Company Registration No: 01917566

PARAGON FINANCE PLC

Report and Financial Statements

Year ended 30 September 2019

STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

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

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

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

The Company has applied International Financial Reporting Standard ('IFRS') 9 – 'Financial Instruments' in calculating its provisions for impairment for the first time in the year. As prior year charges are not required to be restated, the 2019 charge is not strictly comparable to that for 2018.

As shown in the Company's profit and loss account on page 18, the Company's net interest income decreased from £9,005,000 to £8,388,000. Interest payable on loans from other group companies increased while interest received on loans to other group companies decreased. The return on pension scheme liabilities decreased from £750,000 to £514,000. The subordinated loans decreased by 34% (2018: 16% decrease) principally due to securitisation mortgage loans being sold to fellow group companies in the year, therefore the subordinated loans were repaid. Interest charged on the subordinated loans provided to other group companies and related parties decreased. The provision on loans to related parties was £5,000 (2018: release of £20,000) due to the effects of trading between these entities and a decrease in reserves of those companies. The provision on investment in group companies and related parties was £1,614,000 (2018: release of £685,000) due to the effects of trading between group companies and a decrease in reserves of those companies. Therefore, in the current year there was a provision charge of £391,000 compared to a release of provision of £724,000 for the preceding year. Other operating income has increased from £97,921,000 to £107,729,000. This was principally due to the costs recharged to other group companies increasing during the current year. Some securitisation mortgage loans were sold to fellow group companies in the year, therefore there was a decrease in administration fees received by the Company from various special purpose vehicle companies within the group, as the Company administered the loans on their behalf. Operating expenses increased from £92,536,000 to £103,105,000. As a result of the above, operating profit before taxation has fallen from £15,114,000 to £11,565,000, and the profit after tax has decreased from £12,255,000 to £9,257,000.

The balance sheet on page 19 of the Financial Statements shows the Company's financial position at the year end. Net assets have decreased by 1.8% (2018: 9.4% increase) due to the net effect of the profit for the year and actuarial loss on the pension fund. Details of amounts owed from and to other group companies are shown in notes 21 and 25.

No interim dividend was paid during the year (2018: £nil). No final dividend is proposed (2018: £nil).

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

STRATEGIC REPORT (CONTINUED)

OUTLOOK

As part of the Group's wider strategy to enter the first charge residential mortgage market, the Company, as the Group's principal servicing business, now holds the requisite permission from the FCA to administer both second and first charge residential mortgages. As the Group's activities in these areas expand the Company's administration activities will also grow, but no major changes in the nature of its activities are expected in the coming year.

PRINCIPAL RISKS AND UNCERTAINTIES

An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out on pages 4 to 13 and in note 7. A discussion of critical accounting judgements is set out in note 5 and a discussion of critical accounting estimates is set out in note 6.

GOING CONCERN

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

ENVIRONMENT

The Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Group's activities. The Company operates in accordance with group policies, which are described in the Group's Annual Report, which does not form part of this Report.

EMPLOYEES' INVOLVEMENT

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

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

The directors encourage employee involvement at all levels through the staff appraisal process and communication between directors, managers, teams and individual employees.

EMPLOYMENT OF DISABLED PERSONS

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

Approved by the Board of Directors

and signed on behalf of the Board

K G Allen

Director

22 January 2020

STRATEGIC REPORT (CONTINUED)

CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report and the Strategic Report may contain forward-looking statements with respect to certain plans and current goals and expectations relating to the future financial condition, business performance and results of Paragon Finance PLC. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Paragon Finance PLC and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

PRINCIPAL RISKS AND MITIGATION

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

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

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

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

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

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

	Risk increasing		Risk decreasing		Risk stable

Business Risk

Economic Risk

Description	Mitigation
The potential for a deterioration in the UK's economic conditions is harder to forecast given the continuing material uncertainties as to the terms on which the UK will leave the EU. Given that its income is wholly derived from activities within the UK, the Group could be materially affected by a severe downturn in the UK economy, which could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.	The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic advisors. This information supports the senior management's review of objectives each year and helps inform business plans for each of the Group's principal trading operations. As a lender and acquirer of credit portfolios, exposure to any material deterioration in economic conditions is inevitable. The Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise. The Group also uses stress testing to assess its expected performance under a range of operating conditions. This provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities. In addition to considering the credit implications of such economic stress, the Board also considers the operational and liquidity implications of such scenarios, which would include the potential to increase liquidity coverage ratios, access contingent liquidity and further strengthen key risk and servicing functions as and when required.

Change	Whilst UK economic performance has again been broadly stable in the last financial year, the near-term outlook has continued to remain uncertain given a lack of clarity as to the basis of the UK's withdrawal from and future relationship with the EU. This continuing uncertainty has led to the overall risk assessment being considered to have increased further in the last year.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Business Risk

Concentration risk

Description	Mitigation
Lending to customers investing in the UK private rented sector forms a substantial part of the Group's advances and assets. It is therefore exposed to any systemic deterioration in performance of the sector, which will be influenced by underlying factors such as house prices, supply of rental property, and demographic changes. The buy-to-let sector has been subject to a high level of fiscal and regulatory intervention in recent years, where such changes make buy-to-let less attractive or viable to customers' businesses, the Group is exposed to adverse consequences.	The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through several economic cycles together with regular independently conducted research commissioned over many years. The Group seeks to use this expertise constructively by playing an active role in shaping the development of policy for the private rented sector. Given its specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond effectively to the various regulatory changes introduced in recent years in relation to buy-to-let lending. The Group also continues to exploit opportunities to diversify the range of its activities and income streams, such as acquisitions of the Iceberg and Titlestone businesses in the year. This is consistent with its strategic objective of operating as a prudent, risk focussed specialist lender that delivers fair outcomes for its customers.

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

Transition risk

Description	Mitigation
Any failure to manage effectively the transition and implementation risks resulting from material corporate acquisitions such as those of Iceberg and Titlestone in the previous financial year could impact adversely on the Group's financial performance and its reputation.	The Board's M&A strategy is that the Group will only consider acquisitions in areas of business that it understands, and which are complementary to its existing activities. Extensive pre-acquisition due diligence is always undertaken with support from respected, high quality advisors. Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board. Where necessary, enhancements are made to the risk and control frameworks of acquired businesses to ensure these are aligned to those within the wider Group.

Change	Whilst acquisition of new businesses inevitably creates the potential for greater transition risk, the integration of the Iceberg and Titlestone businesses has progressed entirely satisfactorily. The Group remains confident that any residual risks in this area can be managed effectively.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Credit Risk

Customer Risk

Description	Mitigation
Failure to screen potential borrowers, underwrite and manage repayments effectively could expose the Group to the risk of unexpected material losses. Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.	The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved. Credit policies incorporate limits for concentration risks arising from factors such as large exposures to counterparties, geographical areas or types of lending. The Group uses a range of sources to inform expectations of key external factors such as interest rate movements, house price inflation, property rental inflation and asset depreciation which are in turn used to guide policy and underwriting. The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in note 4 to the Group Accounts.

Change	The Group's impairment rate has remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers. The potential for any credit deterioration due to changing economic conditions, particularly given current uncertainties regarding the UK's future relationship with the EU, is being monitored closely across all Group portfolios.	⇔

Counterparty Risk

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

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

PRINCIPAL RISKS AND MITIGATION (Continued)

<table>
<tr><th colspan="2">Conduct Risk</th></tr>
<tr><td colspan="2">Customer Fair Outcomes</td></tr>
<tr><th>Description</th><th>Mitigation</th></tr>
<tr><td>The Group provides a broad range of financial services products across a number of brands to consumers and small business customers.

As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers.

Systemic poor customer treatment may lead to regulatory censure, reputational damage and resulting reductions in profitability.</td><td>The Group has a formal Conduct Risk Management framework which includes a number of detailed policies and standards addressing the fair treatment of customers. At the centre of these is the Conduct Risk Policy, underpinned by additional policies and standards. This sets out the Group's overarching approach to the management of conduct risk as part of a framework within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites.

The management of conduct risk within the Group is tailored to the specific product and customer type concerned. Business areas dealing with consumers have dedicated quality and control teams which validate process adherence and the delivery of fair treatment for customers. This may also include a dedicated customer support team to manage customers deemed to be vulnerable.

During the last financial year, the Group has further strengthened its governance in relation to conduct risk by the introduction of a dedicated Conduct and Compliance Committee ('CCC'). The CCC has a remit which includes overseeing the fair treatment of customers.

The CCC also receives items for review and / or approval, such as product governance submissions, conduct risk related policies and standards, business area incentive schemes, compliance monitoring outputs and regulatory communications.

The Compliance function has a formal monitoring plan which is focussed on conduct risk and the fair treatment of customers, particularly those that are defined as vulnerable, or in financial difficulty. The plan is reviewed and approved on at least an annual basis by the RCC.

Management actions to address any adverse compliance monitoring or Internal Audit reports are overseen at the CCC, ORC and RCC.

The Group's approach to employee remuneration means that very few staff are included in financial incentive schemes. All schemes are required to be approved by the CCC before implementation and then reviewed by the CCC at least annually.</td></tr>
</table>

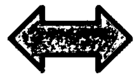
Change	The Group operates in areas which are highly regulated and where continuing changes to the regulatory conduct landscape heighten the potential risk of financial losses or censure. In response to this, the Group has continued to develop and embed its conduct risk management framework during the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

PRINCIPAL RISKS AND MITIGATION (Continued)

Operational Risk

People Risk

Description	Mitigation
The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels. Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives. This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be very difficult to replicate in the short term.	The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies. External remuneration and reward structures are monitored to ensure the Group remains competitive and is able to recruit and retain key personnel. A range of employee benefits are offered in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related pay scheme for most employees Manager and Team Leader Academies have been created to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business The Group has been accredited under the 'Investors in People' scheme since 1997 and achieved Champion status in May 2014. This accreditation is awarded to a very small proportion of organisations who are seen as pioneers in people management practices and role models in strategic leadership.

Change	A strong employment market and particularly buoyant demand for skilled financial services staff has again been a feature of the last financial year. This has led to continued strong competition to recruit and retain employees. Despite the increasingly competitive external environment, the Group remains confident in its ability to manage this risk.	

PRINCIPAL RISKS AND MITIGATION (Continued)

<table>
<tr><th colspan="3">Operational Risk</th></tr>
<tr><td colspan="3">Systems Risk</td></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs and fail to offer adequate protection against the threat of cyber-crime.

Failure in these systems, either in terms of capacity or security, could result in detriment to customers, regulatory censure and reputational damage, all of which could materially impact income and profitability.

This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.</td><td colspan="2">The Group has continued to strengthen its capabilities in relation to operational resilience and in particular it's information technology infrastructure management and security.

The Group has a formally agreed IT strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. It maintains an ongoing programme of investment in IT infrastructure and systems. This includes increased investment in security solutions to counteract cyber security threats and the recruitment of specialist resource.

A formal Cyber Incident Response Plan is in place and reviewed with the RCC to ensure the Group is well placed to deal with any issues or events.

There is ongoing focus on the information security management system (ISO 27001) to which the Group is certified, to ensure that controls, testing and user awareness are maintained and improved.

Change programmes are closely managed with robust control and testing processes to ensure that system developments meet operational requirements and are effectively implemented.</td></tr>
<tr><td>Change</td><td>The Group has continued to invest significantly in order to further enhance its operational resilience. This has included ensuring that it maintains a robust and secure IT infrastructure that supports its operational needs. However, the level and sophistication of cyber-crime continues to increase, heightening the risk that this may impact on the Group's operations and strategic objectives.</td><td>⇧</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATION (Continued)

Operational Risk

Regulatory Risk

Description	Mitigation
The Group is exposed to the risk that its financial performance and reputation could suffer significantly if it fails to identify, interpret and comply with relevant regulatory and legal obligations. The customers and market sectors to which the Group supplies products, and the capital markets from which it obtains some of its funding, have been subject to increasing legislative and regulatory intervention over recent years.	The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the RCC. All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes. The Compliance and Financial Crime functions maintain formal second line monitoring plans. Progress against the plan and the issues identified within individual reviews are reported to the CCC and the RCC to ensure that regulatory requirements have been satisfactorily embedded, and any lessons learnt are applied across all relevant areas of the Group. In order to ensure the Group responded effectively to the requirements of the Data Protection Act 2018, which covered the requirements of the EU General Data Protection Regulation, a formal programme was initiated under the sponsorship of the CRO. This included the delivery of comprehensive training and communications to all staff, the establishment of a Data Protection Office within the second line with appropriate supporting resource and a programme of oversight reviews.

Change	The increasingly regulated nature of the Group's operations heightens the potential risk arising from any failure to comply with current regulations or to respond effectively to new and emerging regulations. The Group therefore continues to ensure it has robust arrangements in place to enable it to respond effectively to new and emerging regulatory developments.	⇧

PRINCIPAL RISKS AND MITIGATION (Continued)

Liquidity and Capital Risk

Funding Risk

Description	Mitigation
The Group relies on its access to various sources of funding to finance the origination of new business, portfolio acquisitions and working capital. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines. Retail deposit taking is central to the Group's funding plans and therefore changes in market conditions could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity.	The Group maintains a diversified range of both retail and wholesale medium and long-term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. Comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due. Paragon Bank, is authorised to accept retail deposits. As such, it is subject to regulation by the PRA, which aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking. During the financial year, further prudent use was made of the Bank of England's TFS to support its ongoing lending activities. The drawings made under the Scheme were well phased to minimise the risks to the Group as they fall due over the coming years. In April 2018, the Company's credit rating from Fitch was increased from BBB- to BBB. This investment grade credit rating helps to support maintenance of access to funding markets.

Change	Following last year's corporate reorganisation, the Group is better placed to access funding from a wide range of sources to meet its future funding requirements. However, despite this, there has been continued strong competition for retail deposits amongst an increasing number of challenger banks during the year.	

Capital Risk

Description	Mitigation
Proposals made by the BCBS regarding potential changes to minimum capital requirements from 2021 could impact on the Group. The BCBS final proposals include increases in risk weights for residential real estate exposures where repayment is materially dependant on cash flows generated by the property, which may include certain categories of buy-to-let lending. The Group's capital requirements would, therefore, be increased to some extent.	In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB approach for credit risk. In support of this, the Group appointed an experienced director of IRB to lead this initiative. A formal IRB project has since been initiated with support from respected external specialist advisors to enable the Group to commence its application process with the relevant regulatory authorities during the first half of the new financial year. In June 2017, the PRA published an updated approach to IRB applications. The process is now modular, with each element covering a different aspect of a firm's plan for IRB implementation. This new application process is now embedded in the Group's IRB project plan.

Change	In December 2017, the BCBS published its 'Basel III: Finalising Post-Crisis Reforms' document. This has clarified the proposed increase to the capital risk weights for buy-to-let lending under the revised standardised approach and the introduction of a capital output floor based on the revised standardised approach. The proposed changes had been anticipated within the Group's IRB project.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Market Risk

Interest rate risk

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

Change	The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. The approach to managing the risks has, however, been enhanced to reflect the BCBS principles. Further information regarding the Group's management of interest rate risk is given in note 4 to the accounts.	⇔

PRINCIPAL RISKS AND MITIGATION (Continued)

Pension Obligation Risk

Pension Obligation Risk

Description	Mitigation
The Group operates both a defined benefit and defined contribution pension schemes in the UK. There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities, either due to adverse investment performance or inaccurate assumptions, including future inflation levels, members' salaries or mortality rates.	The Group's defined benefit scheme ('the Plan') was closed to new members with effect from February 2002. Since that time, new employees have been invited to join the Group's defined contribution pension scheme which carries no investment or mortality risk for the Group. To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the reviews also assist the Trustee in managing the volatility in the underlying investment performance and the risk of a significant increase in the scheme deficit by providing information used in investment strategy decisions. The Plan is subject to triennial formal valuation by the Plan actuary. The most recent valuation process, as at 31 March 2016 included the agreement of a recovery plan which aims to clear the deficit in the Plan by January 2023.

Change	During the last year, changes in bond yields, equity prices, interest rates, mortality assumptions and inflation rates have all impacted favourably on the Group's exposure in relation to its pension obligations. Further details of the Group's exposure to the Plan are given in note 26 to the Group Accounts.	⇔

DIRECTORS' REPORT

The directors present their Annual Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the audited Financial Statements of Paragon Finance PLC, a company registered in England and Wales with registration no: 01917566, for the year ended 30 September 2019.

DIRECTORS

The directors who served during the year and subsequently were:

N S Terrington

J A Heron

R D Shelton

R J Woodman

K G Allen

P E Rowland

M S Hayes

RESEARCH AND DEVELOPMENT

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

AUDITOR

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

A resolution for the re-appointment of KPMG LLP as the auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

INFORMATION PRESENTED IN OTHER SECTIONS

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

- Commentary on the likely future developments in the business of the Company is included in the Strategic Report.
- A description of the Company's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 7 to the accounts.
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in the strategic report.
- Disclosure on any dividends paid during the year is included in the Strategic Report.

Approved by the Board of Directors

and signed on behalf of the Board

K G Allen

Director

22 January 2020

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

STATEMENT OF DIRECTORS' RESPONSIBILITIES
in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of their profit or loss for that period.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets, for the Company's systems of internal control and for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a strategic report and directors' report which comply with the applicable requirements of the Companies Act 2006.

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

P Sharp

Pandora Sharp

Company Secretary

22 January 2020

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

Opinion

We have audited the Financial Statements of Paragon Finance PLC for the year ended 30 September 2019 which comprise the profit and loss account, the statement of comprehensive income, the balance sheet, the statement of movements in equity and the related notes 1 to 29, including the accounting policies in note 4.

In our opinion the Financial Statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including Financial Reporting Standard 101 – 'Reduced Disclosure Framework'; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

The impact of uncertainties due to the UK exiting the European Union on our audit

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the financial statements. All audits assess and challenge the reasonableness of estimates made by the directors, such as impairment on loans and receivables and EIR on loans and advances and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the Company's future prospects and performance.

Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes consequences, with the full range of possible effects unknown. We applied a standardised firm-wide approach in response to that uncertainty when assessing the Company's future prospects and performance. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Going concern

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

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the directors' conclusions, we considered the inherent risks to the company's business model, including the impact of Brexit, and analysed how those risks might affect the company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the company will continue in operation.

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

Strategic report and directors' report

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

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

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

Matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 14, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

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

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

Matthew Rowell (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill, Snow Hill Queensway, Birmingham, B4 6GH

22 January 2020

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2019

	Note	2019 £000	2018 £000
Interest receivable and similar income	8	12,731	13,244
Interest payable and similar charges	9	(4,343)	(4,239)
Net interest income		8,388	9,005
Other operating income	10	107,729	97,921
Total operating income		116,117	106,926
Operating expenses		(103,105)	(92,536)
Provisions for losses	13	(1,448)	724
Operating profit, being profit on ordinary activities before taxation	14	11,564	15,114
Tax on profit on ordinary activities	15	(2,308)	(2,859)
Profit on ordinary activities after taxation	24	9,256	12,255

All activities derive from continuing operations.

STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED 30 SEPTEMBER 2019

	Note	2019 £000	2018 £000
Profit for the year		9,256	12,255
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss			
Actuarial (loss) / profit on pension fund	26	(16,497)	8,894
Deferred tax on actuarial (loss) / profit	16	2,445	(1,688)
Other comprehensive income for the year net of tax		(14,052)	7,206
Total comprehensive income for the year		(4,796)	19,461

BALANCE SHEET

30 SEPTEMBER 2019

	Note	2019 £000	2019 £000	2018 £000	2018 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Intangible assets	17	2,241		1,957	
Tangible assets	18	1,827		1,790	
Investments – group companies	20	312,070		445,397	
			316,138		449,144
CURRENT ASSETS					
Debtors falling due within one year	21	89,608		104,104	
Cash at bank		-		-	
			89,608		104,104
			405,746		553,248
FINANCED BY					
EQUITY SHAREHOLDERS' FUNDS					
Called up share capital	23	76,164		76,164	
Profit and loss account	24	158,563		162,951	
			234,727		239,115
CREDITORS					
Amounts falling due within one year	25		136,536		294,606
RETIREMENT BENEFIT OBLIGATIONS	26		34,483		19,527
			405,746		553,248

These Financial Statements were approved by the Board of Directors on 22 January 2020.

Signed on behalf of the Board of Directors

K G Allen

Director

STATEMENT OF MOVEMENTS IN EQUITY

YEAR ENDED 30 SEPTEMBER 2019

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	9,256	9,256
Other comprehensive income	-	(14,052)	(14,052)
Total comprehensive income for the year	-	(4,796)	(4,796)
Transactions with owners			
Issue of shares	-	-	-
Tax on share based remuneration (note 16)	-	408	408
Total Transactions with owners	-	408	408
Net movement in equity in the year	-	(4,388)	(4,388)
Opening equity	76,164	162,951	239,115
Closing equity	76,164	158,563	234,727

YEAR ENDED 30 SEPTEMBER 2018

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	12,255	12,255
Other comprehensive income	-	7,206	7,206
Total comprehensive income for the year	-	19,461	19,461
Transactions with owners			
Issue of shares	-	-	-
Tax on share based remuneration (note 16)	-	1,107	1,107
Total Transactions with owners	-	1,107	1,107
Net movement in equity in the year	-	20,568	20,568
Opening equity	76,164	142,383	218,547
Closing equity	76,164	162,951	239,115

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

1. GENERAL INFORMATION

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

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

2. BASIS OF PREPARATION

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

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

Adoption of new and reviewed 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')

The effect on the Company's accounting of the adoption of these standards is discussed in note 3.

Comparability of information

IFRS9 does not require that the balance sheet information at 30 September 2018 and the profit and loss information for the year ended on 30 September 2018 to be 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.

3. CHANGES IN ACCOUNTING STANDARDS

The Company is required to adopt IFRS 9 (and the consequent changes to IFRS 7) 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. The Group published a report on its transition to IFRS 9 on 22 March 2019 which is available from the investor section of the Group's website at www.paragonbankinggroup.co.uk.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

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').

In accordance with the new rules:

Cash balances and loans to customers, 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

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 Company have arisen as a result of these classification changes.

There were no changes arising from a change in measurement on transition to IFRS 9.

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 £000	Pre-transition £000
Financial Assets		
Loans to customers	-	-
Investments – group companies	445,397	445,397
Amounts due from group companies	61,015	61,015
	506,412	506,412
Financial Liabilities		
Bank loan and overdrafts	904	904
Amounts due to parent undertaking	278,220	278,220
Amounts due to group companies	214	214
	279,338	279,338

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

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

Under IAS 39 the Company 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 Company has adopted a revised accounting policy for write offs following transition.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

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.

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

4. ACCOUNTING POLICIES

The particular accounting policies applied are described below.

Accounting convention

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

Going concern

The Financial Statements have been prepared on a going concern basis. The directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

Consolidated accounts

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

Operating leases

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

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.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Depreciation

Depreciation is provided on cost or valuation in equal annual instalments over the lives of the assets. The rates of depreciation are as follows:

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

Loans to customers

Year ended 30 September 2019 under IFRS 9

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

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of 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 the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision impairment.

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

Year ended 30 September 2018 under IAS 39

Loans to customers are considered to be 'loans and receivables' as defined by International Accounting Standard 39 – 'Financial Instruments: Recognition and Measurement' ('IAS 39'). They are therefore accounted for on the amortised cost basis.

Such loans are valued at inception as the amount of initial advance, 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. Thereafter they are valued at this amount less the cumulative amortisation calculated using 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 expected future cash payments and receipts arising from the loan to the initial carrying amount.

The Company's policy is to hedge against any exposure to fixed rate loan assets (note 7).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables

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.

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

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

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

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

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

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables (continued)

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. Properties in receivership are 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.

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.

Investments

The investment in the subsidiary companies is shown at cost less provision for impairment.

Cash at bank

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

Current tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Borrowings

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Derivative financial instruments

Derivative instruments utilised by the Company comprise interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Company in line with the Company's risk management policies (note 7).

The Company does not enter into speculative derivative contracts.

All derivatives 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 profit and loss account, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

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 Company has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Company documents, at inception, the relationship between the hedging instruments and the hedged items, as well as its risk management strategy and objectives for undertaking the transaction. The Company 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) 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 profit and loss account at the same time as the hedged item affects the profit and loss account. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction is recognised, or is no longer highly probable.

Amounts owed by or to group companies

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Retirement benefit obligations

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

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

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

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

Revenue

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

Fee and commission income

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

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.

Share based payments

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

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Disclosures

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

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

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

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

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

5. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 4 relate to:

Significant Increase in Credit Risk ('SICR')

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

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

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.

Classification of financial assets

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

- The company's 'business model' – how it intends to generate cash and profit from the assets; 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 or loss.

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

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

6. CRITICAL ACCOUNTING ESTIMATES

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

Impairment losses on loans to customers

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

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

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

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

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

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

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

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

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

6. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

Effective interest rates

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

Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions. These are listed in note 26. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

7. FINANCIAL RISK MANAGEMENT

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

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

Credit risk

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

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

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

The maximum credit risk at 30 September 2019 approximates to the carrying value of subordinated loans (note 20). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios of other group companies.

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

Liquidity risk

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

7. FINANCIAL RISK MANAGEMENT (CONTINUED)

Interest rate risk

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

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

Currency risk

The Company has no material exposure to foreign currency risk.

Use of derivative financial instruments

The Company uses derivative financial instruments for risk management purposes. Such instruments are used only to limit the exposure of the Company to movements in market interest or exchange rates, as described above.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken, and hence all of the Company's derivative financial instruments are for commercial hedging purposes. These are used to protect the Company from exposures principally arising from fixed rate lending or borrowing and borrowings denominated in foreign currencies. Hedge accounting is applied where appropriate, though it should be noted that some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under IAS 39 either because natural accounting offsets are expected, or obtaining hedge accounting would be especially onerous.

8. INTEREST RECEIVABLE AND SIMILAR INCOME

	2019 £000	2018 £000
On loans to other group companies	4,204	5,865
On loans to related parties	2,423	3,654
On loan notes issued by related parties	6,129	3,232
On loan notes issued by other group companies	241	245
Unwinding of discount on purchase on loan notes in other group companies	(268)	248
On deposits	2	-
	12,731	13,244

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

9. INTEREST PAYABLE AND SIMILAR CHARGES

	2019 £000	2018 £000
On bank loans and overdrafts	58	40
On loans from parent undertaking	3,736	2,498
On loans from other group companies	-	863
On loans from related parties	35	88
	3,829	3,489
Return on pension scheme liabilities (note 26)	514	750
	4,343	4,239

10. OTHER OPERATING INCOME

	2019 £000	2018 £000
Loan account fee income	105	145
Insurance income	9	11
Administration fees	16,228	17,416
Costs recharged to other group companies	91,387	80,349
	107,729	97,921

Administration fees are in respect of income receivable from various special purpose vehicle companies within the group which own mortgage and loan assets administered by the Company. Further details are given in note 19.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

11. DIRECTORS AND EMPLOYEES

a) Directors

Three of the directors during the period (2018: three) were also directors of the parent company, Paragon Banking Group PLC. Their remuneration from the Paragon Group is set out in the Directors' Remuneration Report of Paragon Banking Group PLC. No amounts in respect of their emoluments are included in the disclosures below.

	2019 £000	2018 £000
Directors' emoluments:		
Other emoluments	1,198	1,253
	1,198	1,253
Pension contributions paid in respect of directors	15	24
Emoluments of the highest paid director:		
Excluding pension contributions	378	390
Pension contributions	-	-
	378	390

The number of directors during the year to whom retirement benefits were accruing under money purchase schemes was one (2018: two). The number of the directors during the year in respect of whose service shares were received or receivable under the Group's long-term incentive schemes was seven (2018: seven) (three of whom are directors of the parent company (2018: three)). Four of these directors, not including the highest paid director exercised awards during the year.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

11. DIRECTORS AND EMPLOYEES (CONTINUED)

b) Employees

The average number of persons (including directors) employed by the Company during the year was 1,358 (2018: 1,341). The costs incurred during the year in respect of these employees were:

	2019	2019	2018	2018
	£000	£000	£000	£000
Share based remuneration	5,820		6,218	
Other wages and salaries	48,877		44,522	
Total wages and salaries		54,697		50,740
National insurance on share based remuneration	967		1,181	
Other social security costs	6,041		5,138	
Total social security costs		7,008		6,319
Defined benefit pension cost	1,627		1,747	
Other pension costs	1,487		967	
Total pension costs		3,114		2,714
Total staff costs		64,819		59,773

Details of the pension schemes operated by the Company are given in note 26.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

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 Company's profit is shown in note 11.

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 2019	Number 2018
(a)	Sharesave Plan	2,375,606	3,076,408
(b)	Performance Share Plan	4,606,893	4,113,575
(c)	Company Share Option Plan	654,463	491,648
(d)	Deferred Bonus Plan	774,046	496,762
(e)	Restricted Stock Units	134,827	82,787
		8,545,835	8,261,180

(a) Share option schemes

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

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

	2019 Number	2019 Weighted average exercise price p	2018 Number	2018 Weighted average exercise price p
Options outstanding £1 ordinary shares				
At 1 October 2018	3,076,408	289.11	2,474,465	275.56
Granted in the year	1,077,839	360.16	411,303	408.80
In respect of employees transferring in	-	-	489,445	274.38
Exercised in the year	(1,543,971)	253.65	(107,235)	335.74
Lapsed during the year	(234,670)	362.97	(191,570)	307.38
At 30 September 2019	2,375,606	336.98	3,076,408	289.11
Options exercisable	-	-	-	-

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).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. SHARE BASED REMUNERATION (CONTINUED)

(a) Share option schemes (continued)

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

Grant date	Period exercisable	Exercise price	Number 2019	Number 2018
Sharesave Schemes				
23/12/2013	01/02/2018 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	119,125	1,526,405
20/06/2016	01/08/2021 to 01/02/2022	249.44p	412,970	416,578
28/07/2017	01/09/2020 to 01/03/2021	341.76p	454,144	499,929
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	238,561	344,987
31/07/2018	01/09/2023 to 01/03/2024	408.80p	31,980	56,412
30/07/2019	01/09/2022 to 01/03/2023	360.16p	982,159	-
30/07/2019	01/09/2024 to 01/03/2025	360.16p	82,023	-
			2,375,606	3,076,408
			2,375,606	3,076,408

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, which were all made under the Sharesave scheme, are shown below.

Grant date	**30/07/19**	**30/07/19**	**31/07/18**	**31/07/18**
Number of awards granted	991,652	86,187	354,891	56,412
Market price at date of grant	422.00p	422.00p	498.00p	498.00p
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 is based on the annualised standard deviation of daily changes in price over the six years preceding the grant date. The five-year schemes use share price data for the preceding five years.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. SHARE BASED REMUNERATION (CONTINUED)

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

Awards under this plan comprise a right to acquire ordinary shares in the parent 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 §	407,016	1,298,361
01/12/2016	01/12/2019 to 30/11/2026 β	1,289,045	1,291,687
08/12/2017	08/12/2020 to 07/12/2027 β	1,113,818	1,117,266
14/12/2008	14/12/2021 to 13/12/2028 ‡	1,433,408	-
		4,606,893	4,113,575

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

§ 50% of these awards are subject to a Total Shareholder Return ('TSR') test and 50% are subject to an Earnings Per Share ('EPS') test. The TSR test compares the rank of the parent 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 provides that 25% of EPS tested awards will vest where EPS growth of the Group is 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 7% or more. In each case the testing period is the three financial years commencing with the year of grant.

β 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 13 listed financial service entities rather than the entire FTSE-250. 25% of these awards are subject to risk performance conditions which take 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 β above, except that EPS at the end of the test period is compared to an absolute target, rather than RPI.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. SHARE BASED REMUNERATION (CONTINUED)

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

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

Grant date	**14/12/18**	**08/12/17**
Number of awards granted	1,440,370	1,123,569
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 Number	**2019 Weighted average exercise price p**	**2018 Number**	**2018 Weighted average exercise price p**
Options outstanding				
At 1 October 2018	491,648	397.95	234,314	361.88
Granted in the year	172,603	396.04	154,035	477.76
In respect of employees transferring in	-	-	115,139	361.88
Lapsed during the year	(9,788)	410.72	(11,840)	371.77
At 30 September 2019	654,463	397.25	491,648	397.95
Options exercisable	-	-	-	-

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. SHARE BASED REMUNERATION (CONTINUED)

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

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 β	361.88p	336,643	338,624
08/12/2017	08/12/2020 to 07/12/2027 β	477.76p	150,438	153,024
14/12/2018	14/12/2021 to 13/12/2028 β	396.04p	167,382	-
			654,463	491,648

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

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

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

(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	01/12/2018 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 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	483.2p
Fair value per share at date of grant	401.00p	483.2p

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. SHARE BASED REMUNERATION (CONTINUED)

(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	483.2p
Fair value per share at date of grant	401.00p	483.2p

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. PROVISIONS FOR LOSSES

	2019 £000	2018 £000
Impairment of financial assets / (release of provision)		
First mortgage loans	(171)	(19)
Investments in group companies (note 20)	820	-
Investments in related parties (note 20)	794	(685)
Loans to group companies	-	-
Loans to related parties	5	(20)
	1,448	(724)

14. OPERATING PROFIT, BEING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2019 £000	2018 £000
Operating profit is after charging:		
Amortisation of intangible assets (note 17)	1,480	1,425
Depreciation on operating assets (note 18)	798	942
Auditor remuneration - audit services	79	54
Loss on disposal of fixed assets	4	6
Hire of plant and machinery	539	532
Hire of motor vehicles	939	344
Property rents	1,271	1,352

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

15. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2019 £000	2018 £000
Current tax:		
Corporation tax	3,182	3,433
Adjustment in respect of prior periods	(998)	(790)
Total current tax	2,184	2,643
Deferred tax (note 22):		
Origination and reversal of timing differences	(95)	(51)
Recognition of previously unrecognised tax losses	(188)	267
Rate change	407	-
Total deferred tax	124	216
	2,308	2,859

b) Factors affecting the tax charge for the year

	2019 £000	2018 £000
Profit before tax	11,564	15,114
UK corporation tax at 19% (2018: 19%) based on the profit for the year	2,197	2,872
Effects of:		
Tax exempt expenses / (revenues)	155	(286)
Accelerated capital allowances	104	170
Tax on share based remuneration	443	626
Prior year credit	(998)	(523)
Change in rate of taxation on deferred tax balances	407	-
	2,308	2,859

The current rate of corporation tax applicable to the Company for the year ended 30 September 2019 is 19.0%. Legislation has been enacted that will reduce this to 17% with effect from 1 April 2020.

Therefore, the effective rate of corporation tax is expected to be 18% for the year ending 30 September 2020 and 17% thereafter. The deferred tax liability reflects the rate at which temporary differences are expected to reverse.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

16. TAX CREDITED TO EQUITY

	2019 £000	2018 £000
On actuarial profit on pension scheme (note 26)	2,445	(1,688)
Tax on items recognised in comprehensive income	2,445	(1,688)
On share based payment (note 24)	408	1,107
Total tax charged to equity	2,853	(581)
Of which		
Current tax	443	981
Deferred tax (note 22)	2,410	(1,562)
	2,853	(581)

17. INTANGIBLE ASSETS

	Computer software £000	Total £000
Cost		
At 1 October 2017	7,853	7,853
Additions	1,382	1,382
Disposals	-	-
At 30 September 2018	9,235	9,235
Additions	1,764	1,764
Disposals	-	-
At 30 September 2019	10,999	10,999
Accumulated amortisation		
At 1 October 2017	5,853	5,853
Charge for the year	1,425	1,425
On disposals	-	-
At 30 September 2018	7,278	7,278
Charge for the year	1,480	1,480
On disposals	-	-
At 30 September 2019	8,758	8,758
Net book value		
At 30 September 2019	2,241	2,241
At 30 September 2018	1,957	1,957

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

18. TANGIBLE FIXED ASSETS

	Short leasehold premises £000	Plant and machinery £000	Total £000
Cost			
At 1 October 2017	2,248	7,182	9,430
Additions	24	600	624
Disposals	-	(246)	(246)
At 30 September 2018	2,272	7,536	9,808
Additions	-	839	839
Disposals	-	(381)	(381)
At 30 September 2019	2,272	7,994	10,266
Accumulated depreciation			
At 1 October 2017	1,667	5,649	7,316
Charge for the year	285	657	942
On disposals	-	(240)	(240)
At 30 September 2018	1,952	6,066	8,018
Charge for the year	165	633	798
On disposals	-	(377)	(377)
At 30 September 2019	2,117	6,322	8,439
Net book value			
At 30 September 2019	155	1,672	1,827
At 30 September 2018	320	1,470	1,790

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

19. SECURITISATIONS

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

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

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

20. INVESTMENTS - GROUP COMPANIES

	2019 £000	2018 £000
Valuation		
At 1 October 2018	445,397	199,875
Investment during the year	274,458	289,657
Other (credits) / debits	(269)	248
Provisions movement (note 13)	(1,614)	685
Repayment of loans	(405,902)	(45,068)
At 30 September 2019	312,070	445,397

The investments are loans to the Group companies which are not subsidiaries of the Company. The investments include subordinated loans amounting to £78,225,000 (2018: £120,873,000) and investments in Asset Class Notes amounting to £233,845,000 (2018: £324,524,000).

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

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

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

21. DEBTORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Amounts due from group companies	36,639	61,015
Corporation tax	19,134	10,981
Deferred tax (note 22)	9,324	7,038
Other debtors	20,545	21,273
Prepayments and accrued income	3,966	3,797
	89,608	104,104

Included in the amount due from group companies is £36,590,000 (2018: £60,890,000) which is interest bearing.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

22. DEFERRED TAX

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

	2019 £000	2018 £000
Balance at 1 October 2018	7,038	8,816
Charge to reserves (note 16)	2,410	(1,562)
Profit and loss credit (note 15)	95	51
Prior year profit and loss credit / (charge) (note 15)	188	(267)
Rate change (note 15)	(407)	-
Balance at 30 September 2019	9,324	7,038

The net deferred tax asset recognised is analysed as follows:

	2019 £000	2018 £000
Accelerated tax depreciation	533	518
Retirement benefit obligations	5,862	3,710
Impairment and other provisions	2,929	2,810
Net deferred tax asset	9,324	7,038

23. CALLED UP SHARE CAPITAL

	2019 £000	2018 £000
Allotted:		
101,552,255 (2018: 101,552,255) ordinary shares of 75p each	76,164	76,164

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

24. PROFIT AND LOSS ACCOUNT

	£000
At 1 October 2018	142,383
Profit for the financial year	12,255
Actuarial loss on pension fund net of tax (note 26)	7,206
Tax on share based remuneration (note 16)	1,107
At 30 September 2018	162,951
Profit for the financial year	9,256
Actuarial profit on pension fund net of tax (note 26)	(14,052)
Tax on share based remuneration (note 16)	408
At 30 September 2019	158,563

25. CREDITORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Bank loan and overdrafts	806	904
Amounts due to parent undertaking	116,800	278,220
Amounts due to group companies	205	214
Other creditors	972	1,317
Accruals and deferred income	17,753	13,951
	136,536	294,606

The amounts due to parent undertaking is interest bearing and included in the amount due to group companies is £205,000 (2018: £214,000) which is interest bearing.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

26. 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 assets 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 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

26. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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 Company 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 transaction effectively granting the Plan a first charge over its head office building as security for payments under the plan.

(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 and 30 September 2018 and their fair values were:

	2019 £000	2018 £000
Cash	7,107	557
Equity instruments	60,734	61,820
Debt instruments	34,220	28,438
Real estate	10,806	10,673
Total fair value of Plan assets	112,867	101,488
Present value of Plan liabilities	(147,350)	(121,015)
(Deficit) in the Plan	(34,483)	(19,527)

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

The effect of this ruling has been accounted for in the accounts of the Group for the year ending 30 September 2019. The Group's present expectation is that the ruling will result in an additional charge to profit in the year ending 30 September 2020 of £0.3m before tax and this amount has been included as 'post 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

26. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

	2019 £000	2018 £000
At 1 October 2018	101,488	98,289
Interest on Plan assets	3,020	2,647
Cash flows		
Contributions by the Group	4,619	4,464
Contributions by Plan members	237	237
Benefits paid	(2,410)	(4,680)
Administration expenses paid	(704)	(530)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	6,617	1,061
At 30 September 2019	112,867	101,488

The actual return on scheme assets in the year ended 30 September 2019 was £9,637,000 (2018: £3,708,000).

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

	2019 £000	2018 £000
At 1 October 2018	121,015	128,147
Current service cost	1,627	1,747
Past service cost	233	-
Funding cost	3,534	3,397
Cash flows		
Contributions by scheme members	237	237
Benefits paid	(2,410)	(4,680)
Remeasurement (gain) / loss		
Arising from demographic assumptions	(1,437)	(1,849)
Arising from financial assumptions	24,551	(5,984)
Arising from experience adjustments	-	-
At 30 September 2019	147,350	121,015

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

26. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

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

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

	Note	2019 £000	2018 £000
Current service cost	11	1,627	1,747
Past service cost		233	-
Total service cost		1,860	1,747
Administration expenses		704	530
Included within operating expenses		2,564	2,277
Funding cost of scheme liability		3,534	3,397
Interest on Plan assets		(3,020)	(2,647)
Net interest expense	9	514	750
Components of defined benefit costs recognised in profit and loss		3,078	3,027

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

26. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

	2019 £000	2018 £000
Return on Plan assets (excluding amounts included in interest)	6,617	1,061
Actuarial gains / (losses)		
Arising from demographic assumptions	1,437	1,849
Arising from financial assumptions	(24,551)	5,984
Arising from experience adjustments	-	-
Total actuarial (loss) / gain	(16,497)	8,894
Tax credit / (charge) thereon (note 16)	2,445	(1,688)
Net actuarial (loss) / gain	(14,052)	7,206

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

(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.	2.1% decrease
Rate of inflation *	0.1% p.a.	2.1% increase
Rate of salary growth	0.1% p.a.	0.4% increase
Rates of mortality	1 year of life expectancy	2.1% increase

* maintaining a 0.5% real increase in salary growth

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

26. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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 2019 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 duration of the benefit obligations in the Plan at the year end are shown in the table below:

	2019 Years	2018 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 Company sponsors a defined contribution (Worksave) pension scheme, open to all employees who are not members of the Plan. The Company successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme.

The assets of these schemes are not Company assets and are held separately from those of the Company, under the control of independent trustees. Contributions made by the Company to these schemes in the year ended 30 September 2019, which represent the total cost charged against income, were £1.5m (2018: £1.0m) (note 11).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

27. FINANCIAL COMMITMENTS

At 30 September 2019 and 30 September 2018, the Company had outstanding commitments for future minimum lease payments under non-cancellable leases, which fall due as follows:

	2019 £000	2018 £000
Plant and machinery		
Within one year	738	635
Between two and five years	634	726
	1,372	1,361
Land and buildings		
Within one year	1,356	1,356
Between two and five years	3,825	4,256
Over five years	1,642	2,537
	6,823	8,149
	8,195	9,510

Operating lease payments represent rents payable by the Company 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 5 years (2018: 5 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).

28. RELATED PARTY TRANSACTIONS

On 27 May 2010, Mr A K Fletcher, an independent non-executive director of the Group, was appointed as a trustee of the Group Pension Plan, and during the first quarter of 2013 became a director of its Corporate Trustee when that was put in place. In respect of this appointment he was paid £15,000 (2018: £15,000) in the year ended 30 September 2019 by the Company, the sponsoring company of the Plan.

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

Transactions with First Flexible No.5 PLC ('FF5')

At the balance sheet date, the Company was owed £nil (2018: £120,000) by FF5, a company under common control as defined by IAS 24, in relation to payments made on behalf of FF5, which is included in other debtors.

Transactions with Paragon Mortgages (No. 20) PLC ('PM20')

The Company acted as servicer of the mortgages for PM20, a company under common control as defined by IAS 24, and earned £nil (2018: £246,000) during the year in servicing fees. At the balance sheet date PM20 owed £nil (2018: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

The Company had held the subordinated loan for PM20 and Class D notes issued by PM20 were repaid during the preceding year. During the year the Company earned £nil (2018: £414,000) in subordinated loan interest and £nil (2018: £115,000) in Class D note interest. At the balance sheet date PM20 owed £nil (2018: £nil) in relation to subordinated loan interest and £nil (2018: £nil) relating to Class D note interest, which are included in prepayments and accrued income.

The Company was the Fee Letter provider to PM20 which is repaid over a four year period. At the balance sheet date, the outstanding Fee Letter was £nil (2018: £nil), which is included in other creditors. During the year the Company earned £nil (2018: £17,000) in Fee letter interest and at the balance sheet date PM20 owed £nil (2018: £nil) in relation to Fee Letter interest, which is included in prepayments and accrued income.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

28. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with Paragon Mortgages (No. 21) PLC ('PM21')

The Company acted as servicer of the mortgages for PM21, a company under common control as defined by IAS 24, and earned £31,000 (2018: £230,000) during the year in servicing fees. At the balance sheet date, PM21 owed £nil (2018: £15,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date, the Company owed £nil (2018: £206,000) to PM21 in relation to payments made on behalf of the Company, which is included in other creditors.

At the balance sheet date, the Company held the subordinated loan for PM21 of £nil (2018: £6,250,000) and Class D notes issued by PM21 of £nil (2018: £6,300,000), which is included in investments. During the year the Company earned £63,000 (2019: £284,000) in subordinated loan interest and £39,000 (2018: £166,000) in Class D note interest. At the balance sheet date PM21 owed £nil (2018: £12,000) in relation to subordinated loan interest and £nil (2018: £7,000) relating to Class D note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM21 which is repaid over a four year period. At the balance sheet date, the outstanding Fee Letter was £nil (2018: £60,000), which is included in other creditors. During the year the Company earned £2,000 (2018: £26,000) in Fee letter interest and at the balance sheet date PM21 owed £nil (2018: £nil) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 22) PLC ('PM22')

The Company acted as servicer of the mortgages for PM22, a company under common control as defined by IAS 24, and earned £130,000 (2018: £291,000) during the year in servicing fees. At the balance sheet date PM22 owed £nil (2018: £18,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date, the Company was owed £nil (2018: £114,000) by PM22 in relation to payments made on behalf of PM22, which is included in other debtors.

At the balance sheet date, the Company held the subordinated loan for PM22 of £nil (2018: £7,502,000) and Class E notes issued by PM22 of £nil (2018: £7,500,000), which is included in investments. During the year the Company earned £258,000 (2018: £341,000) in subordinated loan interest and £152,000 (2018: £191,000) in Class E note interest. At the balance sheet date PM22 owed £nil (2018: £14,000) in relation to subordinated loan interest and £nil (2018: £8,000) relating to Class E note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM22 which is repaid over a four year period. At the balance sheet date, the outstanding Fee Letter was £nil (2018: £212,000), which is included in other creditors. During the year the Company earned £14,000 (2018: £45,000) in Fee letter interest and at the balance sheet date PM22 owed £nil (2018: £1,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

28. RELATED PARTY TRANSACTIONS (CONTINUED)

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

The Company acted as servicer of the mortgages for PM23, a company under common control as defined by IAS 24, and earned £177,000 (2018: £282,000) during the year in servicing fees. At the balance sheet date PM23 owed £33,000 (2018: £55,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date, the Company was owed £331,000 (2018: £989,000) by PM23 in relation to payments made on behalf of PM23, which is included in other debtors.

At the balance sheet date, the Company held the subordinated loan for PM23 of £7,501,000 (2018: £7,501,000) and Class E notes issued by PM23 of £7,505,000 (2018: £7,505,000), which is included in investments. During the year the Company earned £362,000 (2018: £344,000) in subordinated loan interest and £254,000 (2018: £234,000) in Class E note interest. At the balance sheet date PM23 owed £76,000 (2018: £75,000) in relation to subordinated loan interest and £53,000 (2018: £52,000) relating to Class E note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM23 which is repaid over a four year period. At the balance sheet date, the outstanding Fee Letter was £46,000 (2018: £600,000), which is included in other creditors. During the year the Company earned £26,000 (2018: £53,000) in Fee letter interest and at the balance sheet date PM23 owed £3,000 (2018: £9,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

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

The Company acted as servicer of the mortgages for PM24, a company under common control as defined by IAS 24, and earned £209,000 (2018: £372,000) during the year in servicing fees. At the balance sheet date PM24 owed £41,000 (2018: £69,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date, the Company was owed £629,000 (2018: £1,744,000) by PM24 in relation to payments made on behalf of PM24, which is included in other debtors.

At the balance sheet date, the Company held the subordinated loan for PM24 of £9,542,000 (2018: £9,542,000) and Class D notes issued by PM24 of £8,753,000 (2018: £8,753,000), which is included in investments. During the period the Company earned £422,000 (2018: £405,000) in subordinated loan interest and £383,000 (2018: £362,000) in Class D note interest. At the balance sheet date PM24 owed £89,000 (2018: £88,000) in relation to subordinated loan interest and £80,000 (2018: £81,000) relating to Class D note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM24 which is repaid over a four-year period. At the balance sheet date, the outstanding Fee Letter was £323,000 (2018: £323,000), which is included in other creditors. During the year the Company earned £40,000 (2018: £71,000) in Fee letter interest and at the balance sheet date PM24 owed £5,000 (2018: £13,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

28. RELATED PARTY TRANSACTIONS (CONTINUED)

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

The Company acted as servicer of the mortgages for PM25, a company under common control as defined by IAS 24, and earned £1,398,000 (2018: £610,000) during the year in servicing fees. At the balance sheet date PM25 owed £228,000 (2018: £235,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date, the Company was owed £2,156,000 (2018: £2,814,000) by PM25 in relation to payments made on behalf of PM25, which is included in other debtors. During the year the Company earned £116,000 (2018: £41,000) in Fee letter interest and at the balance sheet date PM25 owed £13,000 (2018: £15,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

At the balance sheet date, the Company held the following asset backed loan notes issued by PM25:

Notes	Maturity date	Call date	Principal notes held 2019	2018
			£m	£m
'A'	May 2050	May 2023	29.1	225.0
'B'	May 2050	May 2023	1.7	1.7
'C'	May 2050	May 2023	1.5	1.5
'D'	May 2050	May 2023	24.7	24.7
'Z'	May 2050	May 2023	17.6	17.6
'S'	May 2050	May 2023	10.3	10.3
'SVFN'	May 2050	May 2023	0.0	6.1

During the year the Company earned £1,548,000 (2018: £1,399,000) in Class A note interest, £30,000 (2018: £13,000) in Class B note interest, £32,000 (2018: £14,000) in Class C note interest, £602,000 (2018: £255,000) in Class D note interest, £607,000 (2018: £259,000) in Class Z note interest, £499,000 (2018: £223,000) in Class S note interest, and £86,000 (2018: £154,000) in Class S VFN note interest. At the balance sheet date, the Company was owed £53,000 (2018: £421,000) in Class A note interest, £4,000 (2018: £4,000) in Class B note interest, £4,000 (2018: £4,000) in Class C note interest, £75,000 (2018: £76,000) in Class D note interest, £76,000 (2018: £77,000) in Class Z note interest, £63,000 (2018: £64,000) in Class S note interest, and £nil (2018: £38,000) in Class S VFN note interest by PM25, which are included in prepayments and accrued income.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

28. RELATED PARTY TRANSACTIONS (CONTINUED)

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

During the year the Company, a company under common control as defined by IAS 24, acted as servicer of the mortgages for PM26 and earned £75,000 in servicing fees. At the balance sheet date, PM26 owed £75,000 to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £1,864,000 from PM26 in relation to payments made on behalf of PM26, which is included in other debtors.

At the balance sheet date, the Company held the following asset backed loan notes issued by PM26:

Notes	Maturity date	Call date	Principal notes held 2019
			£m
'A1'	May 2045	Aug 2024	19.2
'A2'	May 2045	Aug 2024	7.6
'B'	May 2045	Aug 2024	24.7
'C'	May 2045	Aug 2024	18.6
'D'	May 2045	Aug 2024	20.1
'Z'	May 2045	Aug 2024	20.1
'S'	May 2045	Aug 2024	10.2
'SVFN'	May 2045	Aug 2024	9.5

During the year the Company earned £88,000 in Class A1 note interest, £38,000 in Class A2 note interest, £165,000 in Class B note interest, £140,000 in Class C note interest, £169,000 in Class D note interest, £219,000 in Class Z note interest, £121,000 in Class S note interest, and £112,000 in Class S VFN note interest. At the balance sheet date, PM26 owed £88,000 in Class A1 note interest, £38,000 in Class A2 note interest, £165,000 in Class B note interest, £140,000 in Class C note interest, £169,000 in Class D note interest, £219,000 in Class Z note interest, £121,000 in Class S note interest, and £112,000 in Class S VFN note interest, which are included in prepayments and accrued income.

Transactions with Paragon Fifth Funding Limited ('P5F')

The Company acted as servicer of the mortgages for P5F, a company under common control as defined by IAS 24, and earned £nil (2018: £129,000) during the year in servicing fees. At the balance sheet date P5F owed £nil (2018: £nil) to the Company in relation to servicing fees, which is included in other debtors.

Transactions with Paragon Seventh Funding Limited ('P7F')

The Company acted as servicer of the mortgages for P7F, a company under common control as defined by IAS 24, and earned £241,000 (2018: £nil) during the year in servicing fees. At the balance sheet date P7F owed £29,000 (2018: £nil) to the Company in relation to other fees, which is included in other debtors.

Transactions with Paragon Mortgages (No. 12) PLC ('PM12')

The Company acted as servicer of the mortgages for PM12, a company under common control as defined by IAS 24, and earned £2,106,000 (2018: £nil) during the year in servicing fees. At the balance sheet date P7F owed £334,000 (2018: £nil) to the Company in relation to servicing fees, which is included in other debtors.

At the balance sheet date the Company was owed £70,000 from PM12 in relation to payments made on behalf of PM12, which is included in other debtors.

Transactions with Residual Interest Paragon Mortgages (No. 12) PLC ('RIPM12')

At the balance sheet date the Company was owed £1,000 from RIPM12, a company under common control as defined by IAS 24, in relation to payments made on behalf of RIPM12, which is included in other debtors.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

29. ULTIMATE PARENT COMPANY

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

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