

FIRST FLEXIBLE (NO. 7) PLC

Report and Financial Statements

Year ended 30 September 2019



STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

First Flexible (No. 7) PLC ('the Company') is a wholly owned subsidiary of Paragon Banking Group PLC ('the Group') and was set up to provide finance for its mortgage loan assets, by issuing mortgage backed floating rate loan notes and using the proceeds to purchase mortgage loans from other group companies.

During the year the Company operated in the United Kingdom, its principal activities are the provision of first mortgage loans.

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.

On 17 June 2019 the Company sold its mortgage loans to a fellow group company and used the proceeds to repay its outstanding asset backed loan notes and continues to manage its residual assets.

As shown in the Company's profit and loss account on page 10, the Company's net interest income decreased by 59% compared to the prior year (2018: 34% decrease). This was due to the Company selling its mortgage loans on 17 June 2019. The result after tax has stayed consistent at £nil.

The balance sheet on page 11 of the Financial Statements shows the Company's financial position at the year end. Loans to customers have decreased to £nil due to the Company selling its loan book with the sale proceeds used to repay the outstanding asset back loan notes. Details of amounts owed from and to other group companies are shown in notes 14 and 17.

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. For this reason, the Company's directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The performance of the Group's mortgage lending operation, which includes the Company, is discussed in the Group's Annual Report, which does not form part of this Report.

PRINCIPAL RISKS AND UNCERTAINTIES

The assets of the Company are located entirely in the United Kingdom and its results are therefore impacted by the economic environment within the UK. A material downturn in economic performance could increase the numbers of customers who default on loans and / or cause the values of the properties over which the Company enjoys security to fall. The likelihood of this occurring has become more difficult to forecast given the continuing material uncertainties regarding the UK's withdrawal from the European Union.

The Company is a securitisation company and has been structured so as to avoid, in as far as is possible, all forms of financial risk with its outstanding loan notes match-funded to maturity. An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out 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.

FUTURE PROSPECTS

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 discussed in note 4.

STRATEGIC REPORT (CONTINUED)

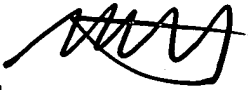
ENVIRONMENT

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

The Company has no employees. All operational services are provided by employees of the Group. The Group's employment policies are described in its Annual Report, which does not form part of this Report.

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

A handwritten signature in black ink, appearing to be 'K G Allen', written over a horizontal line.

K G Allen

Director

23 January 2020

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 First Flexible (No. 7) PLC, a company registered in England and Wales with registration no: 04579544, for the year ended 30 September 2019.

CORPORATE GOVERNANCE

The directors have been charged with governance in accordance with the transactional documentation detailing the mechanism and structure of the transaction. The structure of the Group is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the transaction documents.

DIRECTORS

The directors throughout the year and subsequently were:

R D Shelton

R J Woodman

J Fairrie (resigned 19 November 2018)

K G Allen

J P Giles

P H Whitaker

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.
- 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

23 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.



Pandora Sharp

Company Secretary

23 January 2020

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FIRST FLEXIBLE NO. 7 PLC

Opinion

We have audited the Financial Statements of First Flexible (No. 7) PLC for the year ended 30 September 2019 which comprise the profit and loss account, the balance sheet, the statement of movement in equity and the related notes 1 to 19, 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 result 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.

Emphasis of matter - non-going concern basis of preparation

We draw attention to the disclosure made in note 4 to the financial statements which explains that the financial statements are now not prepared on the going concern basis for the reason set out in that note. Our opinion is not modified in respect of this matter.

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.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FIRST FLEXIBLE (NO. 7) PLC (CONTINUED)

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 4, 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

23 January 2020

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2019

	Note	2019 £000	2018 £000
Interest receivable			
Mortgages		328	561
Other		6	5
		<u>334</u>	<u>566</u>
Interest payable and similar charges	8	(173)	(173)
Net interest income		<u>161</u>	<u>393</u>
Other operating income		6	11
Total operating income		<u>167</u>	<u>404</u>
Operating expenses		(166)	(404)
Provisions for losses	13	(1)	-
Operating profit, being profit on ordinary activities before taxation	10	<u>-</u>	<u>-</u>
Tax on profit on ordinary activities	11	-	-
Profit on ordinary activities after taxation	16	<u>-</u>	<u>-</u>

All activities derive from continuing operations.

There are no recognised gains or losses, other than the result for the current and preceding years, and consequently a separate statement of comprehensive income has not been presented.

BALANCE SHEET

30 SEPTEMBER 2019

	Note	2019 £000	2019 £000	2018 £000	2018 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Financial assets	12		-		11,585
CURRENT ASSETS					
Debtors falling due within one year	14	108		7	
Cash at bank		6		2,004	
			114		2,011
			114		13,596
FINANCED BY					
EQUITY SHAREHOLDERS' FUNDS					
Called up share capital	15	12		12	
Profit and loss account	16	62		62	
			74		74
CREDITORS					
Amounts falling due within one year	17	40		327	
Amounts falling due after more than one year	17	-		13,195	
			40		13,522
			114		13,596

These Financial Statements were approved by the Board of Directors on 23 January 2020.

Signed on behalf of the Board of Directors



R D Shelton

Director

STATEMENT OF MOVEMENT IN EQUITY

YEAR ENDED 30 SEPTEMBER 2019

	Share capital £000	Profit and loss account £000	Total equity £000
<i>Total comprehensive income for the year</i>			
Result for the year	-	-	-
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	-	-
Opening equity	12	62	74
Closing equity	12	62	74

YEAR ENDED 30 SEPTEMBER 2018

	Share capital £000	Profit and loss account £000	Total equity £000
<i>Total comprehensive income for the year</i>			
Result for the year	-	-	-
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	-	-
Opening equity	12	62	74
Closing equity	12	62	74

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

1. GENERAL INFORMATION

First Flexible No. 7 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 04579544. 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'). Further information on this judgement is given in note 5.

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.

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

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

	Post-transition £000	Pre-transition £000
Financial Assets		
Cash at bank	2,004	2,004
Loans to customers	11,585	11,585
Amounts due from group companies	108	108
	<hr/>	<hr/>
	13,697	13,697
	<hr/>	<hr/>
Financial Liabilities		
Asset backed loan notes	12,389	12,389
Intercompany Subordinated loan	806	806
Amounts due to group companies	208	208
	<hr/>	<hr/>
	13,403	13,403
	<hr/>	<hr/>

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 IFRS 9 resulted in an increase in the Company's impairment provision of £79.00 at the transition date, 1 October 2018. The impacts by business segment are set out below:

	IAS 39 £000	IFRS 9 £000	Change £000	Change %
Loans to customers				
Mortgages	11,585	11,585	-	0%
Total	<u>11,585</u>	<u>11,585</u>	<u>-</u>	<u>0 %</u>

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

	£000
Impairment on loans to customers	
At 30 September 2018 under IAS 39	-
IFRS 9 transition adjustments	-
Change in write-off definition	-
	<u>-</u>
At 1 October 2018 under IFRS 9	<u>-</u>

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

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

Cash balances and the amounts due from group companies balance shown in note 14 are classified as financial assets accounted for at amortised cost and are therefore subject to the impairment provisions of IFRS 9. However, these assets are principally exposures to highly rated banks. The ECLs on these counterparties are considered to be minimal. The value, tenor and potential for default of the other exposures is such that any potential IFRS 9 provision is insignificant.

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

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.

This has, therefore, required significant amendments to the disclosures presented as note 13 (loans and impairment) in these accounts compared to those presented for the year ended 30 September 2018. When new notes address impairment, no comparative amounts are required to be disclosed, but for other new requirements, comparative amounts under the new standard at 30 September 2018 are shown.

Summary

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

		£000	£000
Equity at 30 September 2018			74
IFRS 9			
Impairment	(note 13)	-	
Deferred tax thereon		-	
		<hr/>	
		-	
Total adjustments			-
			<hr/>
Equity at 1 October 2018			74
			<hr/>

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

NOTES TO THE ACCOUNTS**YEAR ENDED 30 SEPTEMBER 2019****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

In accordance with IAS 1 – ‘Presentation of Financial Statements’ a company may only present its financial statements on a going concern basis if management do not intend to liquidate the company or cease trading.

Following the disposal of its loan assets and the repayment of its external borrowings on 17 June 2019, the Company has effectively ceased to trade, and the intention of the directors is to settle its remaining assets and liabilities in an orderly fashion and, in due course, dissolve the Company. The directors have considered the available resources of the Company and concluded that all liabilities will be settled in full.

Due to the effective cessation of trade, these financial statements have not been prepared on a going concern basis, but due to the nature of the remaining assets and liabilities, the amounts presented do not differ from the values which would have been presented had the going concern basis been adopted.

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

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

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 procurement 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 the EIR method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the 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.

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 Effective Interest Rate basis.

NOTES TO THE ACCOUNTS**YEAR ENDED 30 SEPTEMBER 2019****4. ACCOUNTING POLICIES (CONTINUED)****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.

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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Deferred purchase consideration

Under the Mortgage sale agreement profits from First Flexible No 7 PLC are paid up to the companies which originated the loans by way of deferred purchase consideration. Deferred purchase consideration is recognised in the period in which it becomes payable and is paid when sufficient cash resources allow. Mortgage Trust Services PLC and Paragon Finance PLC, to whom deferred purchase consideration is paid, are fellow group companies.

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 13 – ‘Fair Value Measurement’
- Certain disclosures required by IFRS 7 – ‘Financial Instruments Disclosures’

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

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.

More information on the definition of SICR adopted is given in note 13.

Definition of default

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

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

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

More information on the Group's definition of default adopted is given in note 13.

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)

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.

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.

7. FINANCIAL RISK MANAGEMENT

Until the sale of its loans and the repayment of the asset backed loan notes, the Company's operations were financed principally by floating rate, asset backed loan notes and, to a lesser extent, by a mixture of share capital and loans from other group companies. The Company issued financial instruments to finance the acquisition of its portfolio of loans to customers. 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 were 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 was primarily attributable to its loans to customers. The maximum credit risk at 30 September 2018 approximates to the carrying value of loans to customers (note 12). There were no significant concentrations of credit risk due to the large number of customers included in the portfolios.

The Company acquired mortgages from Paragon Mortgages Limited and Mortgage Trust Services PLC, fellow Group companies which placed strong emphasis on good credit management at the time of underwriting new loans.

The acquired mortgages were 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 remained the overriding factor in the decision to lend by the originating lender. Additionally, each mortgage had the benefit of one or more life assurance policies and certain mortgages have the benefit of a mortgage guarantee indemnity insurance policy.

Paragon Finance PLC and Mortgages Trust Services PLC, fellow group companies, continued to administer the mortgages on behalf of First Flexible (No. 7) PLC and the collections process was the same as that utilised for all companies in the group.

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 of companies will deal with, established limits for each counterparty and monitors compliance with those limits.

Liquidity risk

The Company's assets were principally financed by asset backed loan notes issued through the securitisation process. Details of the Company's borrowings are given in notes 17 and 18. Securitisation effectively eliminates the Company's liquidity risk by matching the maturity profile of the Company's funding to the profile of the assets to be funded.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

7. FINANCIAL RISK MANAGEMENT (CONTINUED)

Interest rate risk

The rates payable on the asset backed loan notes issued by the Company were reset quarterly on the basis of LIBOR. The Company's assets predominantly bear LIBOR linked interest rates or were base rate linked interest rates. The interest rates charged on the Company's variable rate loan assets were determined by reference to, inter alia, the Company's funding costs and the rates being charged on similar products in the market. Generally this ensured 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.

In part, the Company's interest rate hedging objectives were achieved by the controlled mismatching of the dates on which instruments mature, redeem or have their interest rates reset.

Currency risk

The Company has no material exposure to foreign currency risk.

8. INTEREST PAYABLE AND SIMILAR CHARGES

	2019	2018
	£000	£000
Asset backed loan notes	97	119
Subordinated loan interest	28	37
Interest payable to group companies	2	9
Amortisation of premium	46	8
	<u>173</u>	<u>173</u>

9. DIRECTORS AND EMPLOYEES

Directors' fees from the Company during the year is stated in note 10.

The Company had no employees in the current or preceding year. All administration is performed by employees of the Group. The directors of the Company, with the exception of J Fairrie, and P H Whitaker, are employed by Paragon Finance PLC, a fellow group company, and their remuneration is disclosed within the financial statements of that company, which do not form part of this Report.

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

	2019	2018
	£000	£000
Operating profit is after charging:		
Directors' fees	3	3
Auditor remuneration - audit services	10	8
Deferred purchase consideration	183	326
	<u>196</u>	<u>337</u>

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

11. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2019	2018
	£000	£000
Current tax		
Corporation tax	-	-
	<u>-</u>	<u>-</u>

b) Factors affecting the tax charge for the year

	2019	2018
	£000	£000
Profit before tax	-	-
UK corporation tax at 19% (2018: 19%) based on the profit for the year	<u>-</u>	<u>-</u>
	<u>-</u>	<u>-</u>

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.

12. FINANCIAL ASSETS

	2019	2018
	£000	£000
Loans to customers (note 13)	-	11,585
	<u>-</u>	<u>11,585</u>

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Company's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 12, loans held at amortised cost, accounted for under IFRS 9, subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

- Basis of provision
- Impairments by stage and division
- Movements in impairment provision in the period
- Impairments charged to income

Basis of provision

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

Calculation of expected credit loss ('ECL')

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

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Company's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. The Company utilised all reasonably available information in its possession for this exercise.

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

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

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Significant Increase in Credit Risk ('SICR')

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

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

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR.

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

Definitions of default

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

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

Credit Impaired loans

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

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

During the year the Company revised certain of its default definitions for regulatory purposes. Where appropriate, IFRS 9 definitions have been amended to harmonise with the new definition and hence the staging at 1 October 2018.

As a result of this harmonisation all default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than ninety days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

IFRS 9 Staging

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

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

On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date

Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan

For credit impaired assets, provisions will also be made on the basis of ECLs.

Impairments by stage

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

	Stage 1	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
30 September 2019				
Gross loan book	-	-	-	-
Impairment provision	-	-	-	-
Net loan book	-	-	-	-
Coverage ratio	0.00%	0.00%	0.00%	0.00%
	Stage 1	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
1 October 2018				
Gross loan book	9,211	681	1,693	11,585
Impairment provision	-	-	-	-
Net loan book	9,211	681	1,693	11,585
Coverage ratio	0.00%	0.00%	0.00%	0.00%

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

Analysis of Stage 2 loans

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

	< 1 month arrears £000	> 1 <= 3 months arrears £000	Total £000
30 September 2019			
Gross loan book	-	-	-
Impairment provision	-	-	-
Net loan book	-	-	-
Coverage ratio	0.00%	0.00%	0.00%
1 October 2018			
Gross loan book	314	368	681
Impairment provision	-	-	-
Net loan book	314	368	681
Coverage ratio	0.00%	0.00%	0.00%

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Analysis of Stage 3 loans

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

	> 3 month arrears £000	RoR managed £000	Realisations £000	Total £000
<i>30 September 2019</i>				
Gross loan book	-	-	-	-
Impairment provision	-	-	-	-
Net loan book	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Coverage ratio	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
<i>1 October 2018</i>				
Gross loan book	1,073	-	620	1,693
Impairment provision	-	-	-	-
Net loan book	<u>1,073</u>	<u>-</u>	<u>620</u>	<u>1,693</u>
Coverage ratio	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>

The exposure at default in the calculation shown above for stage 3 accounts is reduced by £nil in respect of the value of security given by customers. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure value in the central economic scenario. Security values are based on the most recent valuation of the relevant property held by the Company, indexed as appropriate.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Movements in impairment provision by stage

The movements in the impairment provision calculated under IFRS 9 is set out below.

	Total £000
At transition – 1 October 2018	-
Recovered in period	-
Amounts written off	-
At 30 September 2019	-

Accounts are considered to be written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions. At 30 September 2019 enforceable contractual balances of £nil were outstanding on assets written off in the period. This will exclude those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances will be kept under review for operational purposes but no amounts will be recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

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

	Stage 1 £000	Stage 2 * £000	Stage 3 * £000	Total £000
Loss allowance at 1 October 2018	-	-	-	-
New assets originated or purchased	-	-	-	-
Changes in loss allowance				
Transfer to stage 1	-	-	-	-
Transfer to stage 2	-	-	-	-
Transfer to stage 3	-	-	-	-
Changes due to credit risk	-	-	19	19
Write offs	-	-	-	-
Assets recognised	-	-	-	-
Changes in models/parameters	-	-	(19)	(19)
Loss allowance at 30 September 2019	-	-	-	-

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

	Stage 1 £000	Stage 2 *	Stage 3 *	Total £000
		£000	£000	
Balances at 1 October 2018	9,211	681	1,693	11,585
New assets originated or purchased	-	-	-	-
Changes in staging				
Transfer to stage 1	-	-	-	-
Transfer to stage 2	-	-	-	-
Transfer to stage 3	-	-	-	-
Redemptions and repayments	(1,585)	(28)	(446)	(2,059)
Assets derecognised	(9,400)	(681)	(1,693)	(11,774)
Write offs	-	-	-	-
Other changes	1,774	28	446	2,248
Balance at 30 September 2019	-	-	-	-
Loss allowance	-	-	-	-
Carrying value	-	-	-	-

Impairments charged to income

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

	2019 IFRS 9 £000	2018 IAS 39 £000
Provided in period	-	-
Written off amounts	1	-
	<u>1</u>	<u>-</u>

Economic impacts

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

In developing its economic scenarios, the Company considers analysis from reputable external sources to form a general market consensus which inform its central scenario. These sources included forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies.

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

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

30 September 2019

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

1 October 2018

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

14. DEBTORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Amounts due from group companies	108	5
Prepayments and accrued income	-	2
	<u>108</u>	<u>7</u>

15. CALLED UP SHARE CAPITAL

	2019 £	2018 £
Allotted:		
49,998 ordinary shares of £1 each (25p paid)	12,500	12,500
2 ordinary shares of £1 each (fully paid)	2	2
	<u>12,502</u>	<u>12,502</u>

16. PROFIT AND LOSS ACCOUNT

	£000
At 1 October 2017	62
Result for the financial year	-
At 30 September 2018	<u>62</u>
Result for the financial year	-
At 30 September 2019	<u>62</u>

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

17. CREDITORS

	2019	2018
	£000	£000
Amounts falling due within one year:		
Amounts due to group companies	28	208
Accruals and deferred income	12	119
	<u>40</u>	<u>327</u>

Included within the accruals and deferred income balance is an amount of £nil (2018: £5,000) due to fellow subsidiaries of Paragon Banking Group PLC.

	2019	2018
	£000	£000
Amounts falling due after more than one year:		
Asset backed loan notes	-	12,389
Intercompany subordinated loan	-	806
	<u>-</u>	<u>13,195</u>

A maturity analysis and further details of the asset backed loan notes are given in note 18.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

18. BORROWINGS

The mortgage backed floating rate notes were secured over a portfolio comprising variable rate mortgage loans secured by first charges over residential properties in the United Kingdom. The notes were subject to mandatory redemption in part on each interest payment date in an amount equal to the principal received or recovered in respect of the mortgage. As a result of this structure, cash received in respect of loan assets is not immediately available for distribution. At 30 September 2019, the amount of restricted cash and investments held within the Company was £6,000 (2018: £2,004,000). The maturity date of the notes matched the maturity date of the underlying assets.

The Company had the option to repay all of the notes at an earlier date (the 'call date'), or at any interest payment date thereafter, at the outstanding principal amount.

On 17 June 2019 the Company sold its mortgage loans to a fellow group company and used the proceeds to repay its outstanding asset backed loan notes.

Interest is payable at a fixed margin above:

- the London Interbank Offered Rate ('LIBOR') on notes denominated in sterling;

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

Notes in issue at 30 September 2019 and 30 September 2018 were:

Notes	Maturity date	Call date	Principal outstanding		Note margin	
			2019	2018	2019	2018
			£m	£m		
'A'	Sept 2033	Mar 2011	0.0	9.20	0.24%	0.24%
'B'	Sept 2033	Mar 2011	0.0	1.60	0.36%	0.36%
'C'	Sept 2033	Mar 2011	0.0	1.60	0.56%	0.56%

All of the above notes were listed on the main market of the London Stock Exchange.

There was a subordinated loan facility under which an amount was drawn down by the Company to establish the first loss fund, which was repayable to Paragon Finance PLC and Mortgage Trust Services PLC on the earlier of the last interest payment date in September 2033 or the first day on which there are no notes outstanding, except that on any interest payment date sums borrowed will be repaid to the extent of any amount released from the first loss fund. Interest was payable at the rate of 4% above the London Interbank Offered Rate for three month sterling deposits.

There are no amounts of committed but undrawn facilities at 30 September 2019 and September 2018.

19. ULTIMATE PARENT COMPANY

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

Copies of the Group's financial statements are available from that company's registered office at 51 Homer Road, Solihull, West Midlands, B91 3QJ.