8.0**	7.4
Charge for share based remuneration	**5.9**	6.1
Gain on derecognition	**(9.7)**	-
Derecognition of cash flow hedge	**(0.9)**	-
Net (increase) / decrease in operating assets:		
Operating lease assets	**(0.9)**	(12.0)
Loans to customers	**(792.0)**	(781.7)
Derivative financial instruments	**169.7**	50.9
Fair value of portfolio hedges	**(88.3)**	15.4
Other receivables	**(73.8)**	(6.1)
Net increase / (decrease) in operating liabilities:		
Retail deposits	**1,095.3**	1,681.2
Derivative financial instruments	**75.8**	(2.4)
Fair value of portfolio hedges	**8.1**	(0.7)
Other liabilities	**(1.6)**	24.6
Cash generated by operations	**437.3**	1,106.4
Income taxes (paid)	**(39.4)**	(32.0)
	397.9	1,074.4

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

(b) The Company

	2019	2018
	£m	£m
Profit before tax	**6.5**	39.6
Non-cash items included in profit and other adjustments:		
Depreciation of property, plant and equipment	**-**	0.2
Non-cash movements on borrowings	**0.7**	0.6
Impairment provision / (release) on investments in subsidiaries	**148.8**	7.4
Charge for share based remuneration	**5.9**	6.1
Net decrease / (increase) in operating assets:		
Other receivables	**109.7**	(176.9)
Net (decrease) / increase in operating liabilities:		
Other liabilities	**(101.1)**	89.1
Cash generated / (utilised) by operations	**170.5**	(33.9)
Income taxes received	**0.4**	3.4
	170.9	(30.5)

47. NET CASH FLOW FROM INVESTING ACTIVITIES

	The Group		The Company	
	2019	2018	2019	2018
	£m	£m	£m	£m
Proceeds from sales of operating property, plant and equipment	**-**	0.5	**-**	18.4
Purchases of operating property, plant and equipment	**(1.1)**	(0.8)	**-**	-
Purchases of intangible assets	**(2.0)**	(1.5)	**-**	-
Movement in loans to subsidiary undertakings	**-**	-	**(105.1)**	(160.2)
Residual disposal (note 7)	**11.4**	-	**-**	-
Acquisitions (note 66)	**-**	(281.0)	**-**	-
Investment in subsidiary undertakings	**-**	-	**-**	(12.5)
Net cash generated / (utilised) by investing activities	**8.3**	(282.8)	**(105.1)**	(154.3)

48. NET CASH FLOW FROM FINANCING ACTIVITIES

	The Group		The Company	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Shares issued (note 42)	**3.9**	0.4	**4.1**	0.4
Dividends paid (note 45)	**(54.0)**	(43.1)	**(54.0)**	(43.1)
Issue of asset backed floating rate notes	**362.5**	432.5	**-**	-
Repayment of asset backed floating rate notes	**(591.1)**	(1,289.7)	**-**	-
Movement on central bank facilities	**(30.0)**	324.4	**-**	-
Movement on other bank facilities	**(148.3)**	(371.1)	**-**	-
Purchase of shares (note 44)	**(34.3)**	(31.8)	**(26.7)**	(25.2)
Net cash (utilised) by financing activities	**(491.3)**	(978.4)	**(76.6)**	(67.9)

49. RECONCILIATION OF NET DEBT

(a) The Group

		Cash flows		Non-cash movements			
	Opening debt	Debt issued	Other	Acquisition / Derecognition	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m	£m
30 September 2019							
Asset backed loan notes	**5,554.7**	**362.5**	**(591.1)**	**(784.1)**	**(124.8)**	**2.2**	**4,419.4**
Bank borrowings	**935.6**	**-**	**(148.3)**	**-**	**-**	**0.2**	**787.5**
Corporate bonds	**149.3**	**-**	**-**	**-**	**-**	**0.3**	**149.6**
Retail bonds	**296.1**	**-**	**-**	**-**	**-**	**0.4**	**296.5**
Central bank borrowings	**1,024.4**	**-**	**(30.0)**	**-**	**-**	**-**	**994.4**
Bank overdrafts	**1.1**	**-**	**(0.1)**	**-**	**-**	**-**	**1.0**
Gross debt	**7,961.2**	**362.5**	**(769.5)**	**(784.1)**	**(124.8)**	**3.1**	**6,648.4**
Cash	**(1,310.6)**	**(362.5)**	**447.7**	**-**	**-**	**-**	**(1,225.4)**
Net debt	**6,650.6**	**-**	**(321.8)**	**(784.1)**	**(124.8)**	**3.1**	**5,423.0**
30 September 2018							
Asset backed loan notes	6,475.8	432.5	(1,289.7)	-	(67.6)	3.7	5,554.7
Bank borrowings	1,306.0	-	(371.1)	-	-	0.7	935.6
Corporate bonds	149.1	-	-	-	-	0.2	149.3
Retail bonds	295.7	-	-	-	-	0.4	296.1
Central bank borrowings	700.0	324.4	-	-	-	-	1,024.4
Bank overdrafts	0.6	-	0.5	-	-	-	1.1
Gross debt	8,927.2	756.9	(1,660.3)	-	(67.6)	5.0	7,961.2
Cash	(1,496.9)	(756.9)	1,224.1	(280.9)	-	-	(1,310.6)
Net debt	7,430.3	-	(436.2)	(280.9)	(67.6)	5.0	6,650.6

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

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

(b) The Company

		Cash flows		Non-cash movements		
	Opening debt	Debt issued	Other	Foreign exchange	Other	Closing debt
	£m	£m	£m	£m	£m	£m
30 September 2019						
Corporate bonds	**149.3**	**-**	**-**	**-**	**0.3**	**149.6**
Retail bonds	**296.1**	**-**	**-**	**-**	**0.4**	**296.5**
Gross debt	**445.4**	**-**	**-**	**-**	**0.7**	**446.1**
Cash	**(24.9)**	**-**	**10.8**	**-**	**-**	**(14.1)**
Net debt	**420.5**	**-**	**10.8**	**-**	**0.7**	**432.0**
30 September 2018						
Corporate bonds	149.1	-	-	-	0.2	149.3
Retail bonds	295.7	-	-	-	0.4	296.1
Gross debt	444.8	-	-	-	0.6	445.4
Cash	(277.6)	-	252.7	-	-	(24.9)
Net debt	167.2	-	252.7	-	0.6	420.5

Other non-cash changes shown above represent EIR adjustments relating to the spreading of initial costs of the bonds.

50. UNCONSOLIDATED STRUCTURED ENTITIES

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

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

51. OPERATING LEASE ARRANGEMENTS

(a) As Lessor

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

Assets subject to these arrangements are shown in note 27 and the income from these activities is shown in note 6.

The future minimum lease payments under these arrangements may be analysed as follows:

	The Group		The Company	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Amounts falling due:				
Within one year	**7.1**	2.0	**-**	-
Between two and five years	**12.7**	7.2	**-**	-
After more than five years	**0.5**	0.6	**-**	-
	20.3	9.8	**-**	-

(b) As Lessee

	The Group		The Company	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Minimum lease payments under operating leases recognised in operating expenses for the year				
Office buildings	**1.9**	1.8	**-**	-
Motor vehicles	**0.9**	0.3	**-**	-
Office equipment	**0.1**	0.1	**-**	-
	2.9	2.2	**-**	-

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

	The Group		The Company	
	2019	2018	**2019**	2018
	£m	£m	**£m**	£m
Amounts falling due:				
Within one year	**3.2**	2.6	**-**	-
Between two and five years	**5.8**	6.8	**-**	-
After more than five years	**1.7**	2.9	**-**	-
	10.7	12.3	**-**	-

Operating lease payments represent rents payable by the Group in respect of certain of its office premises and lease payments on company vehicles and equipment. The average term of the current building leases from inception or acquisition is 7 years (2018: 8 years) with rents subject to review every five years, while the average term of the vehicle leases and office equipment is 3 years (2018: 3 years).

52. RELATED PARTY TRANSACTIONS

(a) The Group

During the year certain of the non-executive directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. No such deposits were outstanding at the year end (2018: £250,000), and the maximum amount outstanding during the year was £250,000 (2018: £250,000).

Mr A K Fletcher, a non-executive director of the Company until 31 December 2018, is a director of Paragon Pension Plan Trustees Limited, which acts as the corporate trustee of the Plan. In respect of this appointment, he was paid £4,000 in the year ended 30 September 2019 by Paragon Finance PLC, the sponsoring company of the Plan up to the date of his resignation as a director of the Company (2018: £15,000).

The Plan is a related party of the Group. Transactions with the Plan are described in note 41.

The Group had no other transactions with related parties other than the key management compensation disclosed in note 11.

(b) The Company

During the year the parent company entered into transactions with its subsidiaries, which are related parties. Management services were provided to the Company by one of its subsidiaries and the Company granted awards to employees of subsidiary undertakings under the share based payment arrangements described in note 12.

Details of the Company's investments in subsidiaries and the income derived from them are shown in notes 30 and 68.

Outstanding current account balances with subsidiaries are shown in notes 25 and 37.

During the year the Company incurred interest costs of £1.6m in respect of borrowings from its subsidiaries (2018: £1.3m).

53. COUNTRY-BY-COUNTRY REPORTING

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

Paragon Banking Group PLC is a UK registered entity. Details of its subsidiaries are given in note 68 and the activities of the Group are described in Section A2.1.

The activities of the Group, described as required by the Regulations for the year ended 30 September 2019 were:

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

	United Kingdom
	£m
Year ended 30 September 2018	
Total operating income	301.9
Profit before tax	181.5
Corporation tax paid	32.0
Public subsidies received	-
Average number of full time equivalent employees	1,103

The Group's participation in Bank of England funding schemes is set out in note 36.

54. DISCLOSURES UNDER IAS 39

Certain disclosures made in respect of IAS 39 based amounts are not directly comparable to IFRS 9 disclosures, but still form part of the comparative financial information. To avoid confusion, these are presented below.

(a) Ageing of IAS 39 exposures (Note 57)

The payment status of the carrying balances of the Group's live loan assets, before provision for impairment, at 30 September 2018, split between those accounts considered as performing and those included in the population for impairment testing, is shown below. This disclosure is not required under IFRS 9, however comparative amounts are still required to be presented. Balances for immaterial asset classes are not shown. 'Asset finance loans' below includes other related loan balances. Fully provided non-live accounts are excluded from the tables below.

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

First mortgages

	2018 £m
Not past due	10,211.1
Arrears less than 3 months	101.7
Performing accounts	10,312.8
Arrears 3 to 6 months	3.0
Arrears 6 to 12 months	2.2
Arrears over 12 months	5.7
Possessions and similar cases	22.1
Impairment population	33.0
Total gross balances	10,345.8
Impairment provision on live cases	(12.7)
Timing adjustments	(0.9)
Carrying balance	10,332.2

Consumer and asset finance

	Second charge mortgage loans	Motor finance loans	Asset finance loans	Total
	£m	£m	£m	£m
30 September 2018				
Not past due	350.7	310.8	388.6	1,050.1
Arrears less than 2 months	19.4	13.2	13.8	46.4
Performing accounts	370.1	324.0	402.4	1,096.5
Arrears 2 to 6 months	11.0	3.2	1.3	15.5
Arrears 6 to 9 months	4.1	0.9	0.7	5.7
Arrears 9 to 12 months	3.3	0.6	-	3.9
Arrears over 12 months	29.9	2.1	0.6	32.6
Specifically impaired asset finance cases	-	-	0.5	0.5
Impairment population	48.3	6.8	3.1	58.2
Total gross balances	418.4	330.8	405.5	1,154.7
Impairment provision on live cases	(1.5)	(1.7)	(1.7)	(4.9)
Timing adjustments	(1.0)	0.3	(0.4)	(1.1)
Carrying balance	415.9	329.4	403.4	1,148.7

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

(b) Analysis of buy-to-let mortgages under IAS 39 (Note 57)

The Group's outstanding exposure to buy-to-let loans with an appointed receiver at 30 September 2018 calculated on the basis of IAS 39 is set out below. A different analysis, based on the IFRS 9 staging approach, has been presented in note 23, superseding this disclosure.

	2018	2018	2018
	Gross	Provision	Net
	£m	£m	£m
Performing loans			
Let with less than 3 months arrears	106.6	(1.1)	105.5
Impaired loans			
Let with over 3 months arrears	5.9	(2.5)	3.4
Vacant or on sale	20.7	(6.4)	14.3
Impairment population	26.6	(8.9)	17.7
Total balances	133.2	(10.0)	123.2

(c) Security (Note 23)

The estimated value of the security held against those loans and receivables at 30 September 2018 which were considered to be impaired or past due under IAS 39, representing, for each such account, the lesser of the outstanding balance on the loan and the estimated valuation of the property was:

	2018
	£m
First mortgage loans	23.1
Second charge mortgage loans	46.2
	69.3

Whilst on motor finance cases the Group has the benefit of the underlying vehicle as security on these loans, no account of this was taken in the allowance for uncollectible amounts in the Group's IAS 39 provision methodology.

For the Group's asset finance loans, estimated valuations of security assets for balances in arrears are undertaken as part of the credit management process. These exercises suggested that the security value of assets under finance leases which were past due or impaired at 30 September 2018 under IAS 39 was £16.4m.

(d) Movement in impairment provision (Note 23)

The following amounts in respect of impairment provisions under IAS 39, net of allowances for recoveries of written off assets, have been deducted from the appropriate assets in the balance sheet. This disclosure has been superseded under IFRS 9, but disclosures for comparator periods are still required.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
At 1 October 2017	89.1	18.3	3.2	110.6
Amounts provided in the period	5.6	0.6	2.9	9.1
Amounts written off	(3.7)	(7.6)	(1.0)	(12.3)
At 30 September 2018	91.0	11.3	5.1	107.4

Of the above balances, the following provisions were held in respect of realised losses not charged off, which remain on the balance sheet and are provided for in full.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
At 30 September 2018	78.2	-	0.9	79.1

The amounts charged to the profit and loss account, net of recoveries of previously provided amounts are set out below.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
Year ended 30 September 2018				
Amounts provided in the year	5.6	0.6	2.9	9.1
Recovery of amounts previously provided	(0.1)	(0.5)	(1.1)	(1.7)
Net impairment for year	5.5	0.1	1.8	7.4

This impairment charge was analysed as set out below

	2018
	£m
Impairment of financial assets	
First mortgage loans	5.5
Second charge mortgage loans	(0.5)
Finance lease receivables	1.8
Development finance loans	-
Other loans	0.6
	7.4

(e) Critical accounting estimates (note 65)

The following analysis was prepared at 30 September 2018 to illustrate the variability of the IAS 39 impairment provision. These were re-calculated by changing one factor in the calculation and keeping all others at their current levels. This exercise indicated that:

- Adopting a sale strategy for 5% of currently let buy-to-let properties with a receiver of rent in place would increase impairment provisions by £2.1m
- 5% of receiver of rent properties currently vacant or for sale becoming fully performing would reduce impairment provisions by £0.3m
- A 10% reduction in house prices would increase impairment provisions across the first mortgage assets by £1.7m, while a 10% increase would reduce these impairment provisions by £1.5m
- A reduction in cash flows from receiver of rent properties of 10% would increase impairment provisions by £0.1m

It should be noted that all of these changes would, in reality, be interrelated so examining them in isolation may not give reliable guidance as to future outcomes.

D2.2 NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the year ended 30 September 2019

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

55. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

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

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

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

(a) Dividend policy

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

The distributable reserves of the Company comprise its profit and loss account balance (note 43) and, other than the requirement for the Bank to retain an appropriate level of capital, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

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

To provide greater transparency, the Company has also indicated that in future its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate. The interim dividend for the year ended 30 September 2019 was declared in accordance with the policy.

The most recent policy review, in November 2019, confirmed this policy but concluded that the size and nature of the non-cash fair value losses in the year, together with the gain arising on the derecognition of PM12, would support a higher pay-out ratio.

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

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

	Note	**2019**	2018
Earnings per share (p)	*17*	**49.4**	55.9
Adjustment (p)		**-**	(7.3)
Adjusted earnings per share (p)		**49.4**	48.6
Dividend cover target (times)		**2.33**	2.50
Proposed dividend per share in respect of the year (p)	*45*	**21.2**	19.4

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

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

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

The Group's consolidated RoTE for the year ended 30 September 2019 is derived as follows:

	Note	**2019**	2018
		IFRS 9	IAS 39
		£m	£m
Profit for the year after tax		**127.4**	145.8
Amortisation of intangible assets	*28*	**2.4**	2.1
Adjusted profit		**129.8**	147.9
Divided by			
Opening equity		**1,073.5**	1,009.4
Opening intangible assets	*28*	**(169.3)**	(104.4)
Opening tangible equity		**904.2**	905.0
Closing equity		**1,108.4**	1,095.9
Closing intangible assets	*28*	**(171.1)**	(169.3)
Closing tangible equity		**937.3**	926.6
Average tangible equity		**920.7**	915.8
Return on Tangible Equity		**14.1%**	16.1%

This table is not subject to audit

(c) Regulatory capital

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

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

The introduction of IFRS 9 on 1 October 2018 impacted the Group's regulatory capital position. The principal impacts were:

- The reduction in reserves caused by increased provisions, net of associated future tax relief, reduces shareholders equity and hence regulatory capital
- The reduction in loans to customers generates a consequential reduction in risk weighted assets ('RWA'), the amount of which will vary by asset type
- Collectively assessed emergence provisions under IAS 39 qualified as tier 2 capital, with £4.9m being included in capital at 30 September 2018 in respect of such provisions. No such provisions are made under IFRS 9, therefore total capital is reduced

The Group has elected to take advantage of the transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors will allow for a 95% add back to CET1 capital and risk weighted assets in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the 2024 financial year. Where such relief is taken, firms are also required to disclose their capital positions calculated as if the relief were not available (the 'fully loaded' basis).

The capital position at 1 October 2018, immediately after transition, is set out in the notes below, marked 2018 IFRS 9.

The tables below demonstrate that at 30 September 2019 the Group's regulatory capital of £1,072.0m (2018: £1,044.8m) was comfortably in excess of the amounts required by the regulator, including £742.9m in respect of Pillar 1 and Pillar 2a capital (unaudited), which is comprised of fixed and variable elements. The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer of 2.5% of risk weighted assets (at 30 September 2019) (2018: 1.875%) and a Counter-Cyclical Buffer, currently 1.0% of risk weighted assets (2018: 0.5%). Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2019 is set out below.

	Note	**30 September 2019**	1 October 2018	30 September 2018
		IFRS 9	IFRS 9	IAS 39
		£m	£m	£m
Total equity		**1,108.4**	1,073.5	1,095.9
Deductions				
Proposed final dividend	*45*	**(35.8)**	(35.8)	(35.8)
IFRS 9 transitional relief	*	**21.2**	21.2	-
Intangible assets	*28*	**(171.1)**	(169.3)	(169.3)
Prudent valuation adjustments	◊	**(0.7)**	(0.9)	(0.9)
Common Equity Tier 1 ('CET1') capital		**922.0**	888.7	889.9
Other Tier 1 capital		**-**	-	-
Total Tier 1 capital		**922.0**	888.7	889.9
Corporate bond	*35*	**150.0**	150.0	150.0
Less: amortisation adjustment	†	**-**	-	-
		150.0	150.0	150.0
Collectively assessed credit impairment allowances	‡	**-**	-	4.9
Total Tier 2 capital		**150.0**	150.0	154.9
Total regulatory capital		**1,072.0**	1,038.7	1,044.8

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

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

This was first included in the Group's regulatory capital position in the year and has been included in comparative amounts for consistency.

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. No such adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026.

‡ Under IFRS 9 there are no collectively assessed credit impairment allowances which are eligible as tier 2 capital.

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

	30 September 2019	1 October 2018	30 September 2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
Credit risk			
Balance sheet assets	**5,997.2**	5,756.3	5,767.3
Off balance sheet	**85.5**	87.8	87.8
IFRS 9 transitional relief	**10.5**	10.5	-
Total credit risk	**6,093.2**	5,854.6	5,855.1
Operational risk	**516.6**	485.1	485.1
Market risk	**-**	-	-
Other	**114.0**	105.1	105.1
Total exposure amount	**6,723.8**	6,444.8	6,445.3
Solvency ratios	**%**	%	%
CET1	**13.7**	13.8	13.8
Total regulatory capital	**15.9**	16.2	16.2

This table is not subject to Audit

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

On a fully loaded basis (excluding the effect of IFRS 9 transitional relief) the Group's capital ratios would be:

	30 September 2019	1 October 2018	30 September 2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
CET1 Capital	**922.0**	888.7	889.9
Add back: IFRS 9 relief	**(21.2)**	(21.2)	-
Fully loaded CET1 Capital	**900.8**	867.5	889.9
TRC	**1,072.0**	1,038.7	1,044.8
Add back: IFRS 9 relief	**(21.2)**	(21.2)	-
Fully loaded TRC	**1,050.8**	1,017.5	1,044.8
Total risk exposure	**6,723.8**	6,444.8	6,445.3
Add back: IFRS 9 relief	**(10.5)**	(10.5)	-
Fully loaded TRE	**6,713.3**	6,434.3	6,445.3
Fully loaded Solvency ratios	**%**	%	%
CET1	**13.4**	13.5	13.8
Total regulatory capital	**15.7**	15.8	16.2

This table is not subject to audit

The total regulatory capital at 30 September 2019 on the fully loaded basis of £1,050.8m was in excess of the Pillar 1 & 2a requirement of £741.8m on the same basis (amounts not subject to audit).

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

		Note	**2019**	2018	2018
			IFRS 9	IFRS 9	IAS 39
			£m	£m	£m
Total balance sheet assets			**14,395.5**	14,487.9	14,515.1
Add:	Credit fair value adjustments on loans to customers	*20*	**-**	24.1	24.1
	Debit fair value adjustments on retail deposits	*31*	**-**	4.2	4.2
Adjusted balance sheet assets			**14,395.5**	14,516.2	14,543.4
Less:	Derivative assets	*24*	**(592.4)**	(855.7)	(855.7)
	Central bank deposits	*18*	**(816.4)**	(895.9)	(895.9)
	CRDs	*25*	**(11.4)**	(6.2)	(6.2)
	Accrued interest on sovereign exposures		**(0.2)**	(0.4)	(0.4)
On-balance sheet items			**12,975.1**	12,758.0	12,785.2
Less: Intangible assets		*28*	**(171.1)**	(169.3)	(169.3)
Total on balance sheet exposures			**12,804.0**	12,588.7	12,615.9
Derivative assets		*24*	**592.4**	855.7	855.7
Potential future exposure on derivatives			**120.0**	172.1	172.1
Total derivative exposures			**712.4**	1,027.8	1,027.8
Post offer pipeline at gross notional amount			**903.4**	817.7	817.7
Adjustment to convert to credit equivalent amounts			**(739.2)**	(569.2)	(569.2)
Off balance sheet items			**164.2**	248.5	248.5
Tier 1 capital			**922.0**	888.7	889.9
Total leverage exposure before IFRS 9 relief			**13,680.6**	13,865.0	13,892.2
IFRS 9 relief			**25.8**	25.8	-
Total leverage exposure			**13,706.4**	13,890.8	13,892.2
UK leverage ratio			**6.7%**	6.4%	6.4%

This table is not subject to audit

The fully loaded leverage ratio is calculated as follows

	30 September 2019	1 October 2018	30 September 2018
	IFRS 9	IFRS 9	IAS 39
	£m	£m	£m
Fully loaded Tier 1 capital	**900.8**	867.5	889.9
Total leverage exposure before IFRS 9 relief	**13,680.6**	13,865.0	13,892.2
Fully loaded UK leverage exposure	**6.6%**	6.3%	6.4%

This table is not subject to audit

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

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

56. FINANCIAL RISK MANAGEMENT

The principal risks arising from the Group's exposure to financial instruments are credit risk, liquidity risk and market risk (particularly, interest rate risk and currency risk). These risks are discussed in notes 57 to 60 respectively. The Board has a Risk and Compliance Committee, consisting of the Chairman and the non-executive directors which is responsible for providing oversight and challenge to the Group's risk management arrangements. The Credit Committee and ALCO are executive sub-committees of the Risk and Compliance Committee which monitor performance against the risk appetites set by the Board and make recommendations for changes in risk appetite where appropriate. They also review and, where authorised to do so, agree or amend policies for managing each of these risks, which are summarised in the relevant note. The Corporate Governance Statement in Section B3 (which is not subject to audit) provides further detail on the operations of these committees.

The financial risk management policies have remained unchanged throughout the year and since the year end. The position discussed in notes 57 to 60 is materially similar to that existing throughout the year.

57. CREDIT RISK

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

	Note	**The Group**		**The Company**	
		2019	2018	**2019**	2018
		£m	£m	**£m**	£m
Financial assets at amortised cost					
Loans to customers	*20*	**12,186.1**	12,127.8	**-**	-
Trade receivables	*25*	**3.6**	2.2	**-**	-
Amounts owed by Group companies	*25*	**-**	-	**106.6**	216.3
Cash	*18*	**1,225.4**	1,310.6	**14.1**	24.9
CSA assets	*25*	**72.2**	3.8	**-**	-
CRDs	*25*	**11.4**	6.2	**-**	-
Accrued interest income	*25*	**0.4**	0.6	**0.7**	0.7
		13,499.1	13,451.2	**121.4**	241.9
Financial assets at fair value					
Derivative financial assets	*24*	**592.4**	855.7	**-**	-
Maximum exposure to credit risk		**14,091.5**	14,306.9	**121.4**	241.9

While this maximum exposure represents the potential loss which might have to be accounted for by the Group, the terms on which a significant proportion of the Group's loan assets are funded, described under Liquidity Risk in note 58, limit the amount of principal repayments on the Group's securitised and warehouse borrowings in cases of capital losses on assets, considerably reducing the effective shareholder value at risk.

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

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

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

Loans to customers

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

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

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

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

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

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

Types of lending

The Group's balance sheet loan assets at 30 September 2019 are analysed as follows:

	2019		2018		2018	
	IFRS 9		IFRS 9		IAS 39	
	£m	**%**	£m	%	£m	%
Buy-to-let mortgages	**10,101.9**	**82.9%**	10,227.4	84.5%	10,261.6	84.6%
Owner-occupied mortgages	**70.6**	**0.6%**	80.9	0.7%	70.6	0.6%
Total first charge residential mortgages	**10,172.5**	**83.5%**	10,308.3	85.2%	10,332.2	85.2%
Second charge mortgage loans	**389.2**	**3.2%**	414.4	3.4%	415.9	3.5%
Loans secured on residential property	**10,561.7**	**86.7%**	10,722.7	88.6%	10,748.1	88.7%
Development finance	**506.5**	**4.1%**	352.9	2.9%	352.8	2.9%
Loans secured on property	**11,068.2**	**90.8%**	11,075.6	91.5%	11,100.9	91.6%
Asset finance loans	**472.9**	**3.9%**	389.9	3.3%	391.0	3.2%
Motor finance loans	**318.9**	**2.6%**	329.2	2.7%	329.4	2.7%
Aircraft mortgages	**19.3**	**0.2%**	12.4	0.1%	12.4	0.1%
Structured lending	**88.1**	**0.7%**	38.7	0.3%	38.7	0.3%
Invoice finance	**18.5**	**0.1%**	21.7	0.2%	21.8	0.2%
Total secured loans	**11,985.9**	**98.3%**	11,867.5	98.1%	11,894.2	98.1%
Professions finance	**46.2**	**0.4%**	42.1	0.4%	42.6	0.4%
Other unsecured commercial loans	**19.3**	**0.2%**	17.2	0.1%	17.3	0.1%
Unsecured consumer loans	**134.7**	**1.1%**	173.8	1.4%	173.7	1.4%
Total loans to customers	**12,186.1**	**100.0%**	12,100.6	100.0%	12,127.8	100.0%

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

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

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

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

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

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

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

	2019	2018
	£m	£m
Buy-to-let mortgages	**149.7**	211.9
Development finance	**212.7**	166.1
Structured lending	**78.8**	29.3
Asset finance	**-**	10.7
	441.2	418.0

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

The fall in large buy-to-let exposures is principally a result of the derecognition of the PM12 assets (note 7) which included elements of several large portfolios.

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2019 is set out below. The analysed amount represents gross carrying amount.

	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
30 September 2019					
Very low risk	**8,693.9**	**92.8**	**26.5**	**49.4**	**8,862.6**
Low risk	**1,267.2**	**77.5**	**6.7**	**26.5**	**1,377.9**
Moderate risk	**781.9**	**75.0**	**9.3**	**45.2**	**911.4**
High risk	**353.2**	**153.0**	**67.9**	**48.5**	**622.6**
Very high risk	**86.0**	**47.0**	**44.0**	**38.7**	**215.7**
Not graded	**200.4**	**13.2**	**13.5**	**10.7**	**237.8**
Total gross carrying amount	**11,382.6**	**458.5**	**167.9**	**219.0**	**12,228.0**
Impairment	**(6.0)**	**(3.7)**	**(32.2)**	**-**	**(41.9)**
Total loans to customers	**11,376.6**	**454.8**	**135.7**	**219.0**	**12,186.1**

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

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to stage 3 cases reported in note 23, other than those shown as 'realisations'.

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

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

IFRS 7 does not require a comparative disclosure and it has been determined that the internal management information was insufficiently mature at 1 October 2018 to produce a reliable comparative.

Credit characteristics by portfolio

Loans secured on residential property

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

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on residential property by value at 30 September 2019 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	2019	**2019**	2018	2018
	First mortgages	**Second charge mortgages**	First mortgages	Second charge mortgages
	%	**%**	%	%
Loan to value ratio				
Less than 70%	**54.3**	**66.5**	60.6	66.1
70% to 80%	**36.2**	**18.5**	29.7	17.4
80% to 90%	**7.2**	**8.9**	7.1	9.3
90% to 100%	**0.6**	**2.7**	0.8	3.5
Over 100%	**1.7**	**3.4**	1.8	3.7
	100.0	**100.0**	100.0	100.0
Average loan to value ratio	**67.3**	**65.7**	66.0	65.9
of which				
Buy-to-let	**67.4**		66.1	
Owner-occupied	**53.2**		51.3	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 0.2% in the year ended 30 September 2019 (2018: 2.0%).

The increase in the LTV ratio for the owner-occupied accounts relates to the greater number of new lending accounts, which have higher LTV levels than legacy cases.

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

	First Charge		**Second Charge**	
	2019	2018	**2019**	2018
	%	%	**%**	%
East Anglia	**3.2**	3.0	**3.3**	3.5
East Midlands	**5.3**	5.2	**6.3**	6.5
Greater London	**18.9**	18.6	**7.8**	7.1
North	**3.3**	3.5	**4.2**	4.7
North West	**10.1**	10.2	**8.0**	8.5
South East	**31.9**	31.3	**37.7**	35.2
South West	**8.9**	9.2	**7.9**	8.0
West Midlands	**5.1**	4.8	**7.6**	8.0
Yorkshire and Humberside	**8.6**	9.4	**6.2**	6.7
Total England	**95.3**	95.2	**89.0**	88.2
Northern Ireland	**0.1**	0.1	**1.9**	2.1
Scotland	**1.4**	1.4	**5.6**	5.9
Wales	**3.2**	3.3	**3.5**	3.8
	100.0	100.0	**100.0**	100.0

Development finance

Development finance loans have an average term of 20 months (2018: 21 months). Settlement of principal and accrued interest takes place once the development is sold or refinanced following its completion and the customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and / or property together with other charges and warranties related to the build.

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

	2019	**2019**	2018	2018
	By value	**By number**	By value	By number
	%	**%**	%	%
LTGDV				
50% or less	**8.5**	**3.4**	3.4	4.4
50% to 60%	**18.2**	**15.5**	18.9	22.8
60% to 65%	**31.6**	**39.1**	63.3	59.6
65% to 70%	**32.3**	**32.4**	7.1	9.6
70% to 75%	**6.8**	**8.2**	0.7	0.7
Over 75%	**2.6**	**1.4**	6.6	2.9
	100.0	**100.0**	100.0	100.0

The average LTGDV cover at the year end was 64.8% (2018: 63.2%).

The increase in LTGDV percentages over the year reflects the changing mix in the portfolio between those accounts originated using the initial cautious underwriting approach of the Group's in-house operation and those originated though the acquired operation. Following acquisition, risk appetites were adjusted to reflect the increased experience and maturity of the combined operation.

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports.

At 30 September 2019 the development finance portfolio comprised 207 accounts (2018: 136) with a total carrying value of £506.5m (2018: £352.8m). Of these accounts only six were included in stage 2 at 30 September 2019 (2018 IFRS 9: none). In addition, three accounts acquired in the Titlestone purchase had been classified as POCI (2018: four). An allowance for these losses was made in the IFRS 3 fair value calculation.

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

	2019	2018
	%	%
East Anglia	**20.2**	21.6
East Midlands	**3.0**	3.0
Greater London	**20.9**	28.5
North	**1.0**	0.7
North West	**0.1**	-
South East	**30.8**	23.0
South West	**13.9**	11.1
West Midlands	**7.2**	8.3
Yorkshire and Humberside	**1.5**	1.2
Total England	**98.6**	97.4
Northern Ireland	**-**	-
Scotland	**1.4**	2.6
Wales	**-**	-
	100.0	100.0

Asset finance and Motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IAS 17. The average contractual life of the asset finance loans was 56 months (2018: 52 months) while that of the motor finance loans was 57 months (2018: 55 months), but it is likely that a significant proportion of customers will choose to settle their obligations early.

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

	2019	2018
	%	%
Commercial vehicles	**30.3**	22.6
Construction plant	**34.8**	38.9
Technology	**7.8**	6.6
Manufacturing	**6.1**	5.2
Print and paper	**4.8**	7.1
Refuse disposal vehicles	**5.2**	6.7
Other vehicles	**3.0**	4.2
Agriculture	**2.7**	1.2
Other	**5.3**	7.5
	100.0	100.0

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

Structured lending

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

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

	2019	2018
Number of transactions	**8**	3
Total facilities (£m)	**135.0**	52.5
Carrying value (£m)	**88.1**	38.7

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

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

At 30 September 2019 there were no significant concerns regarding the credit performance of these facilities.

Unsecured consumer loans

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

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2019 and 30 September 2018, compared to the industry averages at those dates published by UK Finance ('UKF') and the FLA, was:

	2019	2018
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.18**	0.11
Buy-to-let accounts excluding receiver of rent cases	**0.07**	0.03
Owner-occupied accounts	**2.44**	3.15
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	**0.42**	0.42
Buy-to-let accounts excluding receiver of rent cases	**0.37**	0.38
Owner-occupied accounts	**0.81**	0.88
All mortgages	**0.73**	0.79
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	**14.08**	13.64
Post-2010 originations	**0.38**	0.21
Legacy cases (Pre-2010 originations)	**19.85**	17.91
Purchased assets	**16.05**	14.81
FLA data for secured loans	**8.70**	9.40
Car loans		
Accounts more than 2 months in arrears	**5.25**	3.91
FLA data for point of sale hire purchase	**2.70**	2.50
Asset finance loans		
Accounts more than 2 months in arrears	**0.43**	0.78
FLA data for business lease / hire purchase loans	**1.10**	0.70

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2018 has been published by the FLA or UKF, the comparative industry figures above have been amended.

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

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

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

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

Acquired assets

Almost all of the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. The total amount of undiscounted ECL at initial recognition on POCI loans to customers initially recognised during the year ended 30 September 2019 was minimal due to the level of purchases.

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

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

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

	2019	2018	2017
	£m	£m	£m
All purchased consumer assets			
Carrying value	**291.1**	364.2	503.5
84 month ERC	**342.3**	434.9	608.9
120 month ERC	**387.5**	489.6	688.8
POCI assets only			
Carrying value	**168.3**	204.4	302.9
84 month ERC	**214.1**	269.9	317.2
120 month ERC	**246.0**	306.2	359.9

Amounts shown above are disclosed as loans to customers (note 20). They include first mortgages, second charge loans and unsecured consumer loans.

Further information relating to comparative information prepared under IAS 39 is included in note 54(a) and (b).

Cash balances

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

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

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

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

		2019	2018
		£m	£m
The Group			
Cash with central banks rated:			
	AA	**816.4**	895.9
Cash with retail banks rated:			
	AA	**-**	81.3
	AA-	**230.5**	171.5
	A+	**173.5**	97.7
	A	**-**	21.7
	A-	**5.0**	-
	BBB+	**-**	20.9
		409.0	393.1
Investments in money market funds rated:			
	AAA	**-**	21.6
Total exposure		**1,225.4**	1,310.6
The Company			
Cash with retail banks rated:			
	AAA	**-**	15.0
	A+	**9.1**	9.9
	BBB+	**5.0**	-
		14.1	24.9

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

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

Trade debtors

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

Financial assets at fair value

The Group's financial assets held at fair value comprise solely derivate financial instruments used for hedging purposed (note 24)

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

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

The Group uses the International Swaps and Derivatives Association ('ISDA') Master Agreement for documenting certain derivative activity. For certain counterparties a Credit Support Annex ('CSA') has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Collateral pledged to such counterparties by the Group is shown in note 25, while collateral pledged to the Group is shown in note 37.

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

	2019	2018
	£m	£m
Carrying value of derivative financial assets		
Counterparties rated		
AA	**7.3**	7.9
AA-	**155.6**	169.7
A+	**388.8**	5.4
A	**5.5**	630.2
A-	**35.2**	-
BBB+	**-**	42.5
Gross exposure (note 24)	**592.4**	855.7
Collateral amounts posted		
Cross-currency basis swap arrangements	**64.1**	67.5
CSA collateral amounts (note 37)	**-**	10.3
Total collateral	**64.1**	77.8
Net exposure	**528.3**	777.9

The increase in reported credit quality is due to upgrades in the year to the ratings of two of the Group's principal counterparties, Barclays and RBS.

58. LIQUIDITY RISK

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

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

Further liquidity risk arises:

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

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

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

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

	Amounts payable				
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	Total
	£m	£m	£m	£m	£m
30 September 2019					
Retail deposits	**4,418.0**	**1,210.1**	**982.4**	**-**	**6,610.5**
Borrowings	**89.9**	**794.6**	**551.8**	**171.8**	**1,608.1**
Total non-derivative liabilities	**4,507.9**	**2,004.7**	**1,534.2**	**171.8**	**8,218.6**
Derivative liabilities	**(0.1)**	**2.9**	**1.8**	**-**	**4.6**
	4,507.8	**2,007.6**	**1,536.0**	**171.8**	**8,223.2**
30 September 2018					
Retail deposits	3,674.8	1,068.8	720.8	-	5,464.4
Borrowings	118.7	44.6	1,227.4	301.9	1,692.6
Total non-derivative liabilities	3,793.5	1,113.4	1,948.2	301.9	7,157.0
Derivative liabilities	(1.9)	4.7	22.6	(0.4)	25.0
	3,791.6	1,118.1	1,970.8	301.5	7,182.0

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

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

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

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

The responsibility for managing liquidity risk rests with ALCO which makes recommendations for the Group's liquidity policy for Board approval and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times. The Group's liquidity position is managed on a day to day basis by the treasury function, under the supervision of ALCO.

Retail deposits

The Group's retail funding strategy is focussed on building a stable mix of deposit products. A high proportion of balances, 97.8% (2018: 97.9%), are protected by the Financial Services Compensation Scheme ('FSCS') which mitigates against the possibility of a retail run.

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

	2019	2018
	£m	£m
Payable on demand	**1,783.9**	1,294.3
Payable in less than three months	**482.7**	281.9
Payable in less than one year but more than three months	**2,151.4**	2,098.6
Payable in less than one year or on demand	**4,418.0**	3,674.8
Payable in one to two years	**1,210.1**	1,068.8
Payable in two to five years	**982.4**	720.8
	6,610.5	5,464.4

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

At 30 September 2019 the liquidity buffer comprised the following on and off balance sheet assets. All of these assets are held within the Bank and are readily realisable.

	Note	**2019**	2018
		£m	£m
Balances with central banks	*18*	**646.4**	724.9
Short-term investments	*19*	**-**	-
Total on balance sheet liquidity		**646.4**	724.9
FLS drawings	*36*	**109.0**	108.7
		755.4	833.6

The Bank manages its Liquidity Coverage Ratio ('LCR'), the level of its High Quality Liquid Assets ('HQLA') relative to its short term forecast net cash outflows. A minimum level of LCR, the Liquidity Coverage Requirement is set through regulation for all regulated financial institutions. As at 30 September 2019, the Bank's LCR was comfortably above the required minimum regulatory standard. The Bank also monitors its Net Stable Funding Ratio ('NSFR') which measures the stability of the funding profile in relation to the composition of its assets and off-balance sheet activities.

Liquidity is not regulated at Group level.

Borrowings

Set out below is the contractual maturity profile of the Group's and the Company's borrowings at 30 September 2019 and 30 September 2018 based on their carrying values. These are analysed between non-recourse (securitisation) and other funding, with the liquidity position arising principally from the other funding.

	Financial liabilities falling due:				
	In one year or less, or on demand	In more than one year, but not more than two years	In more than two years but not more than five years	In more than five years	Total
	£m	£m	£m	£m	£m
The Group					
30 September 2019					
Secured bank borrowings	**-**	**-**	**-**	**787.5**	**787.5**
Asset backed loan notes	**-**	**-**	**-**	**4,419.4**	**4,419.4**
Total non-recourse funding	**-**	**-**	**-**	**5,206.9**	**5,206.9**
Bank overdrafts	**1.0**	**-**	**-**	**-**	**1.0**
Retail bonds	**-**	**59.9**	**236.6**	**-**	**296.5**
Corporate bond	**-**	**-**	**-**	**149.6**	**149.6**
Central bank facilities	**50.0**	**700.0**	**244.4**	**-**	**994.4**
	51.0	**759.9**	**481.0**	**5,356.5**	**6,648.4**
30 September 2018					
Secured bank borrowings	-	-	-	935.6	935.6
Asset backed loan notes	-	-	-	5,554.7	5,554.7
Total non-recourse funding	-	-	-	6,490.3	6,490.3
Bank overdrafts	1.1	-	-	-	1.1
Retail bonds	-	-	184.3	111.8	296.1
Corporate bond	-	-	-	149.3	149.3
Central bank facilities	80.0	-	944.4	-	1,024.4
	81.1	-	1,128.7	6,751.4	7,961.2
The Company					
30 September 2019					
Retail bonds	**-**	**59.9**	**236.6**	**-**	**296.5**
Corporate bond	**-**	**-**	**-**	**149.6**	**149.6**
	-	**59.9**	**236.6**	**149.6**	**446.1**
30 September 2018					
Retail bonds	-	-	184.3	111.8	296.1
Corporate bond	-	-	-	149.3	149.3
	-	-	184.3	261.1	445.4

IFRS 7 requires the disclosure of future contractual cash flows (including interest) on these borrowings, and these are shown below.

Non-recourse funding

The Group has historically used securitisation as a principal source of funding, but currently only accesses this market on a strategic basis. In a securitisation an SPV company within the Group will issue asset backed loan notes ('Notes') secured on a pool of mortgage or other loan assets beneficially owned by the SPV in a public offer. The Notes have a maturity date later than the final repayment date for any asset in the pool, typically over thirty years from the issue date. The noteholders are entitled to receive repayment of the Note principal from principal funds generated by the loan assets from time to time, but their right to the repayment of principal is limited to the cash available in the SPV. Similarly, payment of accrued interest to the noteholders is limited to cash generated within the SPV. There is no requirement for any Group company other than the issuing SPV to make principal or interest payments in respect of the Notes. This matching of the maturities of the assets and the related funding substantially reduces the Group's exposure to liquidity risk. Details of Notes in issue are given in note 32 and the assets backing the Notes are shown in note 21.

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

Cash received from time to time in each SPV is held until the next interest payment date when, following payment of principal, interest and the associated costs of the SPV, the remaining balances become available to the Group. Cash balances are also held within each SPV to provide credit enhancement for the particular securitisation, allowing interest and principal payments to be made even if some of the loans default. To provide further credit enhancement in certain SPVs, specific economic trigger events exist which cause additional cash to be retained in the SPV rather than being transferred to the Group. While the Group can, if it chooses, contribute additional cash to cover these requirements, it is under no obligation to do so. No such events occurred in the year ended 30 September 2019 or the year ended 30 September 2018. Whether any such events in any of the Group's other SPVs arise in the future will depend on the performance of the general economy and its impact on mortgage and loan arrears in each SPV. However, if all of the remaining trigger events occurred, a total of £55.8m of additional cash would be retained in the SPV companies (2018: £71.0m). The cash balances of the SPV companies are included within the restricted cash balances disclosed in note 18 as 'securitisation cash'.

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

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

As with the SPVs, the Group provides subordinated funding to active warehouse companies and restricted cash balances are held within them. Contributions to the subordinated funding are made each time a drawing on the facility concerned is made. These amounts provide credit enhancement to the warehouse and cover certain fees. This funding is repaid when assets are securitised or refinanced by an internal asset sale. There were no active warehouse companies at 30 September 2019 or 30 September 2018.

Further details of the warehouse facilities are given in note 33 and details of the loan assets within the warehouses are given in note 21.

The final repayment date, for all of the securitisation borrowings and the Paragon Second Funding warehouse borrowing is more than five years from the balance sheet date, the earliest falling due in 2033 and the latest in 2050.

The equivalent sterling principal amount outstanding at 30 September 2019 under the SPV and warehouse arrangements, allowing for the effect of the cross-currency basis swaps, described under currency risk (note 60), which are net settled with the loan payments, was £4,706.1m (2018: £5,669.1m). The total sterling amount payable under these arrangements, were these principal amounts to remain outstanding until the final repayment date, would be £6,267.6m (2018: £8,874.2m). As the principal will, as discussed above, reduce as customers repay or redeem their accounts, the cash flow will be far less than this amount in practice.

Corporate debt

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

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

The Group's ability to issue debt is supported by its credit rating issued by Fitch which was increased to BBB from BBB- in the year ended 30 September 2018 and confirmed in March 2019. It was, however, placed on negative watch, due to Brexit related concerns, in common with other UK bank issuance.

None of the Group's corporate or retail bond issuance falls due for payment earlier than 2020.

Central bank facilities

The Group has accessed term facilities under the central bank schemes described in note 36. The Group has prepositioned further assets with the Bank of England which can be used to release more funds for liquidity or other purposes. At 30 September 2019 the amount of drawings available in respect of prepositioned assets was £1,095.0m (2018: £703.2m).

Contractual cash flows

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

	Contingent consideration	Corporate bonds	Retail bonds	Central bank facilities	Total
	£m	£m	£m	£m	£m
a) The Group					
30 September 2019					
Payable in less than one year	**5.7**	**10.9**	**18.0**	**55.3**	**89.9**
Payable in one to two years	**6.2**	**10.9**	**75.3**	**702.2**	**794.6**
Payable in two to five years	**12.7**	**32.6**	**261.6**	**244.9**	**551.8**
Payable in over five years	**-**	**171.8**	**-**	**-**	**171.8**
	24.6	**226.2**	**354.9**	**1,002.4**	**1,608.1**
30 September 2018					
Payable in less than one year	2.5	10.9	18.0	87.3	118.7
Payable in one to two years	5.7	10.9	18.0	10.0	44.6
Payable in two to five years	18.9	32.6	217.6	958.3	1,227.4
Payable in over five years	-	182.6	119.3	-	301.9
	27.1	237.0	372.9	1,055.6	1,692.6

	Corporate bonds	Retail bonds	Total
	£m	£m	£m
b) The Company			
30 September 2019			
Payable in less than one year	**10.9**	**18.0**	**28.9**
Payable in one to two years	**10.9**	**75.3**	**86.2**
Payable in two to five years	**32.6**	**261.6**	**294.2**
Payable in over five years	**171.8**	**-**	**171.8**
	226.2	**354.9**	**581.1**
30 September 2018			
Payable in less than one year	10.9	18.0	28.9
Payable in one to two years	10.9	18.0	28.9
Payable in two to five years	32.6	217.6	250.2
Payable in over five years	182.6	119.3	301.9
	237.0	372.9	609.9

Amounts payable in respect of the ‘other accruals’ and ‘trade creditors’ shown in note 37 fall due within one year. The cash flows described above will include those for interest on borrowings accrued at 30 September 2019 disclosed in note 37.

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

	2019	2018
	Total cash outflow / (inflow)	Total cash outflow / (inflow)
	£m	£m
On derivative liabilities		
Payable in less than one year	**(0.1)**	(1.9)
Payable in one to two years	**2.9**	4.7
Payable in two to five years	**1.8**	22.6
Payable in over five years	**-**	(0.4)
	4.6	25.0
On derivative assets		
Payable in less than one year	**(14.0)**	(4.3)
Payable in one to two years	**(20.8)**	(1.2)
Payable in two to five years	**(42.0)**	0.2
Payable in over five years	**(0.5)**	-
	(77.3)	(5.3)
	(72.7)	19.7

59. INTEREST RATE RISK

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

The principal market-set interest rate used by the Group is the London Interbank Offered Rate ('LIBOR') which is used to set rates for certain loan assets and borrowings. During the year, the Group issued its first debt with interest set by reference to the Sterling Overnight Index Average ('SONIA'), which is expected to be used more widely going forward.

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

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

IRRBB exposures

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

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

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

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

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

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

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

The Group's use of financial derivatives for hedging interest rate risk is discussed further in note 24.

Interest rate sensitivity

To provide a broad indication of the Group's exposure to interest rate movements, the notional impact of a 1.0% change in UK interest rates on the equity of the Group at 30 September 2019, and the notional annualised impact of such a change on the operating profit of the Group, based on the year-end balance sheet have been calculated.

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

On this basis, a 1.0% increase in UK interest rates would reduce the Group's equity at 30 September 2019 by £1.1m (2018: £1.7m) and increase profit before tax by £10.1m (2018: increase by £19.8m).

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

Although certain of the Group's borrowings have interest rates dependent on US Dollar and Euro LIBOR rates, the effect of the cross-currency basis swaps is such that the Group's results have no material exposure to movements in these rates. The effects of independent 1.0% increases in US or Euro interest rates would be to increase the Group's equity by £0.4m (2018: £0.6m) and £1.1m (2018: £1.4m) respectively, however, in reality these movements would be mitigated by movements in UK interest rates and exchange rates.

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

The Company

All the borrowings of the Company have fixed interest rates. Its assets and liabilities with other group companies bear interest at floating rates based on LIBOR which reset within three months of the balance sheet date; all other balances in the Company balance sheet are non-interest bearing.

60. CURRENCY RISK

The Group has no appetite for material amounts of exposure to foreign currency movements and applies a hedging strategy for any material open positions through the use of spot or forward contracts or derivatives.

All of the Group's significant assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in US dollars and euros, which are described in note 32. Although IFRS 9 requires that they be accounted for as currency liabilities and valued at their spot rates, a condition of the issue of these notes was that bespoke interest rate and currency swaps ('cross-currency basis swaps') were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing eliminating currency risk for these exposures. The amount of this effective borrowing, i.e. the amount of the currency borrowing translated at the exchange rate on inception, is referred to as the 'equivalent sterling principal'.

The equivalent sterling principal amounts of notes in issue under the arrangements described above, and their carrying values at 30 September 2019 and 30 September 2018 are set out below:

	2019	**2019**	2018	2018
	Equivalent sterling principal	**Carrying value**	Equivalent sterling principal	Carrying value
	£m	**£m**	£m	£m
US dollar notes	**447.5**	**721.6**	897.3	1,321.8
Euro notes	**1,007.4**	**1,314.1**	1,320.5	1,724.5
	1,454.9	**2,035.7**	2,217.8	3,046.3

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

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

The Group's use of financial derivatives to manage currency risk is described further in note 24.

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

D2.3 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2019

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

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

61. BASIS OF PREPARATION

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

The particular accounting policies adopted have been set out in note 63 and the critical accounting judgements and estimates which have been required in preparing these financial statements are described in note 64 and 65 respectively.

Adoption of new and revised reporting standards

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

- IFRS 9 – 'Financial Instruments' (together with consequential changes to IFRS 7 - 'Financial Instruments: Disclosures')
- IFRS 15 – 'Revenue from Contracts with Customers'

The effect on the Group's and the Company's accounting of the adoption of these standards is discussed in note 62.

Comparability of information

IFRS 9 does not require that the balance sheet information at 30 September 2017 and 30 September 2018 and the profit and loss information for the years ended on these dates is restated on the adoption of the Standard. The information presented for those periods in these financial statements is derived in accordance with IAS 39 – 'Financial Instruments: Recognition and Measurement' ('IAS 39'), and therefore may not be directly comparable with the balance sheet at 30 September 2019 and the profit and loss account for the year then ended which are prepared under IFRS 9.

In order to aid users of the accounts additional comparative balance sheet amounts at 1 October 2018, immediately following transition, have been provided where relevant. These are marked as 2018 IFRS 9.

Standards not yet adopted

At the date of authorisation of these financial statements IFRS 16 – 'Leases', which has not been applied in these financial statements, was in issue but not yet effective.

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

IFRS 16

IFRS 16 will replace the standards currently governing the accounting for operating and finance leases and will come in to force with effect from the Group's financial statements for the year ending 30 September 2020. The Group has not early adopted IFRS 16 and will adopt IFRS 16 for the year ending 30 September 2020 using the modified retrospective approach.

Lessor accounting

The standard will address accounting by lessees and lessors, but the provisions for lessor accounting are little changed from those in IAS 17 and so the accounting for the Group's finance lease receivables will be largely unaffected.

Lessee accounting

Accounting by lessees will change significantly, with a right of use asset recognised on the balance sheet for all leases, representing the right to use the underlying asset. This includes leases presently treated as operating leases and not recognised on the balance sheet. A corresponding liability arises representing the present value of future lease commitments.

The Group's present commitments under such leases are described in note 51(b). Additionally, the Group has undertaken an exercise to identify potential lease agreements arising from service contracts it holds.

The Group has made use of practical expedients within IFRS 16 when performing its initial impact assessment. These include the right to exclude contracts that have not previously been classified as leases before the implementation date, and the ability to exclude leases of low value and those with a short term. A discount rate based on a 5-year corporate bond rate has been used when performing the present value calculations.

This is expected to result in the recognition of a right of use ('ROU') asset of £9.0m and a corresponding liability of £9.0m. Comparative amounts will not be restated.

There is expected to be no immediate tax impact from transition and the Group's regulatory capital will be unaffected. Under IFRS 16, the amount charged to profit and loss will represent depreciation on the ROU asset and a finance charge on the liability instead of rents. While this is a change of classification, the overall effect on profit is likely to be insignificant. There is no impact on reported cash flows.

62. CHANGES IN ACCOUNTING STANDARDS

The Group is required to adopt IFRS 9 (and the consequent changes to IFRS 7) and IFRS 15 for the first time in preparing its financial statements for the year ended 30 September 2019.

IFRS 9 – Overview

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') and addresses the recognition, classification and measurement of financial assets and liabilities.

IFRS 9 – Classification

IFRS 9 changes the classification requirements for financial assets and liabilities. In order for financial assets to be carried at amortised cost under the new standard, they must be carried in a business model whose objective is to collect the contractual cash flows from the assets and where those cash flows comprise solely payments of principal and interest ('SPPI'). Further information on this judgement is given in note 64.

In accordance with the new rules:

- Cash balances and loans to customers (other than finance leases), which were classified as 'loans and receivables' under IAS 39 are classified as 'financial assets measured at amortised cost' under IFRS 9 and continue to be measured on the amortised cost basis
- Retail deposits and external borrowings, which were classified as 'other financial liabilities' under IAS 39 are classified as 'financial liabilities measured at amortised cost' and continue to be measured on the amortised cost basis
- Derivative financial assets and liabilities, which were carried at fair value under IAS 39 are classified as 'financial assets or liabilities at fair value through profit and loss' under IFRS 9 and continue to be measured on the same basis

The amortised cost and fair value measurement methodologies remain broadly the same in IFRS 9 as they were in IAS 39 and no measurement changes in the accounts of the Group or the Company have arisen as a result of these classification changes.

The Group's financial asset and financial liability balances measured in accordance with IFRS 9 and the preceding standard, IAS 39, at the transition date (1 October 2018) are set out below:

	Post-transition	Pre-transition
	£m	£m
Financial Assets		
Cash – central banks	**895.9**	895.9
Cash – retail banks	**414.7**	414.7
Loans to customers	**12,100.6**	12,127.8
Derivative financial assets	**855.7**	855.7
Sundry financial assets	**15.3**	15.3
	14,282.2	14,309.4
Financial Liabilities		
Short-term bank borrowings	**1.1**	1.1
Retail deposits	**5,296.6**	5,296.6
Derivative financial liabilities	**4.7**	4.7
Asset backed loan notes	**5,554.7**	5,554.7
Secured bank borrowings	**935.6**	935.6
Retail bond issuance	**296.1**	296.1
Corporate bond issuance	**149.3**	149.3
Central bank facilities	**1,024.4**	1,024.4
Other financial liabilities	**82.8**	82.8
	13,345.3	13,345.3

The only changes arising from a change in measurement on transition to IFRS 9 relate to impairment provision on the Group's loans to customers. These are discussed further below.

The Company's financial asset and financial liability balances measured in accordance with IFRS 9 and the preceding standard, IAS 39, at the transition date (1 October 2018) are set out below:

	Post-transition	Pre-transition
	£m	£m
Financial Assets		
Cash – retail banks	**24.9**	24.9
Balances owed by Group companies	**216.3**	216.3
Loans to Group companies	**200.0**	200.0
Sundry financial assets	**0.7**	0.7
	441.9	441.9
Financial Liabilities		
Retail bond issuance	**296.1**	296.1
Corporate bond issuance	**149.3**	149.3
Balances owed to Group companies	**125.7**	125.7
Sundry financial liabilities	**2.8**	2.8
	573.9	573.9

No measurement changes on transition to IFRS 9 arise in the accounts of the Company.

IFRS 9 – Impairment

IFRS 9 changes the basis of impairment provision for all financial assets from an incurred loss to an expected credit loss ('ECL') basis. Therefore, the provisioning is dependent on an assessment of the probability of future default and the loss which might be incurred at that time. This introduces significant additional areas of estimation to the accounting.

This introduces a number of new concepts and changes to the approach required by IAS 39. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. This has the effect of recognising losses on loans earlier than at present, as IAS 39 requires provisions to be made only at the point where a loss has actually occurred and there is objective evidence of credit impairment.

The Standard also requires that companies calculate impairment under a variety of differing economic scenarios and combine these on a weighted average basis to arrive at the final provision, rather than base calculations on a central forecast, as is generally the case under IAS 39.

IFRS 9 requires loan assets to be divided into three 'stages', with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no Significant Increase in Credit Risk ('SICR') since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are credit impaired (Stage 3). It is an important feature of the standard that SICR is not defined solely by the performance of the account, but also by other information available about the customer both internally and externally, such as credit bureau information.

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date. These accounts would be largely unprovided for under IAS 39, although some cases with adverse qualitative indicators might have been addressed by a collective emergence provision. Such provisions under IAS 39 were designed to cover assets where a loss event had occurred before the reporting date, but this event had not yet affected performance

- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan. This is likely to lead to an increase in provision in general, though the IAS 39 emergence provision would have also addressed some of this risk

- For credit impaired assets, provisions will be made on the basis of lifetime expected credit losses, taking account of forward-looking economic assumptions and a range of possible outcomes. Under IAS 39, provisions were based on the asset's carrying value and the present value of the estimated future cash flows. Despite IAS 39 not explicitly taking account of alternative economic scenarios, where loans had attracted a provision under IAS 39, the IFRS 9 provision on transition was, in most cases, broadly similar to the closing IAS 39 position

  Credit impaired assets are identified either through quantitative measures or by operational status. In determining indicators of credit impairment regard is also taken of definitions used for regulatory capital purposes. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes

- For assets which were purchased or originated as credit impaired ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the required treatment is largely similar under IAS 39 and IFRS 9. This classification also includes credit impaired assets recognised in corporate acquisitions under IFRS 3. Purchased performing accounts are not classified as POCI, but are first recognised in Stage 1

Under IAS 39 the Group treated all loan accounts as live where they remained open on its administration system. IFRS 9 requires a firm to consider the prospect of future recovery in its write off approach and the Group has adopted a revised accounting policy for write offs following transition.

Accounts are now written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This change has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions, but provides a more informative value for the coverage ratio.

All accounts which would have been written off for accounting purposes prior to the transition date under the new policy have been written off at transition. All of these cases were fully provided and therefore this has had no impact on reserves.

As disclosed in the transition report, the introduction of IFRS 9 resulted in an increase in the Group's impairment provision of £27.2m at the transition date, 1 October 2018. The impacts by business segment are set out below:

	IAS 39	IFRS 9	Change	Change
	£m	£m	£m	%
Loans to customers				
Mortgages	10,473.5	10,449.5	(24.0)	(0.2) %
Commercial Lending	1,133.2	1,131.3	(1.9)	(0.2) %
Idem Capital	521.1	519.8	(1.3)	(0.2) %
Total	12,127.8	12,100.6	(27.2)	(0.2) %

The movement in impairment provisions in the Group's accounts between the balance disclosed under IAS 39 and the opening balance under IFRS 9 is set out below.

	£m
Loans to customers	
At 30 September 2018 under IAS 39	107.4
IFRS 9 transition adjustments	27.2
Change in write-off definition	(80.4)
At 1 October 2018 under IFRS 9	54.2

The reduction due to write off definitions is principally attributable to part redeemed loan balances which remained live on the administration systems of the Group and were therefore treated as live for accounting purposes. Under IFRS 9 these balances may be defined as written off, and the Group's IFRS 9 write off policy considers them to be so, as this provides users with a more useful measure of provision cover.

The increase in impairment on transition will be allowed as a deduction for the purposes of UK Corporation Tax under the Change in Accounting Practices Regulations. This is spread over the ten years following transition for loan assets and is allowable in the 2019 tax computations for finance leases. A deferred tax asset of £5.0m has been recognised on transition.

Cash balances, 'Trade receivables', and the sundry financial asset balances shown in note 25 are classified as financial assets accounted for at amortised cost and are therefore subject to the impairment provisions of IFRS 9. However, these assets are principally UK sovereign exposures (including exposures to the Bank of England) and exposures to highly rated banks. The ECLs on these counterparties are considered to be minimal. The value, tenor and potential for default of the other exposures is such that any potential IFRS 9 provision is insignificant.

Derivative financial assets are carried at fair value, which includes the consideration of credit risk, as they were under IAS 39.

The introduction of the IFRS 9 impairment regime had no impact on the financial assets of the Company.

IFRS 9 – Hedge accounting

The hedge accounting requirements of IFRS 9 do not specifically address portfolio fair value hedges of interest rate risk ('macro hedges') which IAS 39 deals with directly. A separate financial reporting standard is to be developed in this area. IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented.

As the Group's hedging arrangements are either macro hedges, which are not specifically addressed by the new standard, or bespoke cash flow hedges, which would not be affected by the change of standard, the Group has decided to defer application of these rules until the full new hedge accounting regime is in place.

It thus continues to apply the hedge accounting requirements of IAS 39 and all hedging arrangements in place at 30 September 2018 continue to be recognised on 1 October 2018 after IFRS 9 transition.

However, the consequential changes to IFRS 7 (see below) do apply to these financial statements and the Group's disclosures in respect of hedge accounting and derivatives have been revised and expanded.

There are no hedge accounting arrangements in the accounts of the Company.

IFRS 7 – Disclosure

At the point of adoption of IFRS 9, entities are also required to adopt amendments to IFRS 7 – 'Financial Instruments: Disclosures' made by IFRS 9 in July 2014. The principal amendments affecting the Group's accounts are those concerning the reporting of impairment, taking account of the IFRS 9 measurement requirements for impairment, the reporting of credit risk and the reporting of hedging strategies and outcomes.

This has, therefore, required significant amendments to the disclosures presented as notes 57 (credit risk), 21 to 23 (loans and impairment) and 24 (derivatives and hedging) in these accounts compared to those presented for the year ended 30 September 2018. When new notes address impairment, no comparative amounts are required to be disclosed, but for other new requirements, comparative amounts under the new standard at 30 September 2018 are shown.

IFRS 15 – Impact

IFRS 15 governs the accounting for those of the Group's income streams which are not within the scope of either IFRS 9 or IAS 17 - 'Leases'. These comprise principally third-party servicing income, maintenance income on vehicle leasing, third party commission income and account fee income. The accounting for most of these flows is unchanged as the amounts are charged on an event-by-event basis.

There is a small balance sheet impact in the Group accounts from the accounting for maintenance agreements, decreasing reserves at 30 September 2018 by £0.2m. In view of the low level of impact comparative amounts have not been restated for this change.

The introduction of IFRS 15 had no impact on the accounts of the Company.

Summary

The overall impacts of the changes above on consolidated equity at 30 September 2018 are set out below.

	Note	£m	£m
Equity at 30 September 2018			1,095.9
IFRS 9			
Impairment	20	(27.2)	
Deferred tax thereon	26	5.0	
		(22.2)	
IFRS 15			
Maintenance income		(0.2)	
Total adjustments			(22.4)
Equity at 1 October 2018			1,073.5

All these amendments impacted retained earnings. None of these changes have any impact on the Group's cash flow reporting.

There were no impacts on the equity of the Company.

63. ACCOUNTING POLICIES

The particular policies applied by the Group in preparing these financial statements in accordance with the EU endorsed IFRS regime are described below.

As comparative financial information relating to the year ended 30 September 2018 and earlier periods has not been restated for IFRS 9, as permitted by that standard, the accounting policies applied differ to those used in the accounts for the year ended 30 September 2019. Where this is significant both policies are shown.

(a) Accounting convention

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

(b) Basis of consolidation

The consolidated financial statements deal with the accounts of the Company and its subsidiaries made up to 30 September 2019. Subsidiaries comprise all those entities over which the Group has control, as defined by IFRS 10 – 'Consolidated Financial Statements'.

In addition to legal subsidiaries, where the Company owns shares in the entity, directly or indirectly, in accordance with IFRS 10, companies owned by charitable trusts into which loans originated by group companies were sold as part of its warehouse and securitisation funding arrangements, where the Group enjoys the benefits of ownership and which, therefore, it is considered to control, are treated as subsidiaries.

Similarly, trusts set up to hold shares in conjunction with the Group's employee share ownership arrangements are also treated as subsidiaries.

A full list of the Group's subsidiaries is set out in note 68, together with further information on the basis on which they are considered to be controlled by the Company. The results of businesses acquired are dealt with in the consolidated accounts from the date of acquisition.

(c) Going concern

The consolidated financial statements have been prepared on the going concern basis.

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

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

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

(d) Acquisitions and goodwill

Goodwill arising from the purchase of subsidiary undertakings, representing the excess of the fair value of the purchase consideration over the fair values of acquired assets, including intangible assets, is held on the balance sheet and reviewed annually to determine whether any impairment has occurred.

As permitted by IFRS 1, the Group has elected not to apply IFRS 3 – 'Business Combinations' to combinations taking place before its transition date to IFRS (1 October 2004). Therefore any goodwill which was written off to reserves under UK GAAP will not be charged or credited to the profit and loss account on any future disposal of the business to which it relates.

Contingent consideration arising on acquisitions is first recognised in the accounts at its fair value at the acquisition date and subsequently revalued at each accounting date until it falls due for payment or the final amount is otherwise determined.

(e) Cash and cash equivalents

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

(f) Short term investments

Short term investments are held as part of the liquidity requirement of Paragon Bank PLC. As such they are measured at their fair value which corresponds to their market value at the balance sheet date.

(g) Leases

Leases are accounted for as operating or finance leases in accordance with IAS 17 – 'Leases'. A finance lease is deemed to be one which transfers substantially all of the risks and rewards of the ownership of the asset concerned. Any other lease is an operating lease.

Rental income and costs under operating leases are credited or charged to the profit and loss account on a straight line basis over the period of the leases.

(h) Loans to customers

Year ended 30 September 2019 under IFRS 9

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

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

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

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

Year ended 30 September 2018 under IAS 39

Loans to customers are considered to be 'loans and receivables' as defined by IAS 39 – 'Financial Instruments: Recognition and Measurement'. They are therefore accounted for on the amortised cost basis.

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

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

(i) Finance lease receivables

Finance lease receivables are included within 'Loans to Customers' at the total amount receivable less interest not yet accrued, unamortised commissions and provision for impairment.

Income from finance lease contracts is governed by IAS 17 – 'Leases' and accounted for on the actuarial basis.

(j) Impairment of loans to customers

Year ended 30 September 2019 under IFRS 9

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IAS 17, are reduced by an impairment provision based on their expected credit loss ('ECL'), determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

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

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

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

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

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

Within its buy-to-let portfolio the Group utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver and a tenant is in place, arrears may be reduced or cleared. Properties in receivership are eventually either returned to their landlord owners or sold.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCI. For these assets, the Group recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

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

Year ended 30 September 2018 under IAS 39

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date in accordance with IAS 39. Where loans exhibit objective evidence of impairment (a 'loss event') the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security (net of sales costs) discounted at the original EIR.

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

Loss events reflect both loans that display delinquency in contractual payments of principal or interest or, for buy-to-let loans in receivership but up to date at the balance sheet date, properties where the receiver adopts a sale strategy, where a shortfall may or may not arise.

In addition to loans where loss events are evident, loans are also assessed collectively, grouped by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date. Collective impairment provisions are calculated for each key portfolio based on recent historical performance, with adjustments for expected changes in losses based on management's judgement. In the receiver of rent portfolio, collective provisions are also established for cases where the present strategy might not be sustainable.

For loan portfolios acquired at a discount, the discounts take account of future expected impairments. An impairment charge is only recognised in the income statement if the total receipts from an acquired portfolio are below the original purchase price. Changes to expected cash flows from acquired portfolios are reflected by discounting the future expected cash flows by the original effective interest rate, with any change from the prevailing carrying value being recognised in the income statement.

For financial accounting purposes provisions for impairments of loans to customers when first recognised in the income statement are held in an allowance account. These balances are released to offset against the gross value of the loan when it is written off to profit and loss on the administration system. After this point a salvage balance may be held in respect of any further recoveries expected on the loan.

(k) Amounts owed by or to group companies

In the accounts of the Company, balances owed by or to other group companies are carried at the current amount outstanding less any provision. Where balances owing between group companies fall within the definition of either financial assets or financial liabilities given in IAS 32 – 'Financial Instruments: Presentation' they are classified as assets or liabilities at amortised cost, as defined by IFRS 9.

(l) Property, plant and equipment

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

Assets held for letting under operating leases are depreciated in equal annual instalments to their estimated residual value over the life of the related lease. This depreciation is deducted in arriving at net lease income and is shown in note 6.

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

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

Freehold premises	2% per annum
Short leasehold premises	over the term of the lease
Computer hardware	25% per annum
Furniture, fixtures and office equipment	15% per annum
Company motor vehicles	25% per annum

(m) Intangible assets

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

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

Other intangible assets acquired in business combinations include brands and business networks and are capitalised in accordance with the requirements of IFRS 3 – 'Business Combinations'. Such assets are stated at attributed cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate determined at the point of acquisition.

(n) Investments in subsidiaries

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

(o) Own shares

Shares in Paragon Banking Group PLC held in treasury or by the trustee of the Group's employee share ownership plan are shown on the balance sheet as a deduction in arriving at total equity. Own shares are stated at cost.

(p) Retail deposits

Retail deposits are carried in the balance sheet on the amortised cost basis. The initial fair value recognised represents the cash amount received from the customer.

Interest payable to the customer is expensed to the income statement as interest payable over the deposit term on an EIR basis.

(q) Borrowings

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

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

(r) Central bank facilities

Where central bank facilities are provided at a below market rate of interest, and therefore fall within the definition of government assistance as defined by IAS 20 – 'Accounting for Government Grants and Disclosure of Government Assistance', the liability is initially recognised at the value of its expected cash flows discounted at a market rate of interest for a comparable commercial borrowing. Interest is recognised on this liability on an EIR basis, using the imputed market rate to determine the EIR.

The remaining amount of the advance is recognised as deferred government assistance and released to the profit and loss account through interest payable over the periods during which the arrangement affects profit.

(s) Derivative financial instruments

All derivative financial instruments are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the income statement, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

(t) Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Group has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Group documents the relationship between the hedging instruments and the hedged items at inception, as well as its risk management strategy and objectives for undertaking the transaction. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets or retail deposit liabilities) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument, the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the income statement at the same time as the hedged item affects the income statement. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction occurs, or is no longer expected to take place.

(u) Taxation

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

The Group will hold a provision for any uncertain tax positions at the balance sheet date based on a global assessment of the expected amount that will ultimately be payable.

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

(v) Deferred taxation

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

(w) Retirement benefit obligations

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

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets at the balance sheet date.

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

The charge to the income statement for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

(x) Revenue

The revenue of the Group comprises interest receivable and similar charges, operating lease income and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

(y) Other income

Other income, which is accounted for in accordance with IFRS 15, includes:

- Event-based administration fees charged to borrowers (other than the initial fees included in amortised cost), which are credited when the related service is performed
- Fees charged to third parties for account administration services, which are credited as those services are performed
- Commissions receivable on the sale of insurances, as agent of the third-party insurer, which are taken to profit at the point at which the Group becomes unconditionally entitled to the income
- Maintenance income charged as part of the Group's contract hire arrangements, which is recognised as the services are provided. Costs of these services are deducted in other income
- Broker fees receivable on the arrangement of loans funded by third parties, on an agency basis, which are taken to profit at the point of completion of the related loan

(z) Share based payments

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

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

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

(aa) Dividends

In accordance with IAS 10 – 'Events after the balance sheet date', dividends payable on ordinary shares are recognised in equity once they are appropriately authorised and are no longer at the discretion of the Company. Dividends declared after the balance sheet date, but before the authorisation of the financial statements remain within shareholders' funds.

However, such dividends are deducted from regulatory capital from the point at which they are announced, and capital disclosures are prepared on this basis.

(bb) Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company and all of the other entities in the Group is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with the cash flow hedging provisions of IAS 39.

(cc) Segmental reporting

The accounting policies of the segments are the same as those described above for the Group as a whole. Interest payable by each segment includes directly attributable funding and the allocated cost of retail deposit funds utilised. Costs attributed to each segment represent the direct costs incurred by the segment operations.

64. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 63 relate to:

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

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

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

More information on the definition of SICR adopted is given in note 23.

(b) Definition of default

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

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

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

More information on the Group's definition of default adopted is given in note 23.

(c) Classification of financial assets

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

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

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

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

This is because all of the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

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

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

(d) Derecognition of financial assets and liabilities

On 26 June 2019, the Group disposed of its residual interest in the Paragon Mortgages (No. 12) PLC securitisation transaction. In order to determine whether the financial assets and liabilities of the SPV should be derecognised at that point, a management judgement is required. Following a review of the terms of the sale transaction, it was concluded that the Group was no longer significantly exposed to the risks and rewards in relation to the cash flows arising from the scheme, and hence the criteria for derecognition were met. More information on this transaction is given in note 7.

65. CRITICAL ACCOUNTING ESTIMATES

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

(a) Impairment losses on loans to customers

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

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

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

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

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

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

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

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

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

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

These assumptions are set out in note 23 where the sensitivity of the Group's modelling to them is also discussed.

(b) Effective interest rates

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

To illustrate this, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £7.2m (2018: £4.0m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £6.0m (2018: £4.0m)
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges, would increase balance sheet assets by £4.2m
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £12.5m (2018: £10.3m)

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the cash generating unit, based on management forecasts and other assumptions described in note 29, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the cash generating unit is able to achieve in practice. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 29.

(d) Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions relating to inflation, long-term return on investments and mortality. These are listed in note 41. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

Information on the sensitivity of the valuation to the various assumptions is given in note 41.

66. ACQUISITIONS

On 3 July 2018 the group acquired the entire share capital of Titlestone Property Finance Limited together with a portfolio of loans held by companies related to it (together 'Titlestone'). IFRS disclosures in respect of this acquisition were presented on a provisional basis in note 15 to the group accounts for the year ended 30 September 2018.

During the year ended 30 September 2019, the circumstances, performance and security value of certain of the Titlestone loans were reviewed in more detail, providing further information on the value of those assets at the acquisition date. As a result of this exercise, the initial values of those loans were reduced by £2.7m with a corresponding change in the related deferred tax balances of £0.5m. Consequently, the goodwill balance was increased by £2.2m (note 29).

67. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the year ended 30 September 2019 or the year ended 30 September 2018 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 38).

The Group has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

a) Assets and liabilities carried at fair value

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	2019 £m	2018 £m
Financial assets			
Derivative financial assets	*24*	**592.4**	855.7
Short term investments	*19*	**-**	-
		592.4	855.7
Financial liabilities			
Derivative financial assets	*24*	**80.5**	4.7
Contingent consideration	*38*	**23.7**	25.7
		104.2	30.4

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9, and the introduction of the new standard has had no impact on their classification, valuation basis or valuations.

The Company has no financial assets or liabilities carried at fair value.

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate.

The principal inputs to these valuation models are LIBOR and SONIA benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. However, variability in this input does not have a significant impact on the valuation, compared to other inputs.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 24.

Short term investments

The short-term investments described in note 19 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

Contingent consideration

The value of the contingent consideration balances shown in note 38 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in the respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill and any other new business flows which are or might be attributable to the acquisition agreement, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	**2019**	**2019**	2018	2018	2018
				IFRS 9	IAS 39	
		Carrying amount	**Fair value**	Carrying Amount	Carrying amount	Fair value
		£m	**£m**	£m	£m	£m
The Group						
Financial assets						
Cash	*18*	**1,225.4**	**1,225.4**	1,310.6	1,310.6	1,310.6
Loans to customers	*20*	**12,186.1**	**12,370.1**	12,100.6	12,127.8	12,222.9
Sundry financial assets	*25*	**90.3**	**90.3**	15.3	15.3	15.3
		13,501.8	**13,685.8**	13,426.5	13,453.7	13,548.8
Financial liabilities						
Short term bank borrowings		**1.0**	**1.0**	1.1	1.1	1.1
Asset backed loan notes		**4,419.4**	**4,419.4**	5,554.7	5,554.7	5,554.7
Secured bank borrowings		**787.5**	**787.5**	935.6	935.6	935.6
Retail deposits	*31*	**6,391.9**	**6,408.9**	5,296.6	5,296.6	5,301.7
Corporate and retail bonds		**446.1**	**474.9**	445.4	445.4	478.3
Other financial liabilities	*37*	**83.1**	**83.1**	82.8	82.8	82.8
		12,129.0	**12,174.8**	12,316.2	12,316.2	12,354.2
The Company						
Financial assets						
Cash	*18*	**14.1**	**14.1**	24.9	24.9	24.9
Loans to group companies	*25*	**106.6**	**106.6**	216.3	216.3	216.3
Sundry financial assets	*25*	**0.7**	**0.7**	0.7	0.7	0.7
		121.4	**121.4**	241.9	241.9	241.9
Financial liabilities						
Corporate and retail bonds		**446.1**	**474.9**	445.4	445.4	478.3
Amounts owed to group companies	*37*	**23.8**	**23.8**	125.7	125.7	125.7
Other financial liabilities	*37*	**3.6**	**3.6**	2.8	2.8	2.8
		473.5	**502.3**	573.9	573.9	606.8

The fair values of retail deposits and Corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market based, they are considered to be level 2 measurements.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

68. DETAILS OF SUBSIDIARY UNDERTAKINGS

Subsidiary undertakings of the Group at 30 September 2019, where the share capital is held within the Group are shown below. The holdings shown are those held within the Group. The shareholdings of the Company in the direct subsidiaries listed below are the same as those held by the Group, except that:

- For the shareholdings marked * the Company holds only 74% of the share capital
- For the shareholdings marked † the Company holds only 66.7% of the share capital

In these cases, the remainder is held by other group companies.

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked §, which have additional preference share capital held within the Group.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Car Finance Limited	100%	Vehicle finance
Idem Capital Holdings Limited	100%	Intermediate holding company
Moorgate Servicing Limited	100%	Intermediate holding company
Paragon Bank PLC	100%	Deposit taking, residential mortgages and loan and vehicle finance
The Business Mortgage Company Limited	100%	Mortgage broker
Paragon Fourth Funding Limited	100%	Residential mortgages
Paragon Mortgages (No. 9) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 10) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 11) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 12) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 13) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 14) PLC	100% *	Residential mortgages
Paragon Mortgages (No. 15) PLC	100% *	Residential mortgages
Paragon Secured Finance (No. 1) PLC	100%	Loan finance
First Flexible (No. 7) PLC	100% *	Residential mortgages
Colonial Finance (UK) Limited	100%	Non-trading
Earlswood Finance Limited	100% *	Non-trading
Herbert (1) PLC	100%	Non-trading
Herbert (2) PLC	100%	Non-trading
Herbert (4) PLC	100%	Non-trading
Herbert (5) PLC	100%	Non-trading
Herbert (6) PLC	100%	Non-trading
Herbert (7) PLC	100%	Non-trading
Herbert (8) PLC	100%	Non-trading
Herbert (9) PLC	100%	Non-trading
Herbert (10) PLC	100%	Non-trading
Idem Luxembourg (No. 4) ‡	100%	Non-trading
Idem Luxembourg (No. 9) ‡	100%	Non-trading
Paragon Car Finance (1) Limited	100%	Non-trading
Paragon Dealer Finance Limited	100%	Non-trading
Paragon Loan Finance (No. 1) Limited	100% §	Non-trading
Paragon Loan Finance (No. 2) Limited	100% §	Non-trading
Paragon Mortgages (No. 5) PLC	100%	Non-trading
Paragon Pension Investments GP Limited	100%	Non-trading
Paragon Pension Plan Trustees Limited	100%	Non-trading
Paragon Personal Finance (1) Limited	100%	Non-trading
Paragon Third Funding Limited	100%	Non-trading
Paragon Vehicle Contracts Limited	100%	Non-trading
Plymouth Funding Limited	100%	Non-trading

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
Paragon Loan Finance (No. 3) Limited	100%	Non-trading
Townend Farm (Easington) Management Company Limited	100%	Non-trading
Universal Credit Limited	100%	Non-trading
Yorkshire Freeholds Limited	100%	Non-trading
Yorkshire Leaseholds Limited	100%	Non-trading
Direct and indirect subsidiaries of Paragon Bank PLC		
Paragon Finance PLC	100%	Residential mortgages and asset administration
Mortgage Trust Limited	100%	Residential mortgages
Paragon Mortgages Limited	100%	Residential mortgages
Paragon Mortgages (2010) Limited	100%	Residential mortgages
First Flexible No. 6 PLC	100% §	Residential mortgages
Mortgage Trust Services PLC	100%	Residential mortgages and asset administration
Paragon Second Funding Limited	100%	Residential mortgages and loan and vehicle finance
Paragon Asset Finance Limited	100%	Holding company and portfolio administration
City Business Finance Limited	100%	Asset finance
Paragon Business Finance PLC	100%	Asset finance
Paragon Commercial Finance Limited	80%	Asset finance
Paragon Development Finance Limited	96.39%	Development Finance
Paragon Development Finance Services Limited	100%	Development Finance
Paragon Technology Finance Limited	100%	Asset finance
Premier Asset Finance Limited	100%	Asset finance broker
PBAF Acquisitions Limited	100%	Residential mortgages and loan finance
PBAF (No. 1) Limited	100%	Intermediate holding company
Specialist Fleet Services Limited	100%	Asset finance and contract hire
Collett Transport Services Limited	100%	Non-trading
Fineline Holdings Limited	100%	Non-trading
Fineline Media Finance Limited	100%	Non-trading
Homer Management Limited	100%	Non-trading
Lease Portfolio Management Limited	100%	Non-trading
Paragon Options PLC	100%	Non-trading
State Securities Holdings Limited	100%	Non-trading
State Security Limited	100%	Non-trading
Direct and indirect subsidiaries of Idem Capital Holdings Limited		
Moorgate Loan Servicing Limited	100%	Asset administration
Idem (No. 3) Limited	100%	Asset investment
Idem Capital Securities Limited	100%	Asset investment
Paragon Personal Finance Limited	100%	Consumer loan finance
Other indirect subsidiary undertakings		
Redbrick Survey and Valuation Limited	100%	Surveyors and property consulting
Buy to Let Direct Limited	100%	Non-trading
TBMC Group Limited	100%	Non-trading
The Business Mortgage Company Services Limited	100%	Non-trading

The financial year end of all of the Group's subsidiary companies is 30 September. They are all registered in England and Wales and operate in the UK except:

- Those entities marked ‡ which are registered in the Grand Duchy of Luxembourg
- Paragon Pension Investments GP Limited, which is registered in Scotland and operates in the UK

20% of the equity of Paragon Commercial Finance Limited is subject to a call option agreed as part of the acquisition of the company by PAF. No material minority interest attaches to this holding. 3.61% of the nominal value of the share capital of Paragon Development Finance Limited relates to shares subjects to put and call options issued pursuant to long-term incentive plans. No material minority interest attaches to this holding.

As part of the Group's financing arrangements certain mortgage and consumer loans originated by Paragon Mortgages (2010) Limited and Mortgage Trust Limited or acquired by Idem Capital Securities Limited have been sold to special purpose entity companies, which had raised non-recourse finance to fund these purchases. The shares of these companies are ultimately beneficially owned through independent trusts, but they are considered to be controlled by the Group, as defined by IFRS 10, due to the Group's exposures to the variable returns from the assets of each entity and its ability to direct their activities, within the constraints imposed by the lending documents. Hence, they are considered to be subsidiaries of the Group.

The principal companies party to these arrangements at 30 September 2019 comprise:

Company	Principal activity
First Flexible No. 5 PLC	Residential mortgages
Paragon Fifth Funding Limited	Residential mortgages
Paragon Sixth Funding Limited	Residential mortgages
Paragon Seventh Funding Limited	Residential mortgages
Paragon Mortgages (No. 18) Holdings Limited	Holding company
Paragon Mortgages (No. 18) PLC	Residential mortgages
Paragon Mortgages (No. 19) Holdings Limited	Holding company
Paragon Mortgages (No. 19) PLC	Residential mortgages
Paragon Mortgages (No. 20) Holdings Limited	Holding company
Paragon Mortgages (No. 20) PLC	Residential mortgages
Paragon Mortgages (No. 21) Holdings Limited	Holding company
Paragon Mortgages (No. 21) PLC	Residential mortgages
Paragon Mortgages (No. 22) Holdings Limited	Holding company
Paragon Mortgages (No. 22) PLC	Residential mortgages
Paragon Mortgages (No. 23) Holdings Limited	Holding company
Paragon Mortgages (No. 23) PLC	Residential mortgages
Paragon Mortgages (No. 24) Holdings Limited	Holding company
Paragon Mortgages (No. 24) PLC	Residential mortgages
Paragon Mortgages (No. 25) Holdings Limited	Holding company
Paragon Mortgages (No. 25) PLC	Residential mortgages
Paragon Mortgages (No. 26) Holdings Limited	Holding company
Paragon Mortgages (No. 26) PLC	Residential mortgages
Arianty Holdings Limited	Holding company
Arianty No. 1 Limited	Non-trading

All of these companies are registered and operate in the UK.

Earlswood Finance (No. 3) Limited, a company limited by guarantee, is registered in England and Wales and operates in the UK. It is included in the consolidation as it is ultimately controlled by the parent company.

The Group accounts include the results of two Jersey companies, which are ultimately beneficially owned by a charitable trust, but are considered to be controlled by the Group, using the definition contained in IFRS 10 'Consolidated Financial Statements'. These companies, Idem Jersey (No. 1) Limited and Idem Jersey (No. 2) Limited are registered in the Bailiwick of Jersey and operate in the UK.

The share capital of Idem Jersey (No. 1) Limited is divided into A shares and B shares. All of the 600 B shares are held by Group companies, 100 by the parent company and 500 by other Group companies.

The Paragon Pension Partnership LP is a limited partnership established under Scots law, in which control is vested in members which are Group companies. It is therefore considered to be a subsidiary entity. The outside member is the Group's Pension Plan and the Plan's rights to income from the partnership are set out in the partnership agreement. Therefore, no minority interest arises. The partnership is registered in Scotland and operates in the UK.

The registered office of each of the entities listed in this note is the same as that of the Company (note 1), except that:

- The registered office of The Business Mortgage Company Limited, Buy to Let Direct Limited, TBMC Group Limited, and The Business Mortgage Company Services Limited is Greenmeadow House, 2 Village Way, Greenmeadow Springs Business Park, Cardiff, CF15 7NE
- The registered office of State Security Limited is Burlington House, Botleigh Grange Office Campus, Grange Drive, Hedge End, Southampton, SO30 2AF
- The registered office of the Scottish companies is Citypoint, 65 Haymarket Terrace, Edinburgh, EH12 5HD
- The office of the Luxembourg entities is 8-10, Avenue de la Gare, L-1610 Luxembourg
- The registered office of the Jersey companies is IFC 5, St Helier, Jersey, JE1 1ST

All of the entities listed above are included in the consolidated accounts of the Group.

The following legal subsidiaries of the Group are currently in liquidation. They do not form part of the consolidation as they are considered to be controlled by the liquidator.

Company	Holding	Principal activity
Direct subsidiaries of Paragon Banking Group PLC		
SPV Securities Limited	100%	Non-trading
Paragon Mortgages (No. 7) PLC	100%	Non-trading
Paragon Mortgages (No. 8) PLC	100%	Non-trading
Paragon Mortgages (No. 16) PLC	100%	Non-trading
Paragon Mortgages (No. 17) PLC	100%	Non-trading
Paragon Personal and Auto Finance (No. 3) PLC	100%	Non-trading
Collateralised Mortgage Securities (No. 12) PLC	100%	Non-trading
Finance for People (No. 3) Limited	100%	Non-trading
Finance for People (No. 4) PLC	100% §	Non-trading
Homeloans (No. 4) PLC	100% §	Non-trading
Mortgage Funding Corporation PLC	100%	Non-trading
NHL Second Funding Corporation Limited	100%	Non-trading
NHL Third Funding Corporation Limited	100%	Non-trading
Paragon Mortgages (No. 1) PLC	100% §	Non-trading
Paragon Mortgages (No. 2) PLC	100% §	Non-trading
Paragon Mortgages (No. 4) PLC	100%	Non-trading
Redbrick Real Estate Services Limited	100%	Non-trading
Indirect subsidiaries		
Idem First Finance Limited	100%	Non-trading
Idem Capital Limited	100%	Non-trading

The issued share capital of all subsidiaries consists of ordinary share capital, except those companies marked § which have additional preference share capital held within the Group.

The companies previously controlled by the Group which had been party to the types of financing arrangements described above at 30 September 2019 and which were in liquidation at that date comprise:

Company	Principal activity
First Flexible No. 4 PLC	Non-trading
Arianty Services Limited	Non-trading
First Flexible No. 1 Limited	Non-trading
First Flexible No. 2 Limited	Non-trading
First Flexible No. 3 Limited	Non-trading

Homeloans (No. 7) LLP and Homeloans (No. 8) LLP are limited liability partnerships, established under English law, in which all of the members are Group companies. They are currently in liquidation. Both are registered in England and Wales and operate in the UK.

E.

APPENDICES TO THE ANNUAL REPORT

Additional financial information supporting amounts shown in the Strategic Report (Section A), but not forming part of the Statutory Accounts

E1

Appendices to the annual report

A. UNDERLYING RESULTS

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Groups control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

Transactions relating to acquisition and disposals include the direct transaction costs of the 2018 acquisitions, the additional net funding costs of deposits built up over time to satisfy consideration on those acquisitions and the break costs of the Idem Capital facility, in addition to the gains recognised.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	2019	2018	2018
	£m	£m	£m
Profit on ordinary activities before tax	**159.0**		181.5
Less: Gain on disposal of financial assets	**(9.7)**		(28.0)
Add back: Acquisition related funding costs included in net interest		0.7	
Add back: Overhead costs related to acquisition related funding		0.2	
Add back: Transaction costs		1.3	
Add back: Acquisition related costs	**-**		2.2
Add back: Facility break costs	**-**		1.2
Add back: Other one-off costs	**-**		0.8
Add back: Fair value adjustments	**15.1**		(1.2)
Underlying profit	**164.4**		156.5

Underlying basic earnings per share, calculated on the basis of underlying profit, charged at the overall effective tax rate, is derived as follows.

	2019	2018
	£m	£m
Underlying profit	**164.4**	156.5
Tax at effective rate (note 15)	**(32.7)**	(30.8)
Underlying earnings	**131.7**	125.7
Basic weighted average number of shares (note 17)	**257.6**	260.8
Underlying earnings per share	**51.1p**	48.2p

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	2019	2018
	£m	£m
Underlying earnings	**131.7**	125.7
Amortisation of intangible assets (note 9)	**2.4**	2.1
Adjusted underlying earnings	**134.1**	127.8
Average tangible equity (note 55(b))	**920.7**	915.8
Underlying RoTE	**14.6%**	14.0%

B. INCOME STATEMENT RATIOS

The average net interest margin is calculated as follows:

Year ended 30 September 2019 (IFRS 9)

	Note	**Mortgages**	**Commercial Lending**	**Idem Capital**	**Total**
		£m	**£m**	**£m**	**£m**
Opening loans to customers	*20*	**10,449.5**	**1,131.3**	**519.8**	**12,100.6**
Closing loans to customers	*20*	**10,344.1**	**1,452.1**	**389.9**	**12,186.1**
Average loans to customers		**10,396.8**	**1,291.8**	**454.8**	**12,143.4**
Net interest		**177.8**	**65.0**	**54.3**	**278.4**
NIM		**1.71%**	**5.03%**	**11.94%**	**2.29%**
Impairment provision	*23*	**1.0**	**7.2**	**(0.2)**	**8.0**
Cost of risk		**0.01%**	**0.56%**	**(0.04)%**	**0.07%**

Year ended 30 September 2018 (IAS 39)

	Note	Mortgages	Commercial Lending	Idem Capital	Total
		£m	£m	£m	£m
Opening loans to customers		9,953.9	558.8	611.4	11,124.1
Closing loans to customers	*20*	10,473.5	1,133.2	521.1	12,127.8
Average loans to customers		10,213.7	846.0	566.3	11,626.0
Net interest		157.6	32.2	87.8	254.6
NIM		1.54%	3.81%	15.50%	2.19%
Impairment provision	*23*	5.5	2.0	(0.1)	7.4
Cost of risk		0.05%	0.24%	(0.02)%	0.06%

Net interest margin on an underlying basis is derived as shown below

	2019	2018
	£m	£m
Net interest (as above)	**278.4**	254.6
One off items related to interest		
Acquisition funding costs	-	0.7
Facility break costs	-	1.2
Underlying net interest	**278.4**	256.5
Average loans to customers (as above)	**12,143.4**	11,626.0
Underlying net interest margin	**2.29%**	2.21%

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	Note	2019	2018
		£m	£m
Cost – operating expenses	*9*	**125.2**	114.2
Total operating income		**307.3**	301.9
Cost / Income		**40.7%**	37.8%

Underlying cost:income ratio is derived as follows:

	2019	2018
	£m	£m
Cost – as above	**125.2**	114.2
Acquisition costs expensed	-	(1.5)
Other one-off costs	-	(0.8)
Adjusted cost	**125.2**	111.9
Income – as above	**307.3**	301.9
Gain on disposal of financial asset	**(9.7)**	(28.0)
Acquisition net funding costs	-	0.7
Facility break costs	-	1.2
Adjusted income	**297.6**	275.8
Underlying cost:income ratio	**42.1%**	40.6%

D. NET ASSET VALUE

	Note	2019	2018
Total equity (£m)		**1,108.4**	1,095.9
Outstanding issued shares (m)	*42*	**261.6**	281.6
Treasury shares (m)	*44*	**(5.2)**	(20.8)
Shares held by ESOP schemes (m)	*44*	**(3.9)**	(2.9)
		252.5	257.9
Net asset value per £1 ordinary share		**£4.39**	£4.25
Tangible equity (£m)	*55*	**937.3**	926.6
Tangible net asset value per £1 ordinary share		**£3.71**	£3.59