Company Registration No: 06212267

PARAGON MORTGAGES (NO.15) PLC

Report and Financial Statements

Year ended 30 September 2021

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CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report and the Strategic Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of Paragon Mortgages (No.15) PLC. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. These have been made by the directors in good faith using information available up to the date on which they approved this report and the Company undertakes no obligation to update these forward-looking statements other than in accordance with its legal or regulatory obligations (including under the Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority).

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

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

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

STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

Paragon Mortgages (No.15) 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. There have been no significant changes in the Company's principal activities in the year under review.

On 15 December 2020 the Company sold its mortgage loans to a fellow Group company and used the proceeds to repay its outstanding asset backed loan notes.

As shown in the Company's profit and loss account on page 12, the Company's net interest income decreased by 64% compared to the prior year (2020: 6% increase). This was principally reflecting the sale of the Company's loan book on 15 December 2020. The profit after tax has improved from £31,000 to £1,260,000.

The balance sheet on page 13 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 9 and 12.

No interim dividend was paid during the year (2020: £nil). No final dividend is proposed (2020: £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 PBG's Annual Report, which does not form part of this Report.

PRINCIPAL RISKS AND UNCERTAINTIES

The remaining assets and liabilities of the Company are minor monetary assets and liabilities, principally owed to or by fellow Group companies. There are therefore no significant risks or uncertainties relating to the financial position of the Company at the balance sheet date.

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 14, a discussion of critical accounting judgements is set out in note 17 and a discussion of critical accounting estimates is set out in note 18.

FUTURE PROSPECTS

The directors' intention is that the Company will we wound up once its existing assets and liabilities are settled. The accounts have therefore been prepared on the basis that the Company is not a going concern. This is further discussed in note 16.

STRATEGIC REPORT (CONTINUED)

BOARD AND STAKEHOLDERS

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

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

The principal activity of the Company is to support the business objectives of the Group and therefore, there is substantial common identity between the external non-shareholder stakeholders of the Company and those of the Group.

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

However, in considering items of business directors of the Company make autonomous decisions on each decision's own merits, after due consideration of the long-term success of the Company, those factors set out in section 172 of the Companies Act 2006, where relevant, and the stakeholders impacted. Board meetings are held periodically where the directors consider Company business, such as Company results, funding arrangements and dividend payments.

The Board considers and discusses information from across the organisation to help it understand the Group's business and its impact on the Company. It also reviews strategy, financial, and operational performance, as well as information covering areas such as key risks and legal and regulatory compliance.

SHAREHOLDERS

The Company is a wholly owned subsidiary of PBG, the ultimate parent company of the Group. However, the transaction documents limit this entity to a nominal interest in the risks and rewards of the business of the Company. The interests of the Company's shareholders thus coincide with those of the shareholders of the Group (s172 (1)(f)).

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 Paragon Banking Group PLC Annual Report, which does not form part of this Report. Further information can also be found in the Group's inaugural Responsible Business Report (published on the Paragon Banking Group PLC website).

EMPLOYEES

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

Approved by the Board of Directors

and signed on behalf of the Board

K G Allen

Director

17 February 2022

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 Mortgages (No.15) PLC, a company registered in England and Wales with registration no: 06212267, for the year ended 30 September 2021.

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 (resigned 3 February 2021)

R J Woodman

K G Allen

J P Giles

P H Whitaker

AUDITOR

The directors have taken all necessary steps to make themselves and the Company's auditor 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 are unaware.

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

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 14 to the accounts
- Disclosure on any dividends paid during the year is included in the Strategic Report

DIRECTORS' REPORT (CONTINUED)

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

K G Allen
Director
17 February 2022
Registered Office: 51 Homer Road, Solihull, West Midlands, B91 3QJ

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

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

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

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

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

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

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

K G Allen

Director

17 February 2022

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF PARAGON MORTGAGES (NO.15) PLC

Opinion

We have audited the Financial Statements of Paragon Mortgages (No.15) PLC for the year ended 30 September 2021 which comprise the profit and loss account, statement of comprehensive income, the balance sheet, statement of movement in equity and the related notes 1 to 19, including the accounting policies in note 16.

In our opinion the Financial Statements:

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

Basis for opinion

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

Emphasis of matter - non-going concern basis of preparation

We draw attention to the disclosure made in note 16 to the financial statements which explains that the financial statements have not been prepared on the going concern basis for the reasons set out in that note. Our opinion is not modified in respect of this matter.

Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

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

Our risk assessment procedures included:

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

Using analytical procedures to identify any unusual or unexpected relationships.

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

As required by auditing standards and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that Company management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements such as loan loss provisioning.

We also performed procedures including:

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

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

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

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

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

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

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

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

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

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

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

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

Strategic report and directors' report

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

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

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

Matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 7 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.

M Davidson

Michael Davidson (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

1 Sovereign Square

Sovereign Street

Leeds

LS1 4DA

17 February 2022

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2021

	Note	2021 £000	2020 £000
Interest receivable			
Mortgages		2,016	12,438
Other		4	121
		2,020	12,559
Interest payable and similar charges	2	165	(6,539)
Net interest income		2,185	6,020
Other operating income		8	40
Total operating income		2,193	6,060
Operating expenses		(140)	(4,621)
Provisions for losses	7	(497)	(1,439)
Operating profit, being profit on ordinary activities before taxation	4	1,556	-
Tax on profit on ordinary activities	5	(296)	31
Profit on ordinary activities after taxation		1,260	31

Interest receivable arises from financial assets held at amortised cost.

STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED 30 SEPTEMBER 2021

	2021 £000	2020 £000
Profit for the year	1,260	31
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss		
Cash flow hedge (loss) / profit taken to equity	(1,537)	81
Tax on items taken directly to equity	293	(45)
Other comprehensive income for the year net of tax	(1,244)	36
Total comprehensive income for the year	16	67

BALANCE SHEET

30 SEPTEMBER 2021

	Note	2021 £000	2021 £000	2020 £000	2020 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Financial assets	6		-		724,939
CURRENT ASSETS					
Debtors falling due within one year	9	23		27	
Cash at bank		-		23,076	
			23		23,103
			23		748,042
FINANCED BY					
EQUITY SHAREHOLDERS' FUNDS					
Called up share capital	11	12		12	
Cash flow hedging reserve		-		1,244	
Profit and loss account		5		(1,255)	
			17		1
PROVISIONS FOR LIABILITIES	10		-		-
CREDITORS					
Amounts falling due within one year	12	6		10,527	
Amounts falling due after more than one year	12	-		737,514	
			6		748,041
			23		748,042

These Financial Statements were approved by the Board of Directors on 17 February 2022.

Signed on behalf of the Board of Directors

K G Allen

Director

STATEMENT OF MOVEMENTS IN EQUITY

YEAR ENDED 30 SEPTEMBER 2021

	Share capital £000	Cash flow hedging reserve £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year				
Profit for the year	-	-	1,260	1,260
Other comprehensive income	-	(1,244)	-	(1,244)
Total comprehensive income for the year	-	(1,244)	1,260	16
Opening equity	12	1,244	(1,255)	1
Closing equity	12	-	5	17

YEAR ENDED 30 SEPTEMBER 2020

	Share capital £000	Cash flow hedging reserve £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year				
Profit for the year	-	-	31	31
Other comprehensive income	-	36	-	36
Total comprehensive income for the year	-	36	31	67
Opening equity	12	1,208	(1,286)	(66)
Closing equity	12	1,244	(1,255)	1

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2021

1. GENERAL INFORMATION

Paragon Mortgages (No.15) 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 06212267. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Company's operations and its principal activities are set out in the Strategic Report.

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

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

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

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

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

2. INTEREST PAYABLE AND SIMILAR CHARGES

	2021 £000	2020 £000
Asset backed loan notes	(412)	5,241
Subordinated loan interest	88	433
Interest payable to group companies	159	865
	(165)	6,539

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

3. DIRECTORS AND EMPLOYEES

Directors' fees from the Company during the year is stated in note 4.

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 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.

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

	2021 £000	2020 £000
Operating profit is after charging / (receiving):		
Directors' fees	1	1
Auditor remuneration - audit services	5	11
Deferred purchase consideration	(122)	2,974

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

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

5. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge / (credit) for the year

	2021 £000	2020 £000
Current tax		
Corporation tax	-	-
Total current tax	-	-
Deferred tax (note 10)		
Origination and reversal of timing differences	296	-
Rate change	-	(31)
Total deferred tax	296	(31)
Tax charge / (credit) on profit on ordinary activities	296	(31)

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

	2021 £000	2020 £000
Profit before tax	1,556	-
UK corporation tax at 19% (2020: 19%) based on the loss for the year	296	-
Effects of:		
Change in rate of taxation on deferred tax balances	-	(31)
Tax charge / (credit) for the year	296	(31)

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

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

6. FINANCIAL ASSETS

	2021 £000	2020 £000
Loans to customers (note 7)	-	526,592
Derivative financial assets (note 8)	-	198,347
	-	724,939

7. 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 6, 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').

The Company's process for determining its provisions for impairments is summarised below. This includes:

- The methods used for the calculation of ECL
- How it defines SICR
- How it defines default
- How it identifies which loans are credit impaired, as defined by IFRS 9
- How the ECL estimation process is monitored and controlled
- How the Group develops and enhances the models it uses in the ECL estimation process
- How the Group uses Post Model Adjustments ('PMA's) to ensure all elements of credit risk are fully addressed

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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.

In extreme or unprecedented economic conditions, such as the Covid pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. In these circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2021 the impact of reduced economic activity in the UK from the Covid crisis had not yet been evidenced in customer credit performance and defaults, due to the lagging effect of government policy interventions. Where customers were given payment reliefs, arrears and adverse credit indicators were not recorded by the Company or other lenders, meaning that both internal credit metrics and external credit bureau data might not accurately reflect the customer's credit position leading to modelled PDs being underestimated.

During the year the trend of economic performance has been generally upward, albeit from a low level, meaning that the principal economic indicators are more positive than at 30 September 2020, though still more depressed than pre-Covid levels. The economic forecasts indicate continued recovery, but this upward trend will reduce calculated probabilities of default, even where the absolute levels of metrics remain low and where an underlying credit issues on account have not emerged, which may result in rising defaults as government support initiatives unwind.

These factors have led management to conclude that in the current economic conditions, the Group's models do not fully represent loss expectations, and Post Model Adjustments ('PMA's) have been made to compensate for these weaknesses.

7. 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.

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

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

When reviewing the subsequent payment patterns of accounts that have been granted Covid-related reliefs, it has been evident that there is higher payment volatility (both in terms of account improvement and deterioration) in these cases, particularly in cases where an extension to the payment holiday has been granted. This indicates an increased credit risk, though the impact is not significant in scale in all cases. As a result of this analysis the accounts of customers who have been granted extended payment reliefs have been placed in Stage 2, regardless of other indicators. This aligns the Group's approach to regulatory guidance which suggested that while initial payment reliefs should not automatically be taken as an indication of an SICR, an extension to such a relief was more likely to be so.

This overall approach remains consistent with that taken at 30 September 2020. In reviewing account performance during the current year the Group has not yet identified any positive evidence which would cause it to begin to unwind this position. It will be reviewed going forward as other government economic interventions are scaled back and the post-relief credit characteristics of such accounts become more evident.

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.

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Definitions of default (continued)

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.

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

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

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 90 days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between probationary accounts, receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired. While other indicators of default are in use, the categories shown account for the overwhelming majority of Stage 3 cases.

Monitoring of ECL estimation processes

The Group's ECL models are compiled on the basis of the analysis of relevant historical data. Before a model is adopted for use its operations and outputs are examined to ensure that it is expected to be appropriately predictive and, if it is an updated model, expected to be more predictive than any existing model. Before a new model is adopted the changes and impacts will be considered by the CFO, alongside any advice from the Group's independent model review functions.

The performance of all models is reviewed on an ongoing basis, by senior finance and risk management, including the CFO. Monitoring packs comparing actual and predicted loss levels are produced at regular intervals, set on the basis of the materiality of each model. The continuing appropriateness of model assumptions is also reviewed as part of this process.

Models are revisited on a regular basis to ensure that they continue to reflect the most recent data as the available information increases over time.

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YEAR ENDED 30 SEPTEMBER 2021

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Monitoring of ECL estimation processes (continued)

On a monthly basis all model outputs, model overlays and provisions calculated for non-modelled books are reviewed by senior finance management including the CFO in conjunction with the latest credit risk operational and economic metrics to ensure that the impairment provision by assets type remains appropriate. This exercise will be the subject of particular focus at year end and half year.

This information is summarised for the Audit Committee on a biannual basis, and they have regard to this data in forming their conclusions on the appropriateness of provisioning levels.

Model development

The models used by the Group are updated from time to time to allow for changes in the business, developments in best practice and the availability of additional data with the passing of time. During the year ended 30 September 2021 a major update to the buy-to-let PD model took place.

All revised models and model enhancements are carefully reviewed and tested before adoption, and are subject to a governance process for their approval.

As a result of the reanalysis of updated historical data, the economic inputs identified as most predictive of future PD performance were changed, with the UK unemployment rate being substituted for UK GDP in the model as the indicator of general UK economic activity levels.

The impacts of the adoption of the new PD model on the calculated provision were not significant

Post Model Adjustments ('PMA's)

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, PMAs are applied to the modelled outputs so that the ECL recognised corresponds expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process.

In normal circumstances the Group's objective is to develop its modelling to the point where the level of PMAs required is minimal, but in economic conditions where previous relevant experience is limit or non-existent, as with Covid, some form of PMA is always likely to be necessary.

The current model behaviour and the potential for unobserved credit issues have meant that the requirement for such adjustments at 30 September 2021 was significant. Evidence considered by management included internal performance data, customer feedback, evidence on the wider economy and quantitative and qualitative and quantitative data and statements from industry, government and regulatory bodies. These were combined to form a broad estimate of the level of provision required across the Group.

Other than the behaviour of extended payment relief cases noted above, this analysis found no evidence of particular concentrations of credit risk below portfolio level. Given this and the high level nature of the PMA exercise the PMAs have been allocated on a broad brush basis to individual cases.

The Company will continue to monitor the requirement for these PMAs as the economic situation develops and the impact of government interventions recedes.

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Impairments by Stage

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages.

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

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 2021				
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
30 September 2020				
Gross loan book	453,812	64,678	11,520	530,010
Impairment provision	(264)	(1,112)	(2,042)	(3,418)
Net loan book	453,548	63,566	9,478	526,592
Coverage ratio	0.06%	1.72%	17.73%	0.64%

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

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.

NOTES TO THE ACCOUNTS - ANALYSIS

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7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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.

Cases which have been greater than one month in arrears in the last three months, but which are not at the balance sheet date are shown as 'recent arrears' in the tables below.

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£000	£000	£000	£000
30 September 2021				
Gross loan book	-	-	-	-
Impairment provision	-	-	-	-
Net loan book	-	-	-	-
Coverage ratio	0.00%	0.00%	0.00%	0.00%
30 September 2020				
Gross loan book	62,866	-	1,812	64,678
Impairment provision	(1,091)	-	(21)	(1,112)
Net loan book	61,775	-	1,791	63,566
Coverage ratio	1.73%	0.00%	1.16%	1.72%

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between those:

- In the process of sale or other enforcement procedures ('Realisations')
- Where a receiver of rent ('RoR') has been appointed by the Company to manage the property on the customer's behalf
- Which are being managed on a long-term basis and where full recovery possible, but which are considered to meet regulatory default criteria at the balance sheet date ('>3 month arrears')
- Which no longer meet regulatory default criteria, but which are being retained in Stage 3 for a probationary period ('Probation')
- These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

In these disclosures probation accounts have been analysed separately for the first time, in order to provide better information for users.

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.

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£000	£000	£000	£000	£000
30 September 2021					
Gross loan book	-	-	-	-	-
Impairment provision	-	-	-	-	-
Net loan book	-	-	-	-	-
Coverage ratio	0.00%	0.00%	0.00%	0.00%	0.00%
30 September 2020					
Gross loan book	-	1,590	7,981	1,949	11,520
Impairment provision	-	(102)	(1,437)	(503)	(2,042)
Net loan book	-	1,488	6,544	1,446	9,478
Coverage ratio	0.00%	6.42%	18.01%	25.81%	17.73%

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The exposure at default in the calculation shown above for stage 3 accounts is reduced by £nil (2020: £7,222,000) 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.

Movements in impairment provision by stage

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

	2021	2020
	£000	£000
At 1 October 2020	3,418	2,541
Provided in period	1,137	1,623
Assets derecognised	(3,987)	-
Amounts written off	(568)	(746)
At 30 September 2021	-	3,418

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 2021 enforceable contractual balances of £nil (2020: £58,000) 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.

These tables, and the matching tables analysing movements in gross balances, have been compiled by comparing opening and closing balances on each account and analysing the movements between them.

Changes due to credit risk includes all changes in model parameters whether related to account performance, external credit data or model assumptions, including economic scenarios and weightings.

There have been no changes in models creating significant movements in balances in the period.

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the year ended 30 September 2021 and 30 September 2020 is set out below.

	Stage 1 £000	Stage 2 * £000	Stage 3 * £000	Total £000
Loss allowance at 1 October 2020	264	1,112	2,042	3,418
New assets originated or purchased	-	-	-	-
Changes in loss allowance				
Transfer to stage 1	36	(36)	-	-
Transfer to stage 2	(16)	16	-	-
Transfer to stage 3	-	-	-	-
Change on stage transfer	(4)	58	-	54
Changes due to credit risk	441	(104)	746	1,083
Write offs	-	-	(568)	(568)
Assets derecognised	(721)	(1,046)	(2,220)	(3,987)
Loss allowance at 30 September 2021	-	-	-	-
Loss allowance at 1 October 2019	23	409	2,109	2,541
New assets originated or purchased	-	-	-	-
Changes in loss allowance				
Transfer to stage 1	54	(54)	-	-
Transfer to stage 2	(6)	10	(4)	-
Transfer to stage 3	-	(4)	4	-
Change on stage transfer	(24)	548	100	624
Changes due to credit risk	217	203	579	999
Write offs	-	-	(746)	(746)
Assets recognised	-	-	-	-
Loss allowance at 30 September 2020	264	1,112	2,042	3,418

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

7. 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	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
Balances at 1 October 2020	453,812	64,678	11,520	530,010
New assets originated or purchased	-	-	-	-
Changes in staging				
Transfer to stage 1	5,463	(5,301)	(162)	-
Transfer to stage 2	(6,533)	6,823	(290)	-
Transfer to stage 3	-	(60)	60	-
Redemptions and repayments	(5,884)	(1,095)	85	(6,894)
Assets derecognised	(440,751)	(64,066)	(10,531)	(515,348)
Write offs	-	-	(568)	(568)
Other changes	(6,107)	(979)	(114)	(7,200)
Balance at 30 September 2021	-	-	-	-
Loss allowance	-	-	-	-
Carrying value	-	-	-	-
Balances at 1 October 2019	507,193	47,049	11,818	566,060
New assets originated or purchased	-	-	-	-
Changes in staging				
Transfer to stage 1	22,807	(22,737)	(70)	-
Transfer to stage 2	(42,131)	42,280	(149)	-
Transfer to stage 3	(857)	(1,131)	1,988	-
Redemptions and repayments	(31,345)	(994)	(1,276)	(33,615)
Assets derecognised	-	-	-	-
Write offs	-	-	(746)	(746)
Other changes	(1,855)	211	(45)	(1,689)
Balance at 30 September 2020	453,812	64,678	11,520	530,010
Loss allowance	(264)	(1,112)	(2,042)	(3,418)
Carrying value	453,548	63,566	9,478	526,592

7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Impairments charged to income

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

	2021	2020
	£000	£000
(Released) / provided in period	(71)	693
Written off amounts	568	746
	497	1,439

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.

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 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max	Min	Max	Min	Max	Min	Max	Min
	%	%	%	%	%	%	%	%
Economic driver								
GDP	11.5	1.1	13.3	1.6	7.3	0.9	14.3	(5.9)
HPI	6.1	(4.0)	7.7	0.6	2.9	(9.8)	2.4	(16.9)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	4.0	1.8	3.8	1.8	4.5	1.8	2.0	0.2
Unemployment	5.5	4.1	4.7	3.8	5.9	4.5	11.9	4.8
Secured lending	4.8	3.0	5.5	3.5	4.0	2.5	3.1	(2.5)
Consumer credit	6.4	0.4	8.5	1.9	4.6	(0.1)	9.2	(8.9)

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7. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

30 September 2020

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	18.0	(7.6)	18.8	(5.9)	17.8	(15.1)	20.5	(17.9)
HPI	5.0	(4.0)	4.0	0.0	4.0	(10.0)	4.0	(20.0)
BBR	0.8	0.1	1.0	0.1	1.0	0.1	0.8	(0.4)
CPI	2.4	0.6	2.3	0.7	2.3	0.2	2.3	(0.3)
Unemployment	7.6	4.0	7.0	4.0	9.0	4.5	9.0	5.3
Secured lending	3.9	3.5	4.8	4.0	3.8	1.7	3.7	(1.2)
Consumer credit	6.3	6.0	8.8	6.7	5.7	1.5	4.8	(5.2)

8. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

The Company used derivative financial instruments such as cross-currency basis swaps for risk management purposes only. Each such derivative contract was entered into for economic hedging purposes to manage a particular identified risk (as described in note 14) and any gains or losses arising were incidental to this objective. No trading in derivative financial instruments is undertaken.

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

The Company's hedging arrangements were cash flow hedges, which were used to manage the foreign exchange and interest rate basis risk inherent in its currency borrowings.

The analysis below shows the cash flow hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2021 or the preceding year.

8. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

	2021 Assets £000	2021 Liabilities £000	2020 Assets £000	2020 Liabilities £000
Derivatives in accounting hedge relationships				
Cash flow hedges				
Cross-currency basis swaps				
Dollar-sterling	-	-	141,727	-
Euro-sterling	-	-	56,620	-
Total recognised derivative assets / (liabilities)	-	-	198,347	-

The credit risk inherent in the derivative financial assets shown above is discussed in note 14.

Cash flow hedging

Background and hedging objectives

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

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

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

The effect of these swaps was to translate the required currency payments, both of principal and interest to sterling payments, based on a fixed rate of exchange. They also translate the reference rate of interest on the notes from a dollar or euro London Interbank Offered Rate (LIBOR) basis to a sterling LIBOR basis. This effectively eliminated the foreign exchange and interest rate basis risks with respect to these instruments.

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

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

8. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Hedging instruments

Under these swap agreements

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

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

	2021		2020	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Average fixed exchange rate	-	-	1.47	2.03
Average margin over LIBOR on interest payable (bp)	-	-	0.21%	0.32%
Average margin over US dollar LIBOR / EURIBOR on interest receivable (bp)	-	-	0.19%	0.72%
Notional Principal value (£000)	-	-	247,532	165,671
Fair value (£000)	-	-	141,727	56,620
Average remaining term (years)	-	-	19	19

The current long term credit rating of the swap counterparty issued by Fitch ratings is A+ (2020: A+) and £nil (2020: £nil) of collateral has been posted. This collateral is not included in the company's balance sheet.

8. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

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

In normal conditions the market values of such swaps would be expected to be relatively small. However, the majority of such swaps in the Company date from before the 2008 credit crisis, when a major dislocation in rates occurred, creating significant market value in the instruments. However, economically, this is offset by the corresponding increase in the carrying value of the currency denominated notes.

Sources of potential ineffectiveness

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

In respect of credit risk the hedging instruments are partially collateralised, with additional collateral conditionally available, as described in note 14. This generates a small potential credit valuation adjustment associated with the derivative asset representing the credit risk of the receivable future cash flows that make up the derivative fair value. However, IAS 39 requires that Other Comprehensive Income ('OCI') is adjusted by the lower of the cumulative gain or loss on the derivative or the hedged item (as proxied by a hypothetical derivative). As the derivative bears credit risk of the counterparty (for the uncollateralised portion) it has a lower fair value than the hypothetical derivative. The result is that the full fair value of the derivative is taken to OCI as it is the lower of the two amounts and no ineffectiveness arises.

Accounting impacts

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

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YEAR ENDED 30 SEPTEMBER 2021

8. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

	2021		2020	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Hedging Items				
Cross-currency basis swaps				
Included in derivative financial assets	-	-	141,727	56,620
Included in derivative financial liabilities	-	-	-	-
	-	-	141,727	56,620
Notional principal value	-	-	247,532	165,671
Change in fair value used in calculating hedge ineffectiveness	13,568	648	17,357	712
Hedged Items				
Floating rate notes				
Included in Asset Backed Loan Notes	-	-	247,532	165,671
Changes in fair value used in calculating hedge ineffectiveness	13,568	648	17,357	712
Cash flow hedging reserve	-	-	573	963

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

	2021 £000	2020 £000
Change of value in hedging instrument recognised in cash flow hedge reserve		
US Dollars swaps	(13,568)	17,357
Euro swaps	(648)	712
	(14,216)	18,069
Amount reclassified from cash flow hedge reserve to profit, recognised as foreign exchange differences and interest on asset backed loan notes within interest payable		
US Dollars swaps	(12,995)	17,336
Euro swaps	315	814
	(12,680)	18,150
Net amount recognised in Other Comprehensive Income before tax	(1,536)	81

All amounts reclassified to profit have been transferred because the hedged item has affected profit or loss.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

9. DEBTORS

	2021 £000	2020 £000
Amounts falling due within one year:		
Amounts due from group companies	23	12
Deferred tax (note 10)	-	3
Prepayments and accrued income	-	12
	23	27

10. DEFERRED TAX

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

	2021 £000	2020 £000
Balance at 1 October 2020	3	17
Charge to equity	293	(45)
Rate change (note 5)	(296)	31
Change in accounting policy on adoption of IFRS9	-	-
Balance at 30 September 2021	-	3
The net deferred tax asset / (liability) for which provision has been made is analysed as follows:		
Other timing differences	-	3

11. CALLED UP SHARE CAPITAL

	2021 £	2020 £
Allotted:		
49,998 ordinary shares of £1 each (25p called up and paid)	12,500	12,500
2 ordinary shares of £1 each (fully paid)	2	2
	12,502	12,502

12. CREDITORS

	2021 £000	2020 £000
Amounts falling due within one year:		
Amounts due to group companies	-	9,163
Accruals and deferred income	6	1,364
	6	10,527

Included with the accruals and deferred income balance is an amount of £nil (2020: £165,000) due to fellow subsidiaries of Paragon Banking Group PLC.

	2021 £000	2020 £000
Amounts falling due after more than one year:		
Asset backed loan notes	-	521,681
Asset backed loan notes – fair value adjustment	-	196,811
	-	718,492
Intercompany subordinated loan	-	19,022
	-	737,514

The Company's securitisation borrowings were denominated in sterling, US dollars and euros. All currency borrowings were swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This was currently the case with all foreign currency swaps, although the credit balance is compensated for by retranslating the borrowings at the current exchange rate. A maturity analysis and further details of the asset backed loan notes are given in note 13.

13. 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 are 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 2021, the amount of restricted cash and investments held within the Company was £nil (2020: £23,076,000). The maturity date of the notes matches the maturity date of the underlying assets. It is likely that a substantial proportion of these notes will be repaid within five years.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2021

13. BORROWINGS (CONTINUED)

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 15 December 2020 the Company sold its mortgage loans to a fellow group company and used the proceeds to repay its outstanding asset backed loan notes.

Interest was payable at a fixed margin above:

- the London Interbank Offered Rate ('LIBOR') on notes denominated in sterling;
- the London Interbank Offered Rate ('US Dollar LIBOR') on notes denominated in US dollars; and
- the Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros.

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

Notes in issue at 30 September 2021 and 30 September 2020 were:

Notes	Maturity date	Call date	Principal outstanding 2021	Principal outstanding 2020	Note margin 2021	Note margin 2020
			£m	£m		
'A2a'	Dec 2039	Jun 2011	-	91.5	0.26%	0.26%
'B1a'	Dec 2039	Jun 2011	-	17.0	0.54%	0.54%
			$m	$m		
'A1'	Dec 2039	Jun 2011	-	436.6	0.18%	0.18%
'A2c'	Dec 2039	Jun 2011	-	65.5	0.22%	0.22%
			€m	€m		
'A2b'	Dec 2039	Jun 2011	-	48.0	0.24%	0.24%
'B1b'	Dec 2039	Jun 2011	-	85.5	0.54%	0.54%
'C1b'	Dec 2039	Jun 2011	-	110.5	1.10%	1.10%

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 December 2039 or the first day on which there were no notes outstanding, except that on any Interest Payment Date sums borrowed would 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 were no amounts of committed but undrawn facilities at 30 September 2021 and 30 September 2020.

NOTES TO THE ACCOUNTS – FINANCIAL RISK

YEAR ENDED 30 SEPTEMBER 2021

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

14. 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 and used derivative financial instruments to hedge interest rate risk arising from fixed rate lending. In addition, various financial instruments, for example debtors and accruals, arose 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 reviewed and agreed 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 2021 approximated to the carrying value of loans to customers (note 7). 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 had the benefit of a mortgage guarantee indemnity insurance policy.

At 30 September 2020 65.7% of the Company's mortgage loans by value had a loan-to-value ('LTV') ratio of 70% or less. The weighted average LTV was 65.5%. LTV for each account was calculated by comparing the current balance to the most recent valuation of the mortgaged property, indexed as appropriate.

Paragon Finance PLC and Mortgages Trust Services PLC, fellow group companies, continued to administer the mortgages on behalf of Paragon Mortgages (No.15) 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 determined on a group basis, which counterparties the group of companies would deal with, established limits for each counterparty and monitored compliance with those limits.

The terms of the debt issue required that the companies cash balances were held at institutions with a credit rating greater than P-1 by Moody's and/or A-1 by Standard and Poors and/or F1 by Fitch Ratings.

NOTES TO THE ACCOUNTS – FINANCIAL RISK

YEAR ENDED 30 SEPTEMBER 2021

14. FINANCIAL RISK MANAGEMENT (CONTINUED)

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 12 and 13. 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.

Interest rate risk

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

The rates payable on the asset backed loan notes issued by the Company were reset quarterly on the basis of LIBOR, USD LIBOR or EURIBOR. The Company's assets predominantly bore LIBOR linked interest rates or were hedged fixed rate assets. 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 was relatively short term.

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

Currency risk

All of the Company's assets and liabilities were denominated in sterling with the exception of the asset backed loan notes denominated in euros and US dollars, described in note 13. Although IAS 39 required that they be accounted for as currency liabilities and valued at their spot rates, it was a condition of the issue of these notes that the interest rate and currency swaps were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing. As a result the Company had no material exposure to foreign currency risk.

The equivalent sterling principal amounts of notes in issue under these arrangements, and their carrying values at 30 September 2021 and 30 September 2020 are:

	2021 Equivalent sterling principal £000	2021 Carrying value £000	2020 Equivalent sterling principal £000	2020 Carrying value £000
US dollar notes	-	-	247,532	388,713
Euro notes	-	-	165,671	221,388

14. FINANCIAL RISK MANAGEMENT (CONTINUED)

Use of derivative financial instruments

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

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

The Company had also designated cash flow hedging relationships, principally arising from currency borrowings, where a specified foreign exchange basis swap, set up as part of the terms of the borrowing was used.

Fair values of financial assets and financial liabilities

Derivative financial instruments were stated at their fair values in the accounts. The Group used a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets were not available. These were principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate. The principal inputs to these valuation models were LIBOR benchmark interest rates for the currencies in which the instruments were denominated, sterling, euros and dollars. The cross currency basis swaps had a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affected the valuation of the swaps. In order to determine the fair values the management applied valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviewed the models used on an ongoing basis to ensure that the valuations produced were reasonable and reflected all relevant factors. Details of these assets are given in note 8.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2021

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

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

15. BASIS OF PREPARATION

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

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

The "requirements of the Companies Act 2006" here means accounts being prepared in accordance with "international accounting standards" as defined in section 474(1) of that Act, as it applied immediately before IP Completion Day (the end of the UK's transition period) ('IPCD'), including where the Company also makes use of standards which have been adopted for use within the United Kingdom in accordance with regulation 1(5) of the International Accounting Standards and European Public Limited Liability Company (Amendment etc.) (EU Exit) Regulations 2019, subsequent to the IPCD.
Under the Listing Rules of the FCA, despite the UK's exit from the EU on 31 January 2020, the EU endorsed IFRS regime remains applicable to the Company until its first financial year commencing after the IPCD on 31 December 2020.

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

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

Adoption of new and revised reporting standards

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

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

15. BASIS OF PREPARATION (CONTINUED)

Adoption of new and revised reporting standards (continued)

IAS 39 amendments 'Interest Rate Benchmark Reform'

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

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

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

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

Standards not yet adopted

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

16. 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 15 December 2020, 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.

16. ACCOUNTING POLICIES (CONTINUED)

Loans to customers

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

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

Impairment of loans and receivables

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.

16. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables (continued)

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.

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.

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.

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.

16. ACCOUNTING POLICIES (CONTINUED)

Derivative financial instruments

Derivative instruments utilised by the Company comprise currency swaps and 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 14).

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 – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2021

16. ACCOUNTING POLICIES (CONTINUED)

Revenue

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

Fee and commission income

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

Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with International Accounting Standard 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company is pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of the transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with cash flow hedging provisions of IAS 39.

Deferred purchase consideration

Under the Mortgage sale agreement profits from the Company 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.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2021

16. 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 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.

17. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 16 relate to:

Significant Increase in Credit Risk ('SICR')

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

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

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

More information on the definition of SICR adopted is given in note 7.

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 7.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2021

17. CRITICAL ACCOUNTING JUDGEMENTS (CONTINUED)

Classification of financial assets

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

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

18. 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.

18. 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.

Fair values

Where financial assets and liabilities are carried at fair value, in the majority of cases this can be derived by reference to quoted market prices. Where such a quoted price is not available the valuation is based on cash flow models, based, where possible on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

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.