ARBUTHNOT BANKING GROUP PLC

Annual Report & Accounts 2019

The importance of history and Sun Tzu

The importance of previous experience cannot be overstated. "Those who are not willing to learn from history are doomed to repeat the mistakes of previous generations."

A good place to start, therefore, is with the famous Chinese General, Sun Tzu and his writings in "The Art of War" c. 2500 years ago. He established some basic truths such as:

"He whose ranks are united in purpose will be victorious."

"The commander will surely choose those who are most fortunate."

"The traits of a true commander are: courage, wisdom, humanity and integrity."

Origins of Arbuthnot Latham

George Arbuthnot (1772 – 1843) was a son of the Edinburgh banker Robert Arbuthnot. He started in 1803 as a partner in Latour & Co. in Madras (today Chennai), Southern India. Latour & Co. had been set up in 1780 by Count Francis Joseph Louis Latour de Quercy, who died in 1808. In 1807 Latour & Co. became Arbuthnot & Co. and George Arbuthnot became the leading partner until he retired in 1824. In his farewell letter to the partners he said:

"…not only give the constituent (client) the assurance that his money is safe, but also give him the feeling that he is benefitting himself by dealing with the House."

In 1826 John Alves Arbuthnot started as a clerk at Arbuthnot & Co. and in 1831 became a partner. He married the daughter of George Arbuthnot. Upon his return to London he established, together with Alfred Latham, the trading house Arbuthnot & Latham on 13 March 1833.

(For more details, read the book: Arbuthnot Latham 1833 – 2013 by David Lascelles)

Arbuthnot Banking Group PLC

The Seven Principles

Ever since George Arbuthnot first gave guidance about corporate behaviour, it has been the culture of Arbuthnot to follow his advice. The Seven Principles summarise Arbuthnot's corporate philosophy and ethics.

During the 187 year history of serving its customers, Arbuthnot has proven its ability to adopt and grow by applying such principles with pragmatism and common sense.

1. Arbuthnot serves its **shareholders**, its **customers** and its **employees** with **integrity** and **high ethical standards**. This is demonstrated in a **progressive dividend** policy, in **fair pricing** and in **pay for performance**.

2. Arbuthnot attaches great importance to **good relations** with customers and business partners, and treating them **fairly and promptly**. Arbuthnot believes in **reciprocity**.

3. Arbuthnot is **independent, and profit and growth oriented** while maintaining a **controlled risk profile**.

4. Arbuthnot's business is conducted in an **innovative, flexible** and **entrepreneurial** manner, with an **opportunistic** and **counter-cyclical** attitude.

5. Arbuthnot's approach is based on **diversification** to spread the risk, a **long-term view** to further growth, **empowerment of management** and a culture of **rewards for achievements** to engender loyalty.

6. Arbuthnot does not sacrifice **long term prospects** for short term gains – nor sacrifice **stability** for quick profits, and it will never put the whole company at **risk**.

7. Ultimately, the success of Arbuthnot depends on the **teamwork, commitment**, and **performance** of its employees, combined with the **determination** to win.

The continued application of these principles will allow the business to pursue growth in a controlled manner, providing a high quality service to its customers, whilst delivering good returns to shareholders and securing the well-being of its employees.
To this end, an inclusive and balanced work environment will provide a rewarding as well as challenging multiformity.

Sir Henry Angest
Chairman & CEO

26 March 2020

Business Overview

ARBUTHNOT LATHAM
Private Bankers
Since 1833

ARBUTHNOT
COMMERCIAL BANKING

Private Banking

Arbuthnot Latham provides a high quality private banking and wealth management service, consisting of three core elements:

Private Banking
Comprises current accounts, deposit accounts, loans, overdrafts and foreign exchange. Each client deals with a dedicated Private Banker who is key to providing an individual service.

Financial Planning
Built on long-term relationships and bespoke financial strategies. The service is independent and fee, not commission based.

Investment Management
Comprises asset management, developing tailored investment strategies to ensure that each client's specific investment objectives are met.

Commercial Banking

Arbuthnot Latham provides a bespoke commercial banking service which includes:

Banking
Comprising current accounts, deposits, overdrafts, guarantees and charge cards. Clients have a dedicated Banker who is key to managing the relationship.

Property Finance
Comprises tailored lending to enable funding of both property investments and developments.

Other finance
Comprises individual secured lending which is designed around the needs of each commercial client.

RENAISSANCE
ASSET FINANCE

Asset Finance
Provides asset finance funding in particular for high value and classic cars but also business assets.

ARBUTHNOT
COMMERCIAL
Asset-Based Lending

Asset Based Lending
Provides finance secured on either invoices, assets or stock of the borrower.

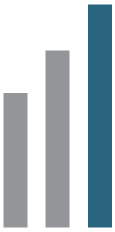
ARBUTHNOT
SPECIALIST FINANCE

Specialist Finance
Provides short term secured lending solutions to professional and entrepreneurial property investors.

ARBUTHNOT
DIRECT

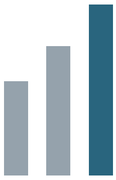
Deposits
Provides deposit products directly to the retail market via a newly created internet platform, with rates advertised on the best buy tables.

Financial Highlights



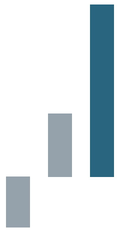
2019
£72.5m
2018
£68.0m
2017
£54.6m

Operating income from continuing operations



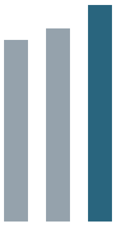
2019
£5.8m
2018
£4.4m
2017
£3.2m

Underlying profit before tax from continuing operations



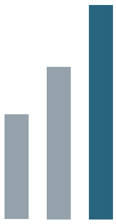
2019
£7.0m
2018
£6.8m
2017
£2.5m

Profit before tax from continuing operations



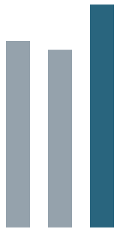
2019
37.0p
2018
35.0p
2017
33.0p

Total ordinary dividend per share



2019
£2.60bn
2018
£2.18bn
2017
£1.85bn

Total assets



2019
£214.5m
2018
£178.6m
2017
£171.7m

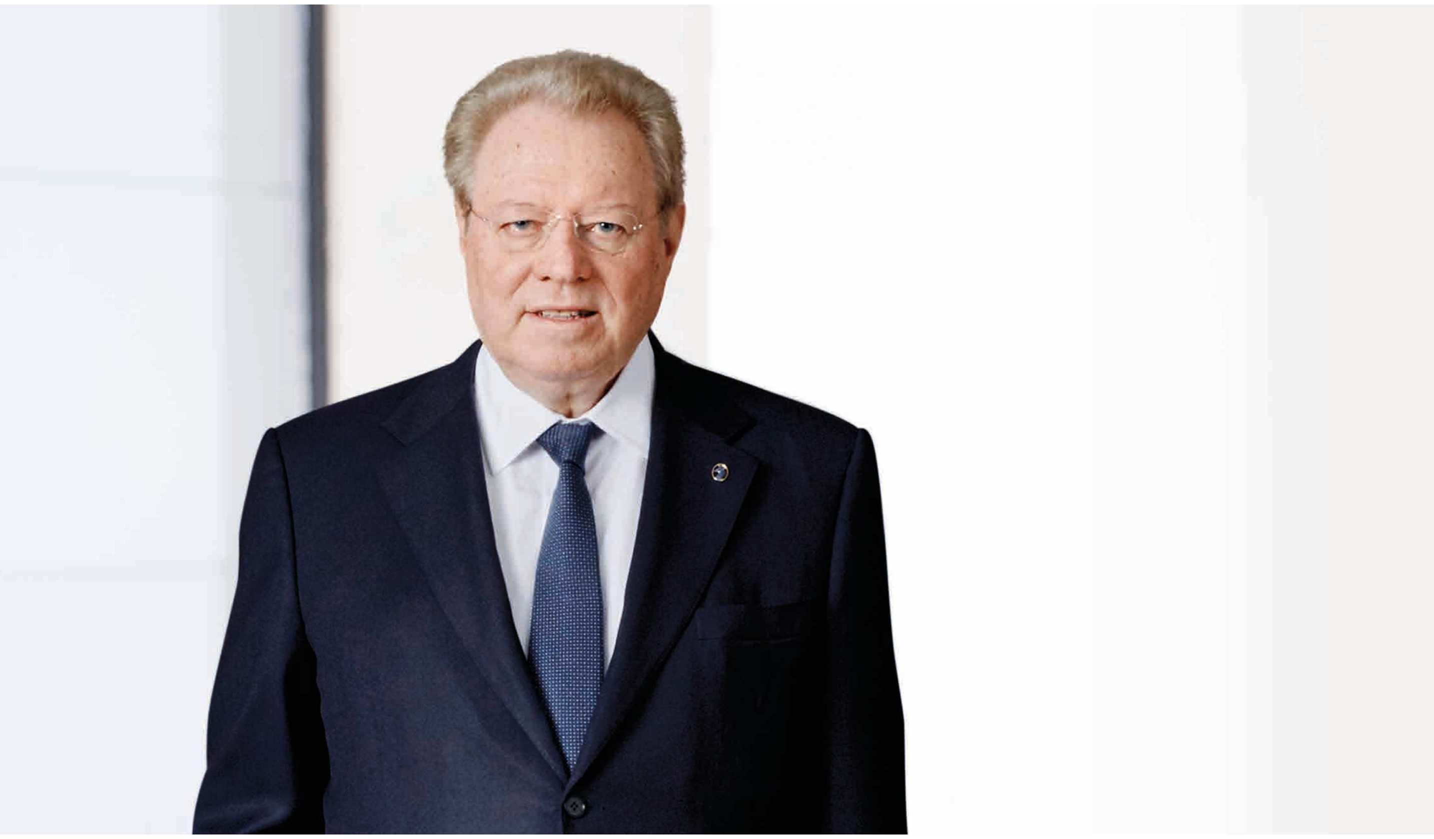
Regulatory capital

£1.6bn
loan book at December 2019

£2.1bn
of deposit funding at December 2019

£1.1bn
assets under management at December 2019

Chairman's Statement



I am pleased to report that Arbuthnot Banking Group ("ABG" or "the Group") has had a successful year of franchise growth and along the way realised several notable achievements. Overall the customer loan balances increased by 31%, while at the same time deposits grew by 22%.

This growth rate would identify the Group as one of the fastest growing banks in the UK, which was achieved while still adhering to our philosophy of controlled and conservative decision making that takes a long term view, rather than fast growth in an uncontrolled and perhaps reckless manner.

Arbuthnot Latham & Co., Limited ("Arbuthnot Latham", "AL" or the "Bank") continued to strengthen its controls and enhanced the three lines of defence model. We appointed Stephen Kelly, previously Finance Director of Arbuthnot Latham, to be the Bank's Chief Risk Officer ("CRO"). This has allowed our principles of risk management, which we have instilled in all of our businesses over the years, to be properly articulated in a robust risk structure and framework. This should enable us to maintain our pace of growth and remain a well run and tightly controlled organisation.

During 2019, the strategy of returning the Private Bank to focussing on attracting and developing deeper relationships with criteria clients started slowly, but the success of the work being done manifested itself in the second half of the year, where for six consecutive months the Investment Management division recorded positive net inflows of client monies. This was a significant turnaround story and continues to demonstrate that the market remains open to the provision of high quality banking services to clients who demand a personalised offering rather than homogeneous service centre banking. It is this strategy that we have been developing in our Commercial Banking division. To that end we had hoped to increase the pace of delivery of this to the SME market via our application to take part in the RBS Remedies process, in particular by submitting an application to the Capabilities and Innovation Fund. Our application was realistic and truly deliverable. It would have helped us to accelerate the development of our personalised approach to business banking for the wider market.

Across the Group there were many notable achievements that have all added to the progress that we made during the year, however, I would like to highlight five in particular that I feel are worth mentioning. These will help to lay a good foundation for the next phase of our evolution.

Highlights

Firstly, in August we completed the purchase of a residential mortgage portfolio. The mortgages totalled £265m in customer balances. After careful due diligence, analysis and strategic negotiation, we were able to acquire this portfolio at a discount of £7m or 2.7% of balances. The loans were generally all performing, well seasoned and at attractive loan to values (an average of 68%). This was our largest portfolio acquisition to date, following on from the purchase we made from the Dunfermline Building Society in 2014. Since completion of the deal, the portfolio has outperformed our model assumptions and should provide a good source of revenue for the next few years.

Secondly, we were able to enter the acquisition process for the mortgages as we were confident that we could restore our surplus liquidity resources to their normal conservative levels, as our new internet deposit raising platform "Arbuthnot Direct" had come on stream in May. As the mortgage portfolio purchase became certain we began to offer competitive market rates which resulted in increased deposits. This new offering was noticed by ITV's Martin Lewis, who mentioned the Direct platform on the "This Morning" programme and we then raised £50m of deposits in the following 3 weeks.

Thirdly, the Asset Based Lending business celebrated its first anniversary in 2019 and has already issued facilities of £76m. During the year the business made payments of £450m and processed £485m of invoice volumes, with the fourth quarter being double the volume of the first quarter. This business has grown the right way, with excellent service to its customers at the centre of everything it does. In 2020 we expect it to be profitable in each month, after having reached break even in 2019.

Fourthly, I would like to mention the progress we have been making in developing our technology platforms. Not only do we take the threat of cybercrime seriously, we have also been enhancing our core systems and delivering new platforms. In 2019 major investment was made in the soon to be established Customer Relationship Management ("CRM") system provided by Salesforce. The total investment will be in excess of £12m, but will enhance our interaction with clients and customers and when linked to our reshaped internet platform, should allow us to be active across all digital platforms. Thus, we will be able to live up to our assertion that "we are a longstanding relationship and service led bank powered by modern technology".

Finally, in November the Bank was awarded the "Best Bank" accolade at the City AM awards ceremony. While we don't usually place much emphasis on such events, it is good to see that the Bank and the progress it is making is now being recognised by the wider market.

Capital

As a fast growing bank, we have by definition been deploying our capital resources at an equal pace. Thus, the following capital transactions that we successfully completed during the year were important in maintaining sufficient capital levels to ensure our growth rates can continue.

Firstly, following a good set of financial results, the market opened up to the fact that Secure Trust Bank ("STB") shares had been oversold after following the challenger bank market downturn during 2018. We saw that demand existed for us to sell a further 1,050,000 of our STB shares at a price of £14.60. This sale was completed in April and created an additional £13.6m of regulatory capital for the Group. However, at the same time we did forgo a dividend of £0.9m that we would have received on these shares during 2019.

Secondly, we were finally able to issue the Arbuthnot Banking Group Ordinary Non-Voting shares. We did this via a bonus issue of 1 share for every 100 Ordinary shares, with the shares being listed on the NEX Exchange Growth Market ("NEX") alongside our Ordinary voting shares. Although this

Chairman's Statement *continued*

did not raise any additional capital, it could prove important in the future as we have now created a new "currency" that we may be able to use to complete transactions. If these shares were used for this purpose, we would probably also offer them via the AIM market in addition to NEX.

Finally, in June we agreed a bilateral sub-ordinated loan with Proventus Capital Partners ("Proventus"). The £25m loan was structured in such a way that it forms part of our capital resources as Tier 2. We were pleased to find Proventus as a lending partner and we developed a good understanding of their investment strategy during the negotiations. We hope that this will grow into a supportive long term relationship.

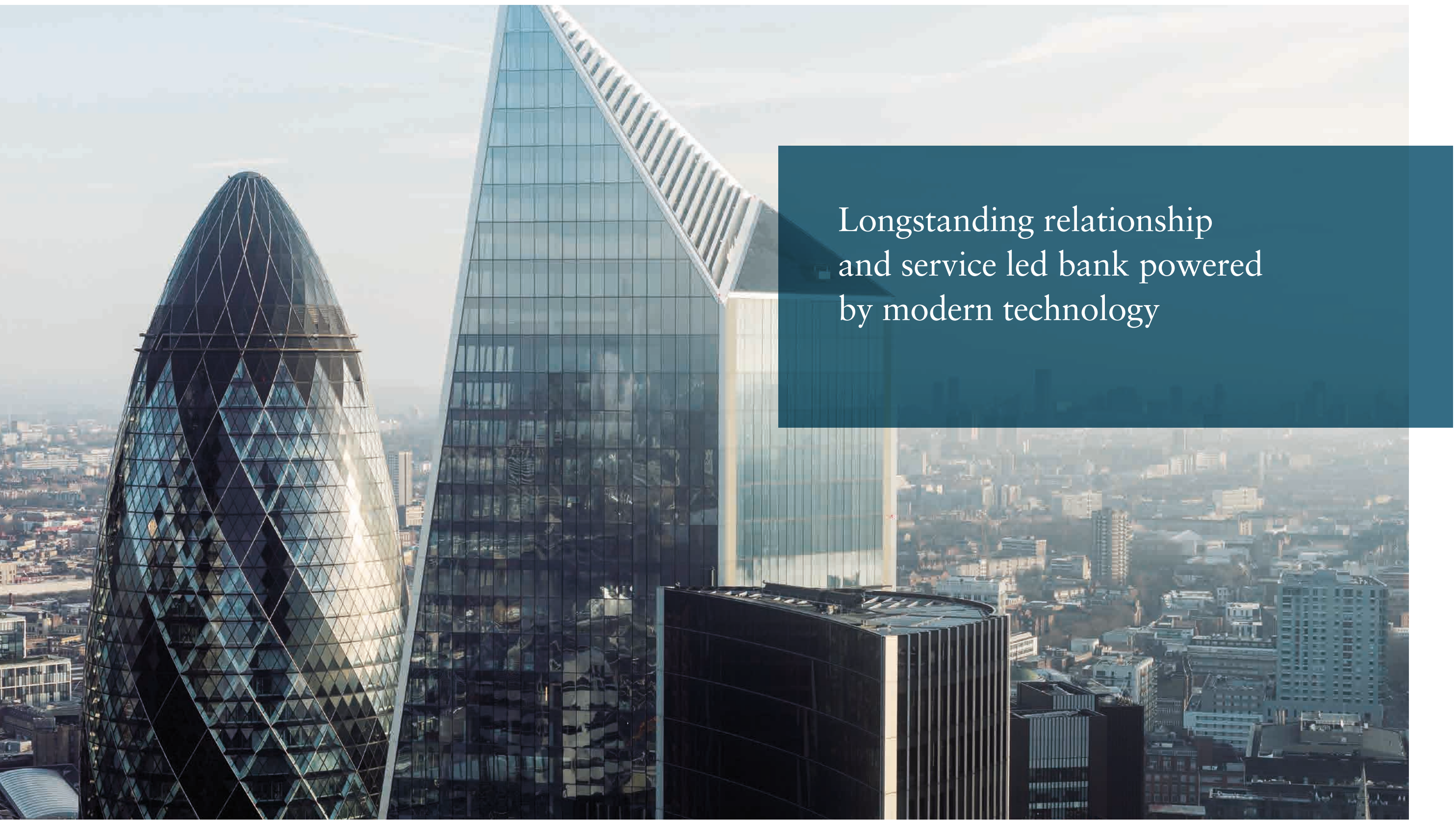
Business Activity

From the beginning of the second half of the year it was clear that the uncertainty caused by the political unrest was reducing the appetite of our clients to complete on lending deals. By the end of the third quarter, the uncertainty grew to a peak as the Brexit stalemate brought about an unexpected general election. As I had previously indicated, I believed that a hard left government with its tax and spend philosophy had the potential to cause a much greater negative impact on the UK economy than Brexit could ever have done.

However, I have previously observed, and this was repeated once again, that the British people do not believe in such radical policies and returned an emphatic result that now leaves the Government in a good position to carry out its manifesto promises. Immediately after the result, the economic sentiment improved and we noticed an uplift in confidence and accordingly customer activity began to increase.

Auditors

I can further report that during the year we carried out a mandatory tender for our audit services. This was after our incumbent auditors, KPMG, reached ten years of continuous service. Given the current focus on the audit sector, we carried out a thorough process involving the audit committees of both the Group and Arbuthnot Latham. We were pleased that following this process we were able to appoint Mazars LLP as our new auditors. As is the trend within the industry, this leaves us now in a position to select from a number of professional firms for the provision of other services, as these have become more homogeneous, rather than being delivered by one firm leveraging its relationship as auditor.



Board Changes and Personnel

During the year we were delighted to welcome Nigel Boardman to the Group Board. He had a long and distinguished career with Slaughter and May where he was legal advisor to more than a dozen FTSE 100 firms. We look forward to working with him in the coming years.

I also would like to thank my colleagues on the Board for their helpful and committed collaboration. As always, the performance of the Group reflects the hard work and commitment of all the members of staff. On behalf of the Board I extend our thanks to all of them for their dedicated efforts in 2019.

Dividend

In light of the current circumstances that will prevent us holding the AGM within our normal timeframes, where the shareholders would have been be able to approve a final dividend, the Board is proposing a second interim dividend in lieu of a final dividend of 21p, an increase of 1p on last year. Together with the first interim dividend of 16p it gives a total dividend of 37p (2018: 35p), which represents an increase of 2p on the total ordinary dividend of the previous year.

The second interim dividend will be paid, as planned, on 22 May 2020 to shareholders on the register at close of business on 24 April 2020.

Outlook

The macro economic outlook is now increasingly difficult to predict. Following the result of the general election, the UK appeared to have increased business confidence and also a growing appetite for investment.

However, recent events have completely overtaken this as the global economy is being significantly impacted by the spread of the coronavirus. Together with the geopolitical unrest among the oil producers, this has had a dramatic effect on financial markets around the world.

In response to the economic situation, the Bank of England recently implemented a number of measures to boost the economy. The withdrawal of the countercyclical capital buffer and the effective extension of the TFS liquidity scheme will in the short term be helpful to the Group. However, the reduction in the base rate will have a material impact on the Group's net interest income in 2020 and possibly beyond, as earnings on our customer loans and assets we hold at the Bank of England will be substantially lower than the benefit we can achieve by lowering our cost of funding.

We have taken substantial steps in terms of business continuity and a large proportion of our staff are now homeworking, in line with Government guidelines.
Our recent investment in technology has aided this process enormously and enabled us to keep in close contact with clients, who remain our first priority.

It is difficult to give any further guidance for 2020 as these events unfold. However we remain well capitalised and hold significant levels of surplus liquidity, while our loan book is conservative and we have good levels of security. Overall the Board feels we are well positioned to withstand the headwinds that all banks will experience in 2020, and potentially to take advantage of any opportunities as we emerge from this.

Sir Henry Angest
Chairman & CEO

26 March 2020

Strategic Report Business Review

Arbuthnot Latham

Arbuthnot Latham & Co., Ltd has reported a profit before tax and Group recharges of £16.2m (2018: £14.6m), which is an increase of 11%. Once again this result includes the impact of a further adjustment to the expected liability due on the management earn out of Renaissance Asset Finance ("RAF"). The reassessment required a release of £1.5m to profit. If this item is excluded and the same adjustment made in 2018 of £2.6m, then the increase in profit would be 23%. Despite this adjustment, RAF continued to perform well increasing its customer balances by 20% during the year.

Overall the Bank saw good growth in all of its leading indicators, namely customer balances. Customer loans increased by 31% and deposits grew by 22%, while Asset Under Management ("AUM") increased by 12%.

On 8 August 2019 the Bank completed the purchase of a performing portfolio of residential mortgages ("Santiago Portfolio"). This acquisition was added to the previous portfolio that was acquired in 2014 from the administrators of the Dunfermline Building Society ("Tay Portfolio"). This brings the total of purchased mortgage portfolios to £362m.

During 2019 the Bank launched its direct to customer deposit platform "Arbuthnot Direct", this proved successful and has so far raised £83m of deposits. Notably after being mentioned by Martin Lewis in the media, the platform was "stress tested" collecting an average of £6m per day for a week.

Arbuthnot Commercial Asset Based Lending continued to make good progress reaching profitability and £76m of drawn balances at the year end, only nineteen months after commencing trading.

The average net margin for the Bank fell by 20bps from 4.7% to 4.5%. This was as a result of the average cost of deposits increasing by more than 10bps as the market for fixed term and notice deposits proved to be competitive.

As the Bank now has a deposit base in excess of £2bn, a small increase in the deposit rates can result in a material increase in the interest expense of the Bank.

Credit losses in the year reduced to £867k (2018: £2,731k) as the Bank now had another year of loss experience on which

Private Banking

Provides full service banking and dedicated Wealth Management to criteria clients to base its IFRS 9 credit models. The requirement of these adjusted models resulted in a release of provisions of £1.1m. These were offset by normal impairments under the models (due to increased lending and changes in circumstances/the Stages of loans).

The Bank continued to reduce the small number of legacy non-performing loans including it has now taken vacant possession of a villa in Majorca and is developing plans to recover the money owed under the original loan.

Private Banking

The Private Bank continued to experience a fall in customer loan balances seeing a reduction of £27m or 4% from the prior year. However, despite this reduction, the Private Bank managed to write £96m of new loans in the year. In fact, the decline in the loan balances of the Private Bank were as a result of resolving the non-performing loans or watch list loans that had been given notice to refinance, thus preventing the possibility of future losses.

The Customer deposits remained unchanged at approximately £1.04bn.

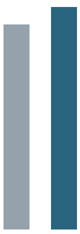
However, the new strategy to refocus the private bankers on attracting new criteria clients who would require Investment Management Services appears to be gaining traction. In the second half of the year, the Investment Management division saw net inflows of client assets (excluding market movement) in every month. AUMs closed the year at £1.1bn, an increase of 12%.

The Wealth Planning division contributed a loss of £1.8m to the Private Bank. This was due to a change to its business proposition. At the end of the first half the business ceased charging clients for ongoing annual reviews, instead the planners now concentrate on providing event based financial advice and thus charge the clients for each piece of specific advice on a transactional basis.

Mortgage Portfolios

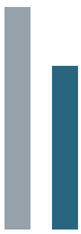
Following the completion of the acquisition of the residential mortgage portfolio in August, the total of the combined portfolio now stands at £306m.

Both portfolios have performed better than expected during the year with gross yields of 4.1% on the Tay Portfolio and 3.8% on Santiago. The two portfolios have average LTVs of 59.1% and 67.5% respectively.



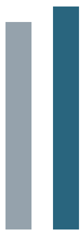
2019
£74.2m
2018
£68.4m

Operating income



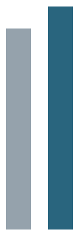
2019
£5.0m
2018
£6.8m

Other income



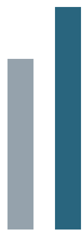
2019
£62.2m
2018
£57.8m

Operating expenses



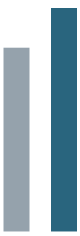
2019
£16.2m
2018
£14.6m

Profit before tax (before Group recharges)



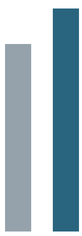
2019
£1,599.1m
2018
£1,224.7m

Customer loans



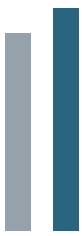
2019
£2,084.9m
2018
£1,714.3m

Customer deposits



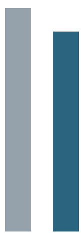
2019
£2,584.8m
2018
£2,172.3m

Total assets



2019
£1,107.3m
2018
£985.1m

Assets under management



2019
4.5%
2018
4.7%

Average net margin

2019
76.7%
2018
71.4%

Loan to deposit ratio

Strategic Report
Business Review *continued*

Commercial Banking

The Commercial Bank increased its loan book to £532m, an increase of 20%. The emphasis of this lending has gradually switched away from commercial real estate towards professional buy to let landlords. The bankers generated £170m of new lending volumes. During the fourth quarter the team completed the largest loan deal in the history of the Bank. The loan totalled £40m to be drawn in two tranches, £29m in 2019 and the remaining £11m in 2020. The security against the loan is a well diversified portfolio of flats in central London with a loan to value ("LTV") of 60%.

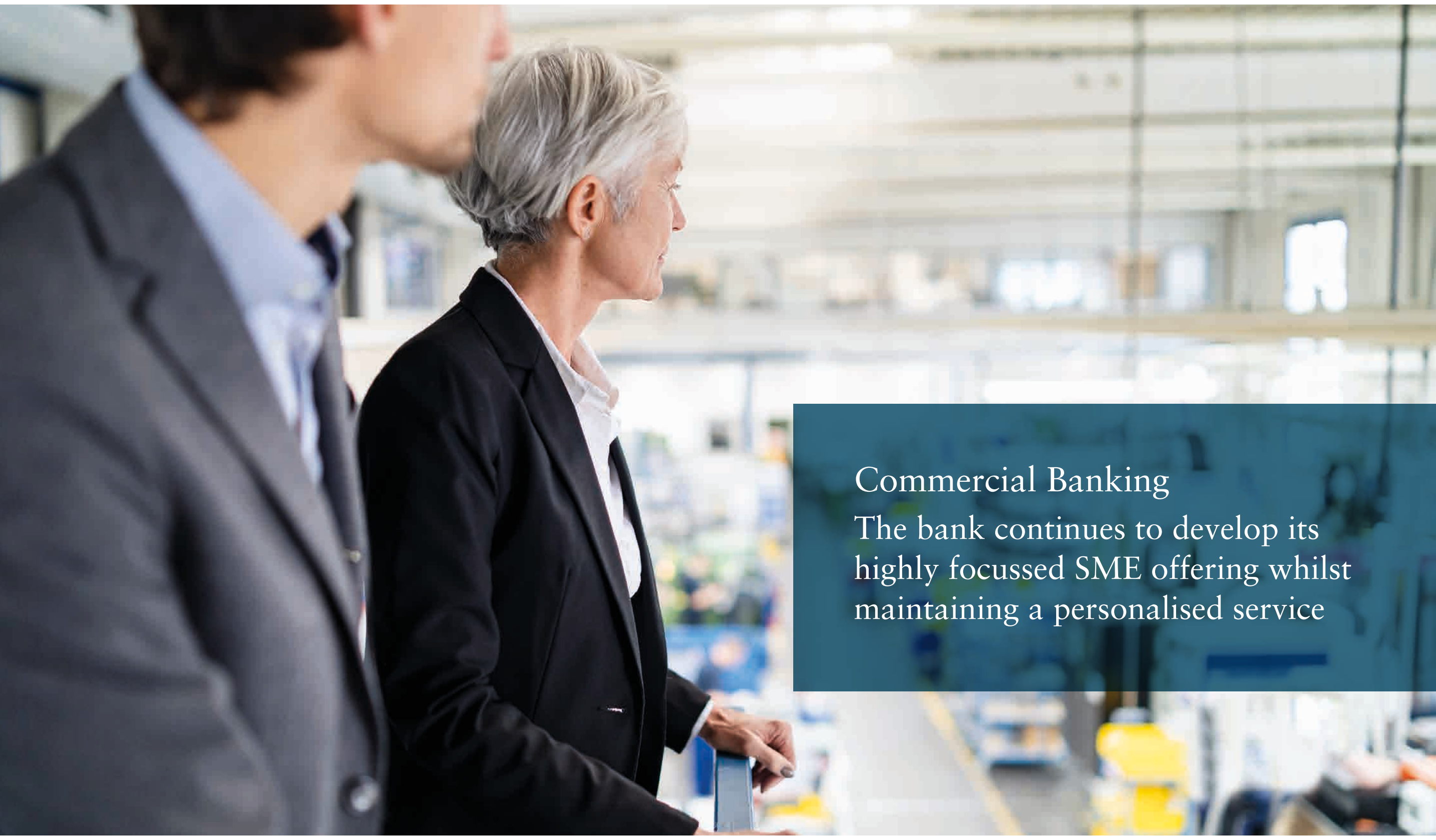
At the same time the Commercial Bank had notable success in attracting new deposits, increasing the total of deposits by 45% to £824m.

Renaissance Asset Finance ("RAF")

RAF made good progress during the year and grew its customer loan balances by 20% to exceed £100m for the first time in its history. The volume of new loans written in the year increased by 21% to reach £68m, which was as a result of receiving an additional 10% of new loan proposals. In fact, the network of introducers increased to 107 brokers (2018: 85), an increase of 26%.

The new business saw average yields hold steady at 8% (2018: 8%).

However, RAF was subject to a number of credit losses, which appear to be isolated incidents rather than a systematic issue with the underwriting processes. The result of these losses saw the credit losses increase by nearly 100% to be £708k in the year.



Commercial Banking

The bank continues to develop its highly focussed SME offering whilst maintaining a personalised service

Arbuthnot Commercial Asset Based Lending ("ACABL")

ACABL recorded a full year profit of £24k, which is a creditable performance given that the business only commenced trading in May 2018.

The customer loan balances ended the year at £76m, an increase of 200%. The client base now stands at 35, with total facility limits totalling £130m. These facilities were generated from 26 different business introducers.

The borrowers are 50% UK manufacturers, 30% of the client base are exporters and they are from 18 industrial sectors and 19 geographical counties. 54% are backed by private equity and the remainder are privately owned.

During the year the business made payments of £450m and processed £485m of invoice volumes. These volumes grew to the extent that the levels processed in the final quarter of the year were double of that in the first quarter.

Arbuthnot Specialist Finance Limited ("ASFL")

ASFL was delayed in starting business due to complications in completing the installation of its operating platform. Once these were resolved the business fully opened itself to receiving proposals from the market. Thus, the business was not able to extend any material volumes to customers until the fourth quarter of the year. The customer loan balance closed at £7.4m.

However, during the year the business received over £600m in enquiries from the market, which resulted in £43m of applications. This business was shortlisted for the NACFB awards in two categories, namely, short term lender of the year and Patron of the year.

Operations & Technology

During the year the banking services provided continued to grow. The number of new accounts opened was 56% higher than in 2018 and the number of active cards increased by 10%, as did the value of spend on those cards. Non card payments increased by 9.6% and as a result the Bank processed over 340,000 transactions with a total value in excess of £4.5bn. Over 92% of these transactions were instructed via our online banking system.

To facilitate this increase in transactional flow, the online banking system was significantly upgraded in October. Also, the delivery of Payments Services Directive (PSD2) has seen ongoing enhancements to our payments security and the delivery of our new Open Banking channel, which required further investment and enhancement of our Oracle Banking Platform.

The Bank has continued to upgrade the underlying IT Infrastructure and Networks, with a phased adoption of cloud services and delivery of an upgrade to the Wide Area Network. This is helping to further improve the Bank's resilience and security, forming part of the overall investment in Cyber Security.

Following on from the launch of the new Arbuthnot Direct Business in February 2019, the Bank has continued to invest in its digital capability, with the start of a significant multi-year investment programme in a new Salesforce CRM platform. It will enable far greater personalisation of the Bank's offering and a more efficient fulfilment of customers' needs. The initial phase of this programme will be launched in the first half of 2020, with further enhancements planned later in the year and beyond.

Strategic Report
Financial Review

Arbuthnot Banking Group adopts a pragmatic approach to risk taking and seeks to maximise long term revenues and returns. Given its relative size, it is nimble and able to remain entrepreneurial and capable of taking advantage of favourable market opportunities when they arise.

The Group provides a range of financial services to clients and customers in its chosen markets of Private and Commercial Banking, Asset Finance, Asset Based Lending and Specialist Finance. The Group's revenues are derived from a combination of net interest income from lending, deposit taking and treasury activities, fees for services provided and commission earned on assets under management. The Group also earns rental income on its investment property and receives dividends from financial investments.

The Group has reported a profit before tax on continuing operations of £7.0m (2018: £6.8m). This is an increase on the prior year of 3%. The underlying profit before tax was £5.8m (2018: £4.4m), an increase of 32%.

The Group continues to deploy surplus capital, while also building operational scale for future growth by investing in IT infrastructure, people and support departments. Once again the reported results contain certain one off items that need explanation.

Firstly, further investment into Specialist Finance, one of the "New Ventures" (Asset Based Lending, Specialist Finance and Arbuthnot Direct) mentioned in last year's Annual Report, lowered the reported profits by £1.2m. The start-up costs for new staff and operating systems was absorbed by the profit of the Group. Encouragingly, Asset Based Lending reached profitability by the end of 2019, ahead of management expectation.

Highlights

Summarised Income Statement

	2019 £000	2018 £000
Net interest income	58,637	55,183
Net fee and commission income	13,828	12,722
Operating income	72,465	67,905
Other income	5,599	6,588
Operating expenses	(70,186)	(64,982)
Impairment losses - loans and advances to customers	(867)	(2,731)
Profit before tax from continuing operations	7,011	6,780
Income tax expense	(835)	(1,121)
Profit after tax from continuing operations	6,176	5,659
Loss from discontinued operations after tax	–	(25,692)
Profit/(loss) for the year	**6,176**	**(20,033)**
Basic earnings per share (pence) - Continuing operations	41.2	38.0
Basic earnings per share (pence) - Discontinued operations	–	(172.5)
Basic earnings per share (pence)	**41.2**	**(134.5)**

Underlying profit reconciliation

31 December 2019	Arbuthnot Latham & Co. £000	Group Centre £000	Arbuthnot Banking Group £000
Profit before tax and group recharges	16,156	(9,145)	7,011
Cost of establishing new ventures	1,208	–	1,208
RAF deferred consideration adjustment	(1,495)	–	(1,495)
Subordinated debt as if from 1 January 2019*	–	(924)	(924)
Underlying profit	**15,869**	**(10,069)**	**5,800**

Underlying basic earnings per share (pence)	**32.8**

* Subordinated debt charge accounted for as if from 1 January, rather than 3 June (date of issue).

Secondly, as was the case in the prior year, the results contain an adjustment to the predicted future liability for the amount payable to the RAF management team. Loan balances increased by £17m to £103m, an increase of 20%. However, the profit for the year was flat compared to the prior year at £1.9m. Accordingly, the liability has been reduced by a further £1.5m (2018: £2.6m) and the corresponding amount recorded as a one off profit in the Income Statement. The earn out agreement comes to an end in 2020.

Finally, on 3 June 2019, the Group completed a private issue of a subordinated loan with Proventus Capital Partners, a Swedish Debt Fund, raising £25m (before expenses) of Tier 2 regulatory capital. The loan matures on 3 June 2029, but can be repaid early by ABG after the fifth anniversary. As this is an ongoing cost for the Group, the full year impact of the interest liability is shown in the underlying profit reconciliation, reducing the current year by £0.9m and the prior year by £2.2m.

The Group has total Basic Earnings per share ("EPS") of 41.2p (2018: negative 134.5p) and also continuing EPS of 41.2p (2018: 38.0p), an increase of 5% or on an underlying basis the continuing EPS is 32.8p (2018: 22.7p), an increase of 44%.

Total operating income earned by the Group increased by 7%. The average net margin on lending was 4.5%, down from the 4.7% recorded in 2018. The average cost of deposits increased by more than 10bps as the market for fixed and notice accounts proved to be competitive. Also as announced on 3 July 2019, the Group purchased a mortgage portfolio of £265m loans, with average yield of 3.6%. The lower yield on this portfolio, together with yield compression in the overall mortgage market and the higher cost of funding from deposits, resulted in the lower net margins compared to 2018. Fees and commissions increased by £1.1m to £13.8m, due to an increase of £1.2m from ACABL. Assets Under Management ("AUM") increased to £1.1bn (2018: £1.0bn), however, the increase was not reflected in the fee and commission income for the Private Bank, as poor market conditions existed throughout the period, which only started to recover towards the end of the year.

Underlying profit reconciliation

31 December 2018	Arbuthnot Latham & Co. £000	Group Centre £000	Arbuthnot Banking Group £000
Profit before tax and group recharges from continuing operations	14,574	(7,794)	6,780
Cost of establishing new ventures	1,579	–	1,579
STB dividend income full year at 2019 shareholding*	160	641	801
RAF deferred consideration adjustment	(2,584)	–	(2,584)
Subordinated debt charge as if applicable from 1 January 2018**	–	(2,188)	(2,188)
Underlying profit	**13,729**	**(9,341)**	**4,388**
Underlying basic earnings per share (pence) - Continuing operations			22.7
Underlying basic earnings per share (pence)			**(149.8)**

* STB dividend income adjusted, as if received for full year at 2019 shareholding.

** Ongoing subordinated debt charge accounted for as if applicable from 1 January 2018.

Balance Sheet Strength

Summarised Balance Sheet

	2019 £000	2018 £000
Assets		
Loans and advances to customers	1,599,053	1,224,656
Liquid assets	815,126	802,189
Other assets	181,200	148,328
Total assets	**2,595,379**	**2,175,173**
Liabilities		
Customer deposits	2,084,903	1,714,286
Other liabilities	302,141	264,931
Total liabilities	2,387,044	1,979,217
Equity	208,335	195,956
Total equity and liabilities	**2,595,379**	**2,175,173**

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The Group's expense base increased by 8%, which is slightly higher than the increase in operating income, however, it does include the cost absorbed for Specialist Finance. During the year the Group impairment losses decreased to £0.9m (2018: £2.7m). In 2018 IFRS 9 was applied for the first time. Since then, the Group reviewed the assumptions applied and also compared those used by market peers, which resulted in some adjusted assumptions being applied in the current year. This resulted in a £1.1m reduction for impairments.

Overall the return on equity for the Group was 3.0% (2018: 3.0% on continuing basis), which is still distorted by the surplus capital. This return when calculated on the capital required is 4.3% (2018: 5.6%). The target return on equity remains in the mid-teen range when the surplus capital has been deployed, the cost income ratio is reduced as the benefits of scale are realised by the additional lending, and once Base Rate returns to normal levels.

Total assets increased to £2.6bn (2018: £2.2bn), which was as a result of our ongoing growth of customer loan balances. As mentioned, during the year a £265m mortgage portfolio was acquired for cash consideration of £258m. The Group maintained its conservative funding policy of relying only on retail deposits and targeting a loan to deposit ratio of between 65-80%. Included in other assets is the Group's investment property, which is held at fair value of £6.8m. Also included in other assets are £75.2m of inventory, which include £62.2m of properties previously classified as investment property. They were transferred at fair value, but now will be accounted for at the lower of cost and net realisable value. These properties are being refurbished with a view to sell. Other assets and other liabilities also include £19.4m and £19.8m respectively relating to right-of-use assets and lease liabilities. This is as the result of the implementation of IFRS 16 (leases).

The net assets of the Group now stand at £13.64 per share (2018: £12.83). The increase is mainly attributable to the £10.2m uplift in the value of the Secure Trust Bank ("STB") shares (held as a financial investment) recorded through Other Comprehensive Income.

Segmental Analysis

The segmental analysis is shown in more detail in Note 44. The Group is organised into eight operating segments as disclosed below:

1. Private Banking – Provides traditional private banking services as well as offering financial planning and investment management services. This segment includes Dubai.
2. Mortgage Portfolios – Acquired mortgage portfolios.
3. Commercial Banking – Provides bespoke commercial banking services and tailored secured lending against property investments and other assets.
4. RAF – Specialist asset finance lender mainly in high value cars but also business assets.
5. ACABL – Provides finance secured on either invoices, assets or stock of the borrower.
6. ASFL – Provides short term secured lending solutions to professional and entrepreneurial property investors.
7. All Other Divisions – All other smaller divisions and central costs in Arbuthnot Latham & Co., Ltd (Investment property and Central unallocated items)
8. Group Centre – ABG Group management.

During the year the Group changed the way indirect costs are allocated to divisions. Treasury income and expenditure and the cost relating to certain support departments are no longer allocated out to divisions. This is in accordance with how the divisions are managed internally. The Mortgage Portfolios were previously included as part of Private Banking. ACABL and ASFL are now also reported separately (previously included in All Other Divisions). The comparative numbers for the divisions have been restated to reflect the new allocation method.

The analysis presented below, and in the business review, is before any consolidation adjustments to reverse the impact of the intergroup operating activities and also intergroup recharges and is a fair reflection of the way the Directors manage the Group.

Private Banking

Private Banking reported a profit before tax of £2.9m (2018: £4.6m). This is a decrease of £1.7m or 37%. This decrease is largely due to reduced lending and higher losses in Wealth Planning, with operating income reducing by 8%. At the end of the first half the Wealth Planning business ceased charging clients for ongoing annual reviews, instead the planners now concentrate on providing event based financial advice and thus charge clients for specific advice on a transactional basis.

Increased competition in the retail lending market and uncertainty in the macro economic outlook led to lower than anticipated loan drawdowns. The Group continues to maintain strong discipline in pricing lending risk, as it expects the current heightened competition in the retail lending markets to pass.

The Wealth Planning division was loss making as a result of a fundamental change in its business proposition and hence its charging structure. In July the business ceased charging clients for ongoing annual advice reviews and moved to an event based model, where clients are charged wealth planning fees when they need specific advice. This resulted in £0.4m reduced fee income.

The change in strategy to focus the Private Bank on identifying and attracting new criteria clients is beginning to show results. AUMs closed the year at £1.1bn (2018: £1.0bn). Poor market conditions during 2019 only started to recover towards the end of the year. As a result, fee and commission income remained fairly flat year on year at £10.7m (2018: £10.8m).

Costs stayed flat, with a decrease in direct costs offset by an increase in indirect costs. The average customer yield was 4.5% (2018: 4.9%).

As mentioned under the Business Review, there was a change in assumptions which resulted in a release of impairments. For the Private Banking division, this was just under £0.3m. Excluding this release, the impairment charge for the year was £0.8m, compared to £2.0m in the prior year. The £1.2m decrease relates to higher than normal impairments in the prior year as the back book of legacy loans continued to be resolved.

The customer loan balances of the Private Bank reduced by £26.7m or 4% during the year. The deposits also decreased to £1,039m (2018: £1,041m). The average loan to value of the Private Banking loans was 54% (2018: 52%).

Mortgage Portfolios

The Mortgage Portfolios reported a profit of £3.3m (2018: £1.9m). This is an increase on the prior year of 74%.

In August the Group completed the purchase of the residential mortgage portfolios which added £265m of mortgages acquired at a discount of 2.7%. The acquired portfolios have average loan to values of 68%. The transition of the portfolios took place smoothly and continue to perform better than indicated by the models used as part of the assessment of the transaction.

Private Banking
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	25,107	28,243
Net fee and commission income	10,687	10,831
Operating income	35,794	39,074
Other income	–	2
Operating expenses - direct costs	(16,673)	(17,272)
Operating expenses - indirect costs	(15,700)	(15,227)
Impairment losses - loans and advances to customers	(485)	(1,966)
Profit before tax	**2,936**	**4,611**

Mortgage Portfolios
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	4,113	2,135
Operating income	4,113	2,135
Operating expenses - direct costs	(807)	(235)
Profit before tax	**3,306**	**1,900**

Strategic Report
Financial Review *continued*

Commercial Banking

The Commercial Bank generated a profit before tax of £7.3m (2018: £2.8m), an increase of £4.5m. This was mainly due to a £5m increase in net interest income, as a result of higher lending balances in 2019 as well as the full year impact from significant growth in loans recorded in the prior year.

The increase in income was partially offset by higher costs. Direct costs reduced slightly due to lower staff costs, while indirect costs increased in line with the greater significance of the business.

As mentioned under the Business Review, there was a change in assumptions which resulted in a release of impairments. For the Commercial book, this was just over £0.8m. Excluding this release, the impairment charge for the year was £0.5m, compared to £0.3m in the prior year. The £0.2m increase relates to the maturing nature and growing value of the loan book and is in line with management expectations.

The customer loan book closed at £532m (2018: £443m), an increase of 20%, while deposits increased by 45% to £824m. The average customer loan yield was 4.7% (2018: 4.6%).

The average loan to value of the Commercial Bank loan portfolio was 44% (2018: 50%).

RAF

Renaissance Asset Finance recorded a profit before tax of £1.9m (2018: £1.9m), which is flat from the previous year.

The increase in net interest income of £0.6m was offset by an increase in costs of £0.4m and higher impairments of £0.3m.

The customer loan balances increased by 20% to close the year at £102.9m (2018: £86m) and the average yield for 2019 was 9.1%, compared to 9.6% for 2018.

Commercial Banking
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	20,151	15,145
Net fee and commission income	1,114	727
Operating income	21,265	15,872
Operating expenses - direct costs	(5,237)	(5,536)
Operating expenses - indirect costs	(9,075)	(7,258)
Impairment losses - loans and advances to customers	320	(278)
Profit before tax	**7,273**	**2,800**

RAF
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	5,873	5,344
Net fee and commission income	207	137
Operating income	6,080	5,481
Other income	64	73
Operating expenses - direct costs	(3,577)	(3,169)
Impairment losses - loans and advances to customers	(708)	(437)
Profit before tax	**1,859**	**1,948**

Arbuthnot Commercial Asset Based Lending ("ACABL")

ACABL recorded a £24k profit before tax (2018: loss of £1.1m), as the start-up division managed to achieve profitability ahead of schedule.

There was a small write back on impairment losses in the year, as part of the review of assumptions applied in the Group's IFRS 9 model, as highlighted earlier in the report. ACABL currently only have loans classified as Stage 1, which is where the revised assumptions resulted in a credit applied across the Group.

Customer loan balances increased threefold to close the year at £75.9m (2018: £25.3m), with issued facilities increasing to £104m from £43m in 2018.

Arbuthnot Specialist Finance ("ASFL")

ASFL recorded a loss before tax of £1.2m (2018: loss of £0.3m), as the Group continue to fund the start-up costs for this business.

Customer loan balances closed the year at £7.4m (2018: £nil).

Arbuthnot Commercial Asset Based Lending ("ACABL")
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	1,345	224
Net fee and commission income	1,377	212
Operating income	2,722	436
Operating expenses - direct costs	(2,708)	(1,500)
Impairment losses - loans and advances to customers	10	(50)
Profit/(loss) before tax	**24**	**(1,114)**

Arbuthnot Specialist Finance ("ASFL")
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	71	–
Operating income	71	–
Operating expenses - direct costs	(1,275)	(345)
Impairment losses - loans and advances to customers	(4)	–
Loss before tax	**(1,208)**	**(345)**

Strategic Report
Financial Review *continued*

Other Divisions

The aggregated profit before tax of other divisions was £2.0m (2018: £4.8m).

Reported within the other divisions were Investment Properties £0.7m (2018: £1.0m) and central items, which this year contains the £1.5m (2018: £2.6m) adjustment to the RAF management earn out liability and rental income earned on space in our Wilson Street offices of £0.2m (2018: £0.7m). The rental income relates to Secure Trust Bank, which moved out at the beginning of the year to occupy their own office space in the City.

Group Centre

The Group costs increased to £9.1m (2018: £7.8m) mainly due to £1.3m of interest costs relating to the subordinated loan issued on 3 June 2019 to Proventus Capital Partners for £25m.

Other income increased by £0.7m, due to dividends received from STB. This was due to the fact that the previous year only included the interim dividend, after the investment changed from an associate to a financial investment.

The increase in other income was offset by an increase in costs of £0.8m.

Other Divisions
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	3,738	4,563
Net fee and commission income	443	815
Operating income	4,181	5,378
Other income	4,955	6,683
Operating expenses - direct costs	(7,170)	(7,287)
Profit before tax	**1,966**	**4,774**

Group Centre
Summarised Income Statement

	2019 £000	2018 £000
Net interest income	(141)	(105)
Subordinated loan stock interest	(1,620)	(366)
Operating income	(1,761)	(471)
Other income	1,420	760
Operating expenses	(8,804)	(8,083)
Loss before tax	**(9,145)**	**(7,794)**

Capital

The Group's capital management policy is focused on optimising shareholder value over the long term. There is a clear focus on delivering organic growth and ensuring capital resources are sufficient to support planned levels of growth. The Board regularly reviews the capital position.

The Group, and the individual banking operation, are authorised by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and are subject to EU Capital Requirement Regulation (EU No.575/2013) ("CRR") and the PRA Rulebook for CRR firms. One of the requirements for the Group and the individual banking operation is that capital resources must be in excess of capital requirements at all times.

In accordance with the EU's Capital Requirements Directive (EU No.36/2013) and the required parameters set out in the PRA Rulebook, the Internal Capital Adequacy Assessment Process ("ICAAP") is embedded in the risk management framework of the Group. The ICAAP identifies and assesses the risks to the Group, considers how these risks can be mitigated and demonstrates that the Group has sufficient resources, after mitigating actions, to withstand all reasonable scenarios.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar 1 plus" approach to determine the level of capital the Group needs to hold. This method takes the Pillar 1 capital requirement for credit, market and operational risk as a starting point, and then considers whether each of the calculations delivers a sufficient amount of capital to cover risks to which the Group is, or could be, exposed. Where the Board considers that the Pillar 1 calculations do not adequately cover the risks, an additional Pillar 2A capital requirement is applied. The PRA will set a Pillar 2A capital requirement in light of the calculations included within the ICAAP. The Group's Total Capital Requirement, as issued by the PRA, is the sum of the minimum capital requirements under the CRR (Pillar 1) and the Pillar 2A requirement.

The ICAAP document will be updated at least annually, or more frequently if changes in the business, strategy, nature or scale of the Group's activities or operational environment suggest that the current level of capital resources are no longer adequate. The ICAAP brings together the management framework (i.e. the policies, procedures, strategies, and systems that the Group has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management. The Group's regulated entity is also the principal trading subsidiary as detailed in Note 43.

The Group's regulatory capital is divided into two tiers:

- Common equity Tier 1 ("CET1"), which comprises shareholder funds less regulatory deductions for intangible assets, including goodwill, deferred tax assets that do not arise from temporary differences, and a portion of the Group's non-significant investment in a financial institution, Secure Trust Bank ("STB"). The portion of the STB investment deducted from CET1 capital is calculated in accordance with EU CRR thresholds.
- Tier 2 comprises qualifying subordinated loans.

Capital ratios are reviewed on a monthly basis to ensure that external requirements are adhered to. All regulated trading entities have complied with all of the externally imposed capital requirements to which they are subject.

Capital ratios

	2019 £000	2018 £000
CET1 Capital Instruments*	219,627	214,024
Deductions	(41,983)	(48,740)
CET1 Capital after Deductions	177,644	165,284
Tier 2 Capital	36,837	13,283
Own Funds	**214,481**	**178,567**
CET1 Capital Ratio (CET1 Capital/Total Risk Exposure)	**14.4%**	**15.9%**
Total Capital Ratio (Own Funds/Total Risk Exposure)	**17.3%**	**17.2%**

* Includes year-end verified profit.

Strategic Report
Financial Review *continued*

Risks and Uncertainties

The Group regards the monitoring and controlling of risks and uncertainties as a fundamental part of the management process. Consequently, senior management are involved in the development of risk management policies and in monitoring their application. A detailed description of the risk management framework and associated policies is set out in note 6.

The principal risks inherent in the Group's business are macroeconomic, strategic, credit, market, liquidity, operational, cyber, conduct and regulatory.

Macroeconomic and competitive environment

The Group is exposed to indirect risks that may arise from the macroeconomic and competitive environment.

Coronavirus

The economic environment is currently unstable and difficult to predict in the UK. This is also the case on the International landscape as many of the developed nations have taken unprecedented steps to completely shut down the normal functioning of their economies. The impact from the coronavirus has already had an adverse effect on the stock markets around the world.

The significant business risks that may arise from the economic shock in addition to the reduction in interest rates as detailed in the Chairman's Statement are:

- Increased credit risk as borrowers are unable to continue to meet their interest obligations as they fall due. It is also currently unclear precisely how the Government's announced package of measures will interact with this clear risk. The mortgage payment holiday for three months will allow borrowers some grace to return to normal payments and may also result in some form of Government guarantee, which would possibly reduce this risk to the Group.
- The uncertainty in the economy could result in a significant fall in the collateral values of our security held against the loans. The Royal Institute of Charter Surveyors ("RICS") has issued a statement suggesting that any valuations they may produce in the current environment would be subject to a warning that the values vary significantly. However, the average loan to value of our property backed lending book is 51.1%, so to have any material impact, this fall in collateral values would have to be severe and prolonged.
- A prolonged reduction in business activity will affect our ability to generate new business opportunities and it is highly likely that repayments in our current lending portfolios will be greater than new originations, which will lead to an overall fall in the Group's customer lending balances and the associated revenue that this generates.
- The economic shock could also lead to a fall in valuations in the Groups investment properties and those properties held in inventory.
- As the revenues earned by the Group's Investment Management business are directly linked to the balances managed on behalf of our customers, any reduction in these values due to market movements will have a corresponding impact on these revenues.

Brexit

Despite the decisive result in the General Election, which gave a clear mandate to complete the Article 50 withdrawal provision, there still remains the uncertainty over the transitional arrangements and negotiation of the final trade deal relating to Brexit, with the UK due to formally exit from the EU rules on 31 December 2020. The Group has tried to anticipate the risks that it may face if an economic shock arises as a result. It has also examined how business activities may be affected if free provision of services cross borders is prohibited. The Group's only overseas operation is in Dubai, so the vast majority of the Group's income and expenditure is based in the UK.

Strategic risk

Strategic risk is the risk that may affect the Group's ability to achieve its corporate and strategic objectives. This risk is important to the Group as it continues its growth strategy. However, the Group seeks to mitigate strategic risk by focusing on a sustainable business model which is aligned to the Group's business strategy. Also, the Board of Directors meets once a year to hold a two day board meeting to ensure that the Group's strategy is appropriate for the market and economy.

Credit risk

Credit risk is the risk that a counterparty (borrower) will be unable to pay amounts in full when due. This risk exists in Arbuthnot Latham, which currently has a loan book of £1,599m (2018: £1,225m). The lending portfolio in AL is extended to clients, the majority of which is secured against cash, property or other high quality assets. Credit risk is managed through the Credit Committee of AL.

Market risk

Market risk arises in relation to movements in interest rates, currencies and equity markets. The Group's treasury function operates mainly to provide a service to clients and does not take significant unmatched positions in any market for its own account. As a result, the Group's exposure to adverse movements in interest rates and currencies is limited to interest earnings on its free cash and interest rate re-pricing mismatches. The Group actively monitors its exposure to future changes in interest rates.

The Group is exposed to changes in the market value of properties. The current carrying value of Investment Property is £6.8m and properties classified as inventory are carried at £75.2m. Any changes in the market value of the property will be accounted for in the Income Statement for the Investment Property and could also impact the carrying value of inventory, which is at the lower of cost and net realisable value. As a result, it could have a significant impact on the profit or loss of the Group.

The Group has a 9.85% interest in STB. This is currently recorded in the Group's balance sheet as a Financial Investment. The carrying value is adjusted to market value at each balance sheet date, according to the share price of STB. Any gains or losses that arise are recorded in Other Comprehensive Income.

Liquidity risk

Liquidity risk is the risk that the Group, although solvent, either does not have sufficient financial resources to enable it to meet its obligations as they fall due, or can only secure such resources at an excessive cost. The Group takes a conservative approach to managing its liquidity profile. Retail client deposits and drawings from the Bank of England Term Funding Scheme fund the Group. The loan to deposit ratio is maintained at a prudent level, and consequently the Group maintains a high level of liquidity. The AL Board annually approves the Internal Liquidity Adequacy Assessment Process ("ILAAP"). The Directors model various stress scenarios and assess the resultant cash flows in order to evaluate the Group's potential liquidity requirements. The Directors firmly believe that sufficient liquid assets are held to enable the Group to meet its liabilities in a stressed environment.

Operational risk

Operational risk is the risk that the Group may be exposed to financial losses from conducting its business. The Group's exposures to operational risk include its Information Technology ("IT") and Operations platforms. There are additional internal controls in these processes that are designed to protect the Group from these risks. The Group's overall approach to managing internal control and financial reporting is described in the Corporate Governance section of the Annual Report.

Cyber risk

Cyber risk is an increasing risk that the Group is subject to within its operational processes. This is the risk that the Group is subject to some form of disruption arising from an interruption to its IT and data infrastructure. The Group regularly test the infrastructure to ensure that it remains robust to a range of threats, and has continuity of business plans in place including a disaster recovery plan.

Conduct risk

As a financial services provider we face conduct risk, including selling products to customers which do not meet their needs, failing to deal with customers' complaints effectively, not meeting customers' expectations, and exhibiting behaviours which do not meet market or regulatory standards.

The Group adopts a low risk appetite for any unfair customer outcomes. It maintains clear compliance guidelines and provides ongoing training to all staff. Periodic spot checks, compliance monitoring and internal audits are performed to ensure these guidelines are being followed. The Group also has insurance policies in place to provide some cover for any claims that may arise.

Regulatory risk

Regulatory risk includes the risk that the Group will have insufficient capital resources to support the business or does not comply with regulatory requirements. The Group adopts a conservative approach to managing its capital. The Board approves an ICAAP annually, which includes the performance of stringent stress tests to ensure that capital resources are adequate over a three year horizon. Capital and liquidity ratios are regularly monitored against the Board's approved risk appetite as part of the risk management framework.

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Regulatory change also exists as a risk to the Group's business. Notwithstanding the assessments carried out by the Group to manage the regulatory risk, it is not possible to predict how regulatory and legislative changes may alter and impact the business. Significant and unforeseen regulatory changes may reduce the Group's competitive situation and lower its profitability.

Stakeholder Engagement and S. 172 (1) Statement

From 2019 directors of public limited companies, such as Arbuthnot Banking Group, are required to publish a statement explaining how they have performed their duty under section 172 of the Companies Act 2006 to have regard to a range of factors when making decisions. This section of the Strategic Report describes how the Directors have had regard to the matters set out in section 172 (1) (a) to (f) and forms the Directors' statement required under section 414CZA of the Companies Act 2006.

The Directors have acted in a way that they considered, in good faith, to be most likely to promote the success of the Company for the benefit of its members as a whole, and in doing so had regard, amongst other matters, to:

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

The stakeholders we consider in this regard are our shareholders, our employees, our customers, our suppliers, our regulators and the environment in which we operate.

The Arbuthnot Principles and Values set out on page 1 explain the Board's approach to its stakeholders. Details of how the Directors had regard to the interests of its key stakeholders during the year are set out below, in the Group Directors Report on page 28 and in the Corporate Governance Report on page 31.

Likely consequences of any decision in the long term

The Directors make their decisions to ensure that long term prospects are not sacrificed for short term gains. As an example, this was demonstrated in the year by the decision to make further significant investment in modern technology to grow the Group's businesses, the cost of which is likely to precede the benefits in the Income Statement. A further illustration of the balancing of the interests of our stakeholders in the long term interest of the Company is dividend policy where the Board approved increased dividends to shareholders in the context of its decisions on capital allocation.

Interests of the Company's employees

The Company has fewer than 20 employees, all of whom have direct access to Board members. As such, it has not been deemed necessary to appoint an employee representative to the Board, nor a formal workforce advisory panel, nor a designated non-executive Director. As explained in the section 172 (1) Statement of Arbuthnot Latham, the Company's operating subsidiary, one of that company's non-executive directors and its Whistleblowing Champion, has been designated by its board as the director to engage with the Group's workforce.

The Board receives an update on Human Resource ("HR") matters of AL at each of its meetings. The Employee Survey undertaken in the year received high engagement and positive responses with 83% of employees proud to work for Arbuthnot Latham. To make AL a better place to work, the following key themes were identified through the survey results and comments: Reward and Recognition; Employee Wellbeing; Communication; and IT. Each of these themes has been and will be areas of focus.

The workforce is able to raise concerns in confidence to the HR Team, with grievances followed up in line with a specified process which satisfies all legal requirements. Additionally, there is an anonymous whistleblowing service via an external provider. There is also protection for employees deriving from the Public Interest Disclosure Act 1998. Whistleblowing events are notified to the Board and to the applicable regulator.

Our people are a vital asset and the Board is committed to ensuring all staff are treated fairly and with respect. Staff were asked for suggestions on what AL could do to demonstrate its commitment to diversity and inclusion. A consistent message was to review Maternity/Adoption and Paternity Pay, as a consequence of which an enhanced policy was implemented and communicated to staff.

Company's business relationships with suppliers, customers and others

The Directors attach great importance to good relations with customers and business partners. In particular, our customers are central to our business and forging and maintaining client relationships are core to the Group's business and crucial for client retention. Our commercial and private bankers are in regular contact with them. As clients' needs and expectations are changing, meaningful relationships with their bankers are more important than ever. Clients now demand access to their bank and relationship managers through a variety of channels and expect efficient and streamlined processes supported by state of the art technology. Accordingly during 2019 a decision was taken to invest in the adoption of modern and integrated Client Relationship Management ("CRM") technology with the potential to improve significantly front-office operations and help us support our existing and new clients better.

The Group is committed to following agreed supplier payment terms. There is a Supplier Management Framework in place covering governance around the Group's procurement and supplier management activities. For due diligence and compliance purposes, suppliers are assessed through an external registration system. The Board has adopted a Modern Slavery Statement which sets out the steps that the Company has taken to give assurance that slavery and human trafficking are not taking place in its supply chains or any part of its business.

Other stakeholders include the Group's regulators, the PRA and the FCA, with whom open and continuous dialogue is maintained. The Board received and considered feedback, following the PRA's review of the Group's risk governance, the Bank's ILAAP and the Periodic Summary Meeting.

Impact of the Company's operations on the community and the environment

As a financial services company our impact on the environment is limited. Nevertheless there is growing consensus that an orderly transition to a low-carbon economy will bring structural adjustments to the global economy which will have financial implications, bringing both risks and opportunities. Accordingly, in November the Board of AL adopted a Climate Change Framework, reflecting the PRA's expectation.

Desirability of the Company maintaining a reputation for high standards of business conduct

The Directors believe that the Arbuthnot culture set out in the Arbuthnot Principles and Values on page 1 manifests itself at Board level and in the external view of the Group as a whole. The importance of the Group's reputation is considered at each Board meeting. It was encouraging in this respect when the Bank won the City A.M. Bank of the Year Award in November 2019.

Acting fairly as between members of the Company

The majority shareholder, Sir Henry Angest, is Chairman and CEO of ABG. There is continuing engagement with other major shareholders and the Directors make their decisions on behalf of all shareholders. As an example, a decision was made in March 2019 to recommend to shareholders a bonus issue of one new Non-Voting share for every 100 Ordinary shares held. As explained in last year's Annual Report, the purpose of the creation of this new class of share was to provide us with the means to raise further capital, to continue to develop the business and to fund suitable inorganic deals should opportunities arise, whilst enabling us to maintain the control structure for the benefit of all shareholders. The new class of shares was approved by shareholders and the shares duly issued to eligible shareholders in May 2019, and the Non-Voting shareholders have the right to receive the same dividend per share as the Ordinary shareholders.

James Cobb
Group Finance Director

26 March 2020

Board of Directors

Sir Henry Angest

James Cobb

Andrew Salmon

Nigel Boardman

Ian Dewar

Sir Christopher Meyer

Sir Alan Yarrow

Nicholas Jennings

Company Secretary

Sir Henry Angest

Appointed to the Board in December 1985.

Sir Henry is the Chairman and Chief Executive and is also Chairman of Arbuthnot Latham & Co., Limited. He gained extensive national and international experience as an executive of The Dow Chemical Company and Dow Banking Corporation. He was previously Chairman of Secure Trust Bank PLC and a Director until August 2018, Chairman of the Banking Committee of the London Investment Banking Association and a Director of the Institute of Directors. He is a Past Master of the Worshipful Company of International Bankers.

James Cobb FCA

Joined the Board in November 2008 as Group Finance Director.

He was also appointed Deputy Chief Executive of Arbuthnot Latham & Co., Limited in May 2018 and took on the role of Finance Director in April 2019. He was previously Deputy Chief Financial Officer and Controller of Citigroup's Global Consumer Group in Europe, Middle East and Africa and qualified as a Chartered Accountant with Price Waterhouse.

Andrew Salmon FCA

Appointed a Director in March 2004.

He joined the Company in 1997 as Head of Business Development and is also Chief Operating Officer and since July 2018 Chief Executive of Arbuthnot Latham & Co., Limited. He was a director of Secure Trust Bank PLC until August 2018. He was previously a director of Hambros Bank Limited and qualified as a Chartered Accountant with KPMG.

Nigel Boardman

Appointed a Non-Executive Director in June 2019.

He was a partner at Slaughter and May from 1982 until his transition from partner to consultant on 30 April 2019, having joined the firm in 1973. Since 1 May 2019, he has been a consultant for the firm. Whilst a partner, Nigel's broad practice included domestic and international corporate finance, mergers and acquisitions, joint ventures, IPOs, demergers, private acquisitions and disposals, private equity, public takeovers, issues of compliance and corporate governance, investigations and insolvency, restructurings, investigations and sports law. Nigel was previously a Vice President of Save the Children UK, is a non-executive board member at the Department for Business, Energy and Industrial Strategy where he chairs the audit, risk and assurance committee. He is also Deputy Chairman of the British Museum, chair of Hot Spots Movement Ltd, an HR consultancy and a director of ABP Holdings, a holding company for an Irish based agri-business.

Ian Dewar FCA

Appointed a Non-Executive Director in August 2015.

He is Chairman of the Audit Committee. He was a Partner for 19 years in the Financial Services Practice of KPMG from which he retired in 2012 after 32 years at the firm. He is a non-executive director of Brewin Dolphin Holdings PLC.

Sir Christopher Meyer

Appointed a Non-Executive Director in October 2007.

He had a distinguished diplomatic career, culminating in 1997 as Ambassador to the USA. He was previously Ambassador to Germany, Press Secretary to Prime Minister John Major and from 2003 to 2009 Chairman of the Press Complaints Commission. He is also on the International Advisory Board of British American Business Inc., Distinguished Fellow of the Royal United Services Institute and Honorary Fellow of Peterhouse, Cambridge.

Sir Alan Yarrow FCSI (Hon)

Appointed a Non-Executive Director in June 2016.

Sir Alan spent 37 years with Dresdner Kleinwort until 2009, latterly as Group Vice Chairman and Chairman of the UK Bank and then served as Chairman of the Chartered Institute for Securities & Investment until October 2018. He is Chairman of Turquoise Global Holdings Ltd and a director of Institutional Protection Services Ltd. He is also Vice President of the Royal Mencap Society, Independent Partnership Advisor to James Hambro & Partners and an advisor to Zeamo. Sir Alan is an Alderman, Magistrate and HM Lieutenant of the City of London, a member of the Court of the Fishmongers' Company, and Liveryman of several other Livery Companies. He is a member of the Takeover Appeal Board, the Advisory Board of the Commonwealth Investment & Advisory Council. Sir Alan was Lord Mayor of the City of London for the year 2014-15.

Nicholas Jennings FCA

Appointed Group Company Secretary in July 2018.

He was previously Company Secretary of Daily Mail and General Trust plc and of Close Brothers Group plc. He is a Chartered Accountant.

Group Directors' Report

The Directors present their report for the year ended 31 December 2019.

Business Activities

The principal activities of the Group are banking and financial services. The business review and information about future developments, key performance indicators and principal risks are contained in the Strategic Report on pages 8 to 23.

Corporate Governance

The Corporate Governance report on pages 30 to 35 contains information about the Group's corporate governance arrangements, including in relation to the Board's decision to apply the UK Corporate Governance Code, published by the Financial Reporting Council ("FRC") in July 2018, in response to a change in the AIM Rules.

Results and Dividends

The results for the year are shown on page 48 of the financial statements. The profit after tax for the year of £6.2m (2018: loss of £20.0m) is included in reserves. The Directors recommend the payment of a second interim dividend in lieu of a final dividend of 21p (2018: 20p) per share. This is in light of the fact we are currently unable to schedule the AGM as previously planned. Together with the interim dividend of 16p (2018: 15p) paid on 16 August 2019, this makes a total dividend per share for the year of 37p (2018: 35p).

Directors

The names of the Directors of the Company at the date of this report, together with biographical details, are given on page 25 of this Annual Report. Mr. N.P.G. Boardman was appointed to the Board on 3 June 2019. All the other Directors listed on those pages were directors of the Company throughout the year.

Mr. Boardman offers himself for election under Article 75 of the Articles of Association. Mr. A.A. Salmon and Sir Alan Yarrow being eligible, offer themselves for re-election under Article 78 of the Articles of Association. Mr. Salmon has a service agreement terminable on twelve months' notice. Mr. Boardman and Sir Alan Yarrow, independent non-executive directors, each has a letter of appointment terminable on three months' notice.

Viability Statement

In accordance with the UK Corporate Governance Code, the Directors confirm that there is a reasonable expectation that the Group will continue to operate and meet its liabilities, as they fall due, for the three-year period up to 31 December 2022. A period of three years has been chosen because it is the period covered by the Group's strategic planning cycle and also incorporated in the Internal Capital Adequacy Assessment Process ("ICAAP"), which forecasts key capital requirements, expected changes in capital resources and applies stress testing over that period.

The Directors' assessment has been made with reference to:

- the Group's current position and prospects – please see the Financial Review on pages 12 to 23;
- the Group's key principles – please see Corporate Philosophy on page 1; and
- the Group's risk management framework and associated policies, as explained in Note 6.
- the asset classes that the Group is exposed to via its lending portfolios, which is almost all secured on property or other assets and may have personal guarantees attached.

The Group's strategy and three-year plan are evaluated and approved by the Directors annually. The plan considers the Group's future projections of profitability, cash flows, capital requirements and resources, and other key financial and regulatory ratios over the period. The Group's ICAAP is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. The ICAAP process is used to stress the capital position of the Group over the three year planning period. It is updated at least annually as part of the business planning process.

The Board have made assessments via a number of economic scenarios which have included the impact of the Bank of England base rate falling to zero and along with significant falls in residential and commercial property values and at the same time a substantial fall in equity markets. Also, the Board has examined how the limitations of the Group could be tested to extremes via a reverse stress test scenario. Given the secured nature of the Group's lending and the modest LTVs associated with this lending the Board is satisfied, that after it has applied any mitigating actions that are readily available to it, such as reducing bonus payouts, altering its dividend strategy and reducing its appetite to lend, the Group can remain viable over the foreseeable future.

Going Concern

After making appropriate enquiries which assessed strategy, profitability, funding, risk management (see Note 6 to the financial statements) and capital resources (see Note 7), and conducting a number of stress scenarios as mentioned above, the Directors are satisfied that the Company and the Group have adequate resources to continue in operation for the foreseeable future. The financial statements are therefore prepared on the going concern basis.

Share Capital

In May 2019 shareholders approved a bonus issue of one new Non-Voting share for every 100 Ordinary shares. The Company now has in issue two classes of shares. The new class of Non-Voting shares rank pari passu with the Ordinary shares, including the right to receive the same dividends as Ordinary shares, except that they do not have the right to vote in shareholder meetings.

Authority to Purchase Shares

Shareholders will also be asked to approve a Special Resolution renewing the authority of the Directors to make market purchases of shares not exceeding 10% of the issued Ordinary and Ordinary Non-Voting share capital. The Directors will keep the position under review in order to maximise the Company's resources in the best interests of shareholders. Details of the resolution renewing this authority will be included in the Notice of Meeting. During the year the Company issued 3,902 Ordinary Non-Voting shares as Treasury shares as part of the bonus issue of shares. It subsequently purchased 7,408 Ordinary Non-Voting shares as Treasury shares. The maximum number of Treasury shares held at any time during the year was 390,274 Ordinary shares and 11,310 Ordinary Non-Voting shares of 1p each.

Financial Risk Management

Details of how the Group manages risk are set out in the Strategic Report and in Note 6 to the financial statements.

Directors' Interests

The interests of current Directors and their families in the shares of the Company at the dates shown, together with the percentage of the current issued share capital held (excluding treasury shares), were as follows:

Beneficial Interests - Ordinary shares

Beneficial Interests	1 January 2019	31 December 2019	26 March 2020	%
Sir Henry Angest	8,351,401	8,351,401	8,351,401	56.1
J.R. Cobb	6,000	6,000	6,000	–
A.A. Salmon	51,699	51,699	51,699	0.3

Beneficial Interests - Ordinary Non-Voting shares

Beneficial Interests	1 January 2019	31 December 2019	26 March 2020	%
Sir Henry Angest	N/A	83,513	83,513	59.1
J.R. Cobb	N/A	60	60	–
A.A. Salmon	N/A	516	516	0.4

Substantial Shareholders

The Company was aware at 9 March 2020 of the following substantial holdings in the Ordinary shares of the Company, other than those held by one director shown above:

Holder	Ordinary Shares	%
Liontrust Asset Management	1,357,175	9.1
Slater Investments	585,638	3.9
Mr. R Paston	529,130	3.6
M&G Investment Management	529,216	3.6
Unicorn Asset Management	484,522	3.3

Significant Contracts

No Director, either during or at the end of the financial year, was materially interested in any contract with the Company or any of its subsidiaries, which was significant in relation to the Group's business. At 31 December 2019, one Director had a loan from Arbuthnot Latham & Co., Limited amounting to £502,000 (2018: £515,000) and four directors had deposits with Arbuthnot Latham amounting to £3,066,000 (2018: £1,884,000), all on normal commercial terms as disclosed in Note 42 of the financial statements.

Directors' Indemnities

The Company's Articles of Association provide that, subject to the provisions of the Companies Act 2006, the Company may indemnify any Director or former Director in respect of liabilities (and associated costs and expenses) incurred in connection with the performance of their duties as a Director of the Company or any subsidiary and may purchase and maintain insurance against any such liability. The Company maintained directors and officers liability insurance throughout the year.

Group Directors' Report *continued*

Employee Engagement

The Company gives due consideration to the employment of disabled persons and is an equal opportunities employer. It also regularly provides employees with information on matters of concern to them, consults on decisions likely to affect their interests and encourages their involvement in the performance of the Company through regular communications and in other ways. Further information on employee engagement is given in the Strategic Report on pages 22 and 23.

Engagement with Suppliers, Customers and Others

Information on engagement with suppliers, customers and other stakeholders is given in the Strategic Report on page 23, under the S. 172 statement.

Political Donations

The Company made political donations of £77,000 to the Conservative Party during the year (2018: £6,000).

Branches outside of the UK

During the year Arbuthnot Latham & Co., Limited operated a branch in Dubai which is regulated by the Dubai Financial Services Authority.

Non-adjusting events after the Balance Sheet Date

Details of material post balance sheet events are given in Note 47.

Annual General Meeting ("AGM")

It has not been possible to arrange a date for the AGM, due to the restrictions that are currently in place, the meeting will be arranged as soon as we are able to do so. At the AGM, Ordinary Shareholders will be asked to vote on a number of resolutions. The resolutions will be put to the shareholders via a Notice of Meeting that will be sent to them in due course.

Auditor

During the year KPMG LLP resigned as auditors to the Company and Mazars LLP were appointed by the Directors. A resolution for the re-appointment of Mazars LLP as auditor will be proposed at the forthcoming AGM in accordance with section 489 of the Companies Act 2006.

Disclosure of Information to the Auditor

Each of the persons who are Directors at the date of approval of this Annual Report confirm that:

- so far as each director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- they have taken all the steps they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Statement of Directors' Responsibilities in Respect of the Strategic Report and the Directors' Report and the Financial Statements

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the Financial Statements in accordance with applicable law and regulations. Company Law requires the Directors to prepare Group and Parent Company Financial Statements for each financial year. As required by the AIM Rules of the London Stock Exchange and in accordance with the NEX Exchange Growth Market – Rules for Issuers, they are required to prepare the Group Financial Statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU and applicable law and have elected to prepare the Parent Company Financial Statements on the same basis.

Financial Statements

Under Company Law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the Group profit or loss for that period. In preparing each of the Group and Parent Company 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 IFRSs as adopted by the EU;
- assess the Group and Parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they intend either to liquidate the Group or the Parent 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 Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its 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.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

The Directors confirm that the Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group and Parent Company's position, performance, business model and strategy.

By order of the Board

N D Jennings
Secretary

26 March 2020

Corporate Governance

Introduction and Overview

Arbuthnot Banking Group has a strong and effective corporate governance framework. The Board endorses the principles of openness, integrity and accountability which underlie good governance and takes into account the provisions of the UK Corporate Governance Code, published by the Financial Reporting Council ("FRC") in July 2018 ("the Code"), in so far as they are considered applicable to and appropriate for it, given its size and circumstances, and the role and overall shareholding of its majority shareholder. Moreover, the Group contains two subsidiaries authorised to undertake regulated business under the Financial Services and Markets Act 2000, one of which (Arbuthnot Latham & Co., Limited) is regulated by the Prudential Regulatory Authority and the Financial Conduct Authority and is an authorised deposit-taking business. It in turn has a subsidiary, Renaissance Asset Finance Limited, which is regulated by the Financial Conduct Authority. Arbuthnot Latham & Co., Limited also operates a branch in Dubai, which is regulated by the Dubai Financial Services Authority. Accordingly, the Group operates to the high standards of corporate accountability and regulatory compliance appropriate for such a business.

In March 2018, the AIM Rules were amended to require AIM companies to state which corporate governance code they had decided to apply, how the AIM company complies with that code, and where it departs from its chosen code an explanation of the reasons for doing so. This information is published, as required, on the Company's website and the Company reviews it each year as part of its annual reporting cycle.

The Board decided to report against the UK Corporate Governance Code. This section of the Annual Report summarises how the Company applies the Code and in broad terms how it has complied with its provisions throughout the year, giving explanations where it has chosen not to do so.

The Company is led by the Board which, following a new appointment in June 2019, comprises seven members: the executive Chairman, two other executive directors, Andrew Salmon and James Cobb, and four independent non-executive directors who thereby constitute at least half of the Board in line with the Code. The Board sets the long term focus and customer oriented culture of the Group. The responsibilities of Sir Henry Angest as Chairman include leading the Board, ensuring its effectiveness in all aspects of its role, ensuring effective communication with shareholders, setting the Board's agenda and ensuring that all Directors are encouraged to participate fully in the activities and decision-making process of the Board.

In 2016 an independent Board Effectiveness Review was carried out by an external consultant. In 2017, 2018 and again in October 2019 it was determined to carry out the annual Board Effectiveness Review internally. The 2019 evaluation took the form of a confidential questionnaire which assessed the performance of the Board and its Committees. The questions were set to explore the themes developed the previous year, including Board effectiveness, Board composition, Board dynamics, alignment of the Board and executive team, interaction with major shareholders, induction, performance and training, Board Committees and the Secretariat. The feedback was collated by the Company Secretary and discussed by the Board in November 2019. The responses were positive, confirming that the Board was of the view that it receives the correct level of insight into and oversight of the Company, both directly to it and in terms of management information and oral updates provided during meetings. Directors also agreed that the Arbuthnot culture set out in the Arbuthnot Principles and Values manifests itself at Board level and in the external view of the Group as a whole.

The Board

The Board met regularly throughout the year, holding six scheduled meetings as well as two ad-hoc meetings respectively to consider the acquisition of a mortgage portfolio and to approve the appointment of new external auditors as well as a two-day off-site strategy meeting. Substantive agenda items have briefing papers, which are circulated in a timely manner before each meeting. The Board ensures that it is supplied with all the information that it requires and requests in a form and of a quality to fulfil its duties.

In addition to overseeing the management of the Group, the Board has determined certain items which are reserved for decision by itself. These matters include approval of the Group's long-term objectives and commercial strategy, ensuring a sound system of internal control, risk management strategy, approval of major investments, acquisitions and disposals, any changes to the capital structure and the overall review of corporate governance.

The Company Secretary is responsible for ensuring that the Board processes and procedures are appropriately followed and support effective decision making. All directors have access to the Company Secretary's advice and services. There is an agreed procedure for directors to obtain independent professional advice in the course of their duties, if necessary, at the Company's expense.

All directors receive induction training upon joining the Board, with individual AIM and NEX Exchange training provided by the Company's Nominated Adviser and Corporate Adviser. Regulatory and compliance training is provided by the Group Head of Compliance or an external firm of lawyers. Risk management training is provided (including that in relation to the ICAAP and ILAAP) by the AL Chief Risk Officer with an overview of credit and its associated risks and mitigation by the AL Chief Credit Officer.

Overview of Compliance with the FRC Code, together with Exceptions

The Board focuses not only on the provisions of the Code but its principles, ensuring as follows:

- The Company's purpose, values and strategy as a prudently managed organisation align with its culture, with a focus on fairness and long-term shareholder returns.
- The Board has an appropriate combination of executive and non-executive directors, who have both requisite knowledge and understanding of the business and the time to commit to their specific roles.
- The Board comprises directors with the necessary combination of skills to ensure the effective discharge of its obligations, with an annual evaluation of the capability and effectiveness of each director as well as the Board as a composite whole; appropriate succession plans are also in place and reviewed annually, or more frequently if appropriate.
- The Board and Audit Committee monitor the procedures in place to ensure the independence and effectiveness of both external and internal auditors, and the risk governance framework of the Company, with all material matters highlighted to the relevant forum (Board/Committee).
- Remuneration policies and practices are designed to support strategy and promote long-term sustainable success, with a Remuneration Committee in place to oversee director and senior management pay.

In respect of the Code's specific provisions, an annual review is carried out, comparing the Company's governance arrangements and practices against them. Any divergences are noted, with relevant rationale considered carefully to determine whether it is appropriate. Consideration is also given to guidance issued, which may require a review of the relevant reasoning intra-year. In line with the FRC's Guidance on Board Effectiveness, the Board additionally takes into account its suggestions of good practice when applying the Code focusing on the five key principles specified in the Code.

Where the Company's governance does not completely align with the Code, it is generally as a result of the role of its overall majority shareholder, itself adding a level of protection to long-term shareholder interests, and it has had no negative impact on the Company.

All divergences from the Code, with an explanation of the reasons for doing so are set out below:

Provision 3 - The majority shareholder is Chairman and Chief Executive of ABG. Engagement with other major shareholders is carried out as appropriate by the Chairman, the Group Chief Operating Officer or the Group Finance Director. There has been no requirement to date to consult with them on matters delegated to Board committees, but if appropriate/when requested, this would be arranged.

Provision 5 – The Board has regard to the interests of all its key stakeholders in its decision making. The Company has fewer than 20 employees, all of whom have direct access to Board members. As such, it has not been deemed necessary to appoint an employee representative to the Board, nor a formal workforce advisory panel, nor a designated non-executive Director. As stated in the s. 172(1) Statement on page 22, one of the non-executive directors of Arbuthnot Latham and its Whistleblowing Champion, has been designated by its board as the director to engage with the Group's workforce.

Provision 9 - Sir Henry Angest carries out the role of Chairman and Chief Executive, given his long-term interest as majority shareholder, itself aligning with the interests of other shareholders. The Group Chief Operating Officer and the Group Finance Director provide a strong, independent counterbalance, ensuring challenge and independence from a business perspective, against the stakeholder focus of the Chairman carrying out his Chairman's role. The Company follows the US model that is very successful in ensuring commercial success with strong corporate governance and stakeholder awareness, having a shared Chairman and CEO, with a separate, empowered, Chief Operating Officer.

Provision 10 ¬ The Board considers Sir Christopher Meyer to be independent, notwithstanding his serving more than nine years, since his views and any challenge to executive management remain firmly independent.

Provision 12 – The Board has not appointed a Senior Independent Director, as major shareholders talk openly with the Chairman, the Group Chief Operating Officer and the Group Finance Director on request.

Corporate Governance *continued*

Provision 14 – Attendance at meetings is not reported as, should a Director be unable to attend a meeting, that Director receives relevant papers in the normal manner and relays any comments in advance of the meeting to the Chairman. The same process applies in respect of the Board Committees.

Provision 18 – For the purposes of stability and continuity, the Company continues to offer Directors for re-election on a three-year rolling basis in accordance with the Company's Articles of Association and company law. The Directors seeking re-election at the 2020 AGM are Mr. Salmon, an executive Director, and Sir Alan Yarrow. Mr. Boardman is seeking election, having been appointed by the Board during the year. The contributions of Mr. Salmon, Sir Alan and Mr. Boardman have been invaluable in the successful development of the Company. Accordingly, the Board fully supports the resolutions for their reappointment.

Provision 19 - Sir Henry Angest's role as Chairman has extended over nine years and is expected to continue indefinitely, given his key role as majority shareholder both in protecting the stability of his and other shareholder interests and in overseeing a balanced and risk-managed approach to growing the business with a view to the longer-term.

Provision 20 - The Board did not deem it necessary to use advertising or an external consultancy in identifying during the year Mr. Boardman as a suitable new non-executive director with legal expertise, given his credibility, knowledge and reputation and his availability following the announcement of his retirement from partnership.

Provision 32 – Sir Henry Angest is Chairman of the Remuneration Committee, as is appropriate in the context of his majority shareholding.

Internal Control and Financial Reporting

The Board of directors has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable, but not absolute, assurance against the risk of material misstatement or loss.

The Directors and senior management of the Group review and approve the Group's Risk Management Policy and Risk Appetite framework. The Risk Management Policy describes and articulates the risk management and risk governance framework, methodologies, processes and infrastructure required to ensure due attention to all material risks for Arbuthnot Latham, including compliance with relevant regulatory requirements.

The Risk Appetite framework sets out the Board's risk attitude for the principal risks through a series of qualitative statements and quantitative risk tolerance metrics. These guide decision-making at all levels of the organisation, and form the basis of risk reporting. The key business risks and emerging risks are continuously identified, evaluated and managed by means of limits and controls at an operational level by AL management, and are governed through AL Committees.

At its offsite meeting, the Board discussed the principal risks pertinent to the Group's strategic objectives over the three-year budget period and the operation of the Risk Management Framework and Policy in managing and providing oversight in relation to them. In November 2019, the Board carried out its annual review of the effectiveness of the Group's risk management and internal control systems.

Significant risks identified in connection with the development of new activities are subject to consideration by the Board. There are well-established budgeting procedures in place and reports are presented regularly to the Board detailing the results, in relation to Arbuthnot Latham, of each principal business unit, variances against budget and prior year, and other performance data. The Board receives regular reports on any risk matters that need to be brought to its attention, enabling it to assess the Group's emerging and principal risks.

Shareholder Communications

The Company maintains communications via one to one meetings as appropriate with its major shareholders and makes full use of the AGM to communicate with shareholders. The Company aims to present a balanced and understandable assessment in all its reports to shareholders, its regulators, other stakeholders and the wider public. Key announcements and other information can be found at www.arbuthnotgroup.com.

Board Committees

The Board has established Audit, Nomination, Remuneration and Donations Committees, each with formally delegated duties and responsibilities and with written terms of reference, which require consideration of the committee's effectiveness. The Board keeps the governance arrangements under review. Further information in relation to these committees is set out below. The Board maintains direct responsibility for issues of Risk without the need for its own Risk Committee, since responsibility for large lending proposals is a direct responsibility of its subsidiary, Arbuthnot Latham.

Audit Committee

Membership and meetings

Membership of the Audit Committee is restricted to non-executive Directors and comprises Ian Dewar (as Chairman), Sir Christopher Meyer and Sir Alan Yarrow. Mr. Dewar has recent and relevant financial experience and the Committee as a whole has competence relevant to the financial sector in which the Company operates. The Company Secretary acts as its Secretary. The Committee met five times during the year, including one ad-hoc meeting held to consider the outcome of the audit tender.

The Audit Committee oversees, on behalf of the Board, financial reporting, the appropriateness and effectiveness of systems and controls, the work of Internal Audit and the arrangements for and effectiveness of the external audit. The ultimate responsibility for reviewing and approving the Annual Report and Accounts and the Interim Report lies with the Board. The Audit Committee also reviews whistleblowing arrangements for employees to raise concerns in confidence.

External Audit

During the year the Audit Committee conducted a competitive audit tender, as required by the EU Audit Regulation 2014. Following this tender, the Committee recommended to the Board that Mazars LLP be appointed as auditor in place of KPMG LLP who had held office since 2009. The Committee assesses the independence and objectivity, qualifications and effectiveness of the external auditors on an annual basis as well as making a recommendation to the Board on their reappointment. The Committee received a report showing the level of non-audit services provided by the external auditors during the year and members were satisfied that the extent and nature of these did not compromise auditor independence. The Committee has concluded that Mazars are independent and that their audit is effective.

Activity in 2019

Internal Audit

On behalf of the Board, the Audit Committee monitors the effectiveness of systems and controls. To this end, Internal Audit provides the Audit Committee and the Board with detailed independent and objective assurance on the effectiveness of governance, risk management and internal controls. Since Arbuthnot Latham, the Company's operating subsidiary, has its own Audit Committee, the role of the Group Audit Committee is mainly supervisory in relation to internal audit matters, though it receives items of material note deriving from Arbuthnot Latham's internal audits, including an assessment of culture which forms part of every internal audit.

The Audit Committee approves the Internal Audit risk based programme of work and monitors progress against the annual plan. The Committee reviews Internal Audit resources and the arrangements that: ensure Internal Audit faces no restrictions or limitations to conducting its work; that it continues to have unrestricted access to all personnel and information; and that Internal Audit remains objective and independent from business management.

The Head of Internal Audit provides reports on the outcomes of Internal Audit work directly to the Committee and the Committee monitors progress against actions identified in these reports.

The Committee received a Quality Assessment report on Internal Audit, carried out by an external assessor, in September 2019 and it is satisfied with Internal Audit arrangements during 2019.

Integrity of Financial Statements and oversight of external audit

The Committee:

- Received and agreed the Audit Plan prepared by the external auditors;
- Considered and formed a conclusion on the critical judgements underpinning the Financial Statements, as presented in papers prepared by management. In respect of all of these critical judgements, the Committee concluded that the treatment in the Financial Statements was appropriate;
- Received reports from the external auditors on the matters arising from their work, the key issues and conclusions they had reached;
- The Chairman of the Committee attended, as an observer, Audit Committee meetings of Arbuthnot Latham;
- The Committee monitored the changes to financial reporting requirements which came in effect on 1 January 2019, being IFRS 16, Leases, where it was determined to use a modified retrospective approach, as explained in Note 2;
- It approved a recommendation that the layout of the accounting policies within the financial statements be amended to integrate them within the relevant note.
- In addition the Committee discussed correspondence between the Company and the FRC, following review by the FRC of the Group's 2018 Accounts, as a consequence of which disclosures have been enhanced in the 2019 Accounts.

Corporate Governance *continued*

The reports from the external auditors include details of internal control matters that they have identified as part of the annual statutory financial statements audit. Certain aspects of the system of internal control are also subject to regulatory supervision, the results of which are monitored closely by the Committee and the Board. In addition, the Committee receives by exception reports on the ICAAP and ILAAP which are key control documents that receive detailed consideration by the board of Arbuthnot Latham.

The Committee approved the terms of engagement and made a recommendation to the Board on the remuneration to be paid to the external auditors in respect of their audit services.

Significant areas of judgement

The Audit Committee considered the following significant issues and accounting judgements in relation to the Financial Statements:

Impairment of loans and advances to customers

The Committee reviewed presentations from management detailing the provisioning methodology across the Group as part of the full year results process. The Committee considered and challenged the provisioning methodology applied by management, including timing of cash flows, valuation and recoverability of supporting collateral on impaired assets. The Committee concluded that the impairment provisions, including management's judgements, were appropriate.

The charge for impaired loans and advances totalled £0.9m for the year ended 31 December 2019. The disclosures relating to impairment provisions are set out in Note 4.1(a) to the financial statements.

Effective Interest rate

Interest earned on loans and receivables is recognised using the Effective Interest Rate ("EIR") method. The EIR is calculated on the initial recognition of a loan through a discounted cash flow model that incorporates fees, costs and other premiums or discounts. There have been no changes to the EIR accounting policies during the year.

The Committee considered and challenged the EIR methodology applied by management and specifically in relation to acquired loan portfolios. The Committee considered management assumptions including expected future customer behaviours and concluded that the EIR methodology was appropriate as at 31 December 2019.

The disclosures relating to EIR are set out in Note 4.1(b) to the financial statements.

Valuation of Investment Property

The investment property is held at fair value. The Committee reviewed and challenged the key assumptions used in the valuation of the property including yields and rental income. Two other investment properties were transferred to inventory during the year. The Committee reviewed the appropriateness of this accounting treatment.

As at 31 December 2019, the Group's property investment portfolio totalled £6.8m, as detailed in Note 30.
The disclosures relating to the fair value of the investment property is set out in Note 4.1(c) to the financial statements.

Inventory

As mentioned above, two investment properties were transferred to inventory during the year. These are carried at the lower of cost and net realisable value. The Committee reviewed the appropriateness of the carrying value.

The disclosures relating to the carrying value of the inventory is set out in Note 4.1(d) to the financial statements.

Going Concern and Viability Statement

The financial statements are prepared on the basis that the Group and Company are each a going concern. The Audit Committee reviewed management's assessment and is satisfied that the going concern basis and assessment of the Group's longer-term viability is appropriate.

Other Committee activities

In November 2019, Committee members contributed to the review of the Committee's effectiveness as part of its evaluation by the Board. There were no issues or concerns raised by them in regard to discharging their responsibilities.

On behalf of the Board, the Committee reviewed the financial statements as a whole in order to assess whether they were fair, balanced and understandable. The Committee discussed and challenged the balance and fairness of the overall report with the executive directors and also considered the views of the external auditor. The Committee was satisfied that the Annual Report could be regarded as fair, balanced and understandable and proposed that the Board approve the Annual Report in that respect.

Nomination Committee

Membership and meetings

The Nomination Committee is chaired by Sir Henry Angest and its other members are Sir Christopher Meyer and Sir Alan Yarrow. The General Counsel acts as its Secretary. The Committee met twice during the year. It is required to meet formally at least once per year and otherwise as required.

The Nomination Committee assists the Board in discharging its responsibilities relating to the composition of the Board. The Nomination Committee is responsible for and evaluates on a regular basis the balance of skills, experience, independence and knowledge on the Board, its size, structure and composition, retirements and appointments of additional and replacement directors and will make appropriate recommendations to the Board on such matters.
The Nomination Committee also considers succession planning, taking into account the skills and expertise that will be needed on and beneficial to the Board in the future.

Activity in 2019

During the year, the Nomination Committee was involved in the identification, assessment and appointment of an additional independent Non-Executive Director. In April 2019 it met to recommend that Mr. Boardman, a highly-regarded corporate lawyer, having spent many years as a partner of Slaughter and May, be appointed as a director. The Committee continually considers the question of diversity and had considered for some time that the appointment of a legal expert, particularly one of Mr. Boardman's credibility, knowledge and reputation to the Board would be a real benefit both in terms of collective and individual suitability, but also when third parties are considering dealings with the wider group. For this reason, Mr. Boardman was approached following the announcement of his retirement from the partnership. It was not considered necessary to widen the search to comprise other legal experts for the role, given Mr. Boardman's status and profile and so neither advertising nor an external consultancy was used for this appointment.

The Committee reviewed policies on Board Diversity, Board Suitability and Board Training and Development. It also assessed and confirmed the collective and individual suitability of Board members. The contribution of Sir Henry Angest remains invaluable in the successful development of the Company. As regards the non-executive Directors' skill sets, Ian Dewar, with a wealth of experience as a partner in a major accounting firm, has successfully chaired the Audit Committee. Sir Christopher Meyer's wide-ranging experience including as a diplomat at the highest level has provided an important independent measure of challenge to executive management. The Board has benefitted from Sir Alan Yarrow's wise counsel, challenge to management and many years' experience in the City of London.

In November 2019, the Committee confirmed that the Board's current composition provides the Company with a balanced, knowledgeable, diverse and informed group of directors, bringing strategic acumen, foresight and challenge to the executive, commensurate with the size of the business.

The Committee reviewed succession planning and agreed that there was a sensible and strong plan in place. In terms of any new hires, it noted that account would be taken of provisions in the Board Diversity Policy. The Committee also agreed that it continued to operate effectively and, as such, no changes to its membership, composition or activities were proposed to the Board.

Remuneration Committee

Membership and meetings

Membership is detailed in the Remuneration Report on page 36. The Committee met twice during the year. It is required to meet formally at least once per year and otherwise as required.

The Remuneration Committee assists the Board in determining its responsibilities in relation to remuneration including, inter alia, in relation to the Company's policy on executive remuneration determining, the individual remuneration and benefits package of each of the Executive Directors and the fees for Non-Executive Directors.

The Committee also deals with remuneration-related issues under the Prudential Regulation Authority's Remuneration Code applicable to the Company. The Remuneration Report on pages 36 and 37 gives further information and details of each Director's remuneration.

Donations Committee

Membership and meetings

The Donations Committee is chaired by Sir Henry Angest and its other members are Sir Christopher Meyer and Sir Alan Yarrow. The Committee met once during the year.

The Committee considers any political donation or expenditure as defined within sections 366 and 367 of the Companies Act 2006.

By order of the Board

N D Jennings
Secretary

26 March 2020

Remuneration Report

Remuneration Committee

Membership of the Remuneration Committee is limited to non-executive directors together with Sir Henry Angest as Chairman. The members of the Committee are Sir Henry Angest, Sir Christopher Meyer and Sir Alan Yarrow. The General Counsel acts as its Secretary. The Committee met twice during the year.

The Committee has responsibility for producing recommendations on the overall remuneration policy for directors for review by the Board and for setting the remuneration of individual directors. Members of the Committee do not vote on their own remuneration.

Remuneration Policy

The Remuneration Committee determines the remuneration of individual directors having regard to the size and nature of the business; the importance of attracting, retaining and motivating management of the appropriate calibre without paying more than is necessary for this purpose; remuneration data for comparable positions, in particular the rising remuneration packages at challenger banks; the need to align the interests of executives with those of shareholders; and an appropriate balance between current remuneration and longer-term performance-related rewards. The remuneration package can comprise a combination of basic annual salary and benefits (including pension), a discretionary annual bonus award related to the Committee's assessment of the contribution made by the executive during the year and longer-term incentives, including executive share options. Pension benefits take the form of annual contributions paid by the Company to individual money purchase schemes. The Remuneration Committee reviews salary levels each year based on the performance of the Group during the preceding financial period. This review does not necessarily lead to increases in salary levels. For the purposes of the FCA Remuneration Code, all the provisions of which have been implemented, the Group and its subsidiaries are all considered to be Tier 3 institutions.

Activity in 2019

The Remuneration Committee undertook its regular activities during the year including reviewing the operation of the Remuneration Policy, having regard to the performance of the Company during the year, with particular regard to the level of discretionary bonus awarded and the level of inflation impacting on salaries.

Directors' Service Contracts

Sir Henry Angest, Mr. Salmon and Mr. Cobb each have service contracts terminable at any time on 12 months' notice in writing by either party.

Long Term Incentive Schemes

Grants were made to Messrs Salmon and Cobb on 14 June 2016 under Phantom Option Scheme introduced on that date, to acquire ordinary 1p shares in the Company at 1591p exercisable in respect of 50% on or after 15 June 2019 and in respect of the remaining 50% on or after 15 June 2021 when a cash payment would be made equal to any increase in market value.

Under this Scheme, Mr. Salmon and Mr. Cobb were granted a phantom option to acquire 200,000 and 100,000 ordinary 1p shares respectively in the Company, which remained outstanding at 31 December 2019. The fair value of these options at the grant date was £1.0m.

Directors' Emoluments

	2019 £000	2018 £000
Fees (including benefits in kind)	240	205
Salary payments (including benefits in kind)	4,334	4,387
Pension contributions	70	93
	4,644	**4,685**

	Salary £000	Bonus £000	Benefits £000	Pension £000	Fees £000	Total 2019 £000	Total 2018 £000
Sir Henry Angest	1,200	–	93	–	–	1,293	1,279
JR Cobb	650	550	17	35	–	1,252	977
IA Dewar	–	–	–	–	75	75	75
IA Henderson (to 31/08/2018)	–	–	–	–	–	–	367
Sir Christopher Meyer	–	–	–	–	60	60	60
AA Salmon	1,200	600	24	35	–	1,859	1,857
Sir Alan Yarrow	–	–	–	–	70	70	70
Nigel Boardman	–	–	–	–	35	35	–
	3,050	**1,150**	**134**	**70**	**240**	**4,644**	**4,685**

Details of any shares or options held by directors are presented on page 36 and 120.

The emoluments of the Chairman were £1,293,000 (2018: £1,279,000). The emoluments of the highest paid director were £1,859,000 (2018: £1,857,000) including pension contributions of £35,000 (2018: £35,000).

Secure Trust Bank was paid a fee of £36,000 up to 8 August 2018 for the services of Mr. Lynam rendered as a non-executive director.

Retirement benefits are accruing under money purchase schemes for two directors who served during 2019 (2018: three directors).

Sir Henry Angest
Chairman of the Remuneration Committee

26 March 2020

Independent Auditor's Report
to the members of Arbuthnot Banking Group PLC

Opinion

We have audited the financial statements of Arbuthnot Banking Group PLC (the 'Parent Company') and its subsidiaries (the 'Group') for the year ended which comprise: the Consolidated Statement of Comprehensive Income; Consolidated Statement of Financial Position; Company Statement of Financial Position; Consolidated Statement of Changes in Equity; Company Statement in Changes in Equity; Consolidated Statement of Cash Flows; Company Statement of Cash Flows; and, notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2019 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements 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 under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

The impact of uncertainties due to both the COVID-19 coronavirus and the United Kingdom exiting the European Union on our audit

The Directors' view on the impacts of the COVID-19 coronavirus and Brexit are disclosed on page 20 and Note 47.

The full impact following the recent emergence of the global coronavirus is still unknown. It is therefore not currently possible to evaluate all the potential implications to the Group and Parent Company's trade, customers, suppliers and the wider economy.

The United Kingdom withdrew from the European Union on 31 January 2020 and entered into an Implementation Period which is scheduled to end on 31 December 2020. However the terms of the future trade and other relationships with the European Union are not yet clear, and it is therefore not currently possible to evaluate all the potential implications to the Group and Parent Company's trade, customers, suppliers and the wider economy.

We considered the impacts of Brexit on the Group and Parent Company as part of our audit procedures, applying a standard firm wide approach in response to the uncertainty associated with the Group's and Parent Company's future prospects and performance.

However, no audit should be expected to predict the unknowable factors or all possible implications for the Group and Parent Company and this is particularly the case in relation to both COVID-19 coronavirus and Brexit.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Parent Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We summarize on pages 40 to 43 the key audit matters in forming our audit opinion above, together with an overview of the principal audit procedures performed to address each matter and, where relevant, key observations arising from those procedures.

Independent Auditor's Report to the members of Arbuthnot Banking Group PLC *continued*

Loan Loss Provisions

Group - £4.8 million; 2018: £6.6 million (See Note 23)

The risk

Credit risk is an inherently judgemental area due to the use of subjective assumptions and a high degree of estimation. The impairment provision relating to the Group's loan portfolio requires the Directors to make judgements over the ability of the Groups' customers to make future loan repayments.

The Group adopted IFRS 9 from 1 January 2018. IFRS 9 requires loan loss provisions to be determined on an Expected Credit Loss ("ECL") basis.

The largest element of credit risk relates to Loans and Advances to Customers where the Bank is exposed to secured and unsecured lending to private and commercial clients.

Individual impairment assessments are made for loans classified as Stage 3 and 2. This is based on assumptions around probability of default and the present value of future cash flows arising primarily from the sale or repossession of collateral. For loans classified as stage 1 ECL is determined through the use of a model.

The model used by the Group to determine expected losses requires judgement to the input parameters and assumptions as set out in Notes 3.4 and 4.1 of the financial statements.

The most significant areas where we identified greater levels of management judgement are:

- staging of loans and the identification of Significant Increase in Credit Risk;
- key assumptions in the model including probability of default ("PD") and loss given default ("LGD") including the present value of future cash flows from collateral;
- Use of macro-economic variables reflecting a range of future scenarios.

Disclosures regarding the Group's and Parent Company's measurement and classification of financial instruments held under IFRS 9 are key to understanding the key judgements and inputs.

Our response

Planning

We have performed a risk assessment over the Group and Parent Company's loan portfolio to identify areas of heightened risk.

We have assessed the methodology of identifying Significant Increase in Credit Risk.

Controls Testing

We have tested the design and operating effectiveness of the key controls operating across the Group in relation to credit processes (including underwriting, monitoring, collections and provisioning). This also included attendance at a Non-Performing Loan Committee meeting, missed payments monitoring, credit reviews at origination and annual review, watch list movements through the year, and revaluation controls.

Test of detail

We have reviewed credit files in order to verify data used in the determination of PD and LGD assumptions. This was performed for all loans in Stage 3 and Stage 2 and for a sample of loans in Stage 1 with characteristics of heightened credit risk (e.g. high Loan-to-Value secured exposures and unsecured exposures).

Expected Credit Loss Models

We have assessed the models used by management to determine expected loss calculations. We have:

- Considered the methodology used by management;
- Tested the data inputs used in applying the methodology adopted and assessed for reasonableness;
- Tested the completeness of the loan portfolio applied to the model;
- Tested the process in place to allocate loans to the respective risk categories (Staging);
- Reviewed the key assumptions applied to determine probability of default and loss given default;
- We have included in-house Credit Risk and Economic specialists in the assessment of model approach and assumptions.

Disclosures

We evaluated whether the disclosures are a clear true and fair reflection of managements approach to classification and measure under IFRS 9 and key assumptions made.

Key observations

We found the approach taken in respect of loan loss provisions to be consistent with the requirements of IFRS 9 and judgements made were reasonable.

Disclosures were appropriate.

Revenue Recognition: Effective Interest Rate

Group - £76.9 million; 2018: £65.3 million (See Note 8)

The risk

The financial reporting fraud risk over revenue recognition specifically relates to income recognised on an effect interest method (EIR) on Loans and Advances to Customers including originated and acquired loan portfolios.

The EIR takes into account cash flows that are an integral part of the instrument's yield including: premiums, discounts and acquisition costs which are spread over the expected life of the loan.

Models adopted to calculate EIR are prepared manually and are therefore have an increased risk of error or fraud.

Judgement is required to determine whether fees are recognised as EIR or recognised when a service has been performed.

The most significant areas where we identified greater levels of management judgement are:

- Unwinding of the discount on acquired portfolios where estimations are made to adjust expected future cash flows;
- assumptions over the timing of cash flows used in revenue recognition of originated exposures.

Our response

Acquired Portfolios

We have assessed the design and tested the operating effectiveness of controls in place in the Group relating to acquired portfolios and monitoring of expected cash flows when determining effective interest.

We have tested controls in place at service providers where acquired portfolios are managed by third parties.

We have assessed the basis for recognising revenue of acquired portfolios against the requirements of IFRS 9.

We have assessed key judgements over expected future cash flows including estimations over early repayments and credit losses.

We have performed tests of detail relating to loan information and security valuations on a sample of exposures in the acquired portfolios.

Originated Portfolios

We have assessed the design of controls in place over models used within the EIR calculation.

We have re-performed model data inputs to identify instances of error. Over a sample of instruments we have verified details to underlying agreements.

We have assessed the EIR model calculation for compliance with IFRS 9. Where approximations have been adopted in the EIR model we have assessed impact.

Key observations

We identified discrepancies in the application of EIR adjustments in acquired portfolios which were discussed with management and the Audit Committee; however we gained assurance we required in this area.

Independent Auditor's Report to the members of Arbuthnot Banking Group PLC *continued*

Investment Properties

Group - £6.8 million; 2018: £67.1 million (See Note 30)

The risk

The Group has an accounting policy to hold Investment Properties at fair value.

Management engage third party experts to provide observations and market data e.g. property rental yields. This data is included in models built in-house.

The outcome of the model is highly sensitive to assumptions made.

Where there is a change in use and the property developed with a view to sell, Investment Properties are reclassified as inventory. IAS 40 sets criteria for reclassification which can results in misclassification if the criteria is not met.

Where property is reclassified as inventory it is held at cost, calculated as being the fair value on date of reclassification using the same in-house models

Our response

We have assessed accounting classification of all Investment Property and Property Held for Sale held by the Group.

In assessing fair value, either at the balance sheet date or at the date of reclassification, we have agreed data inputs in the fair value models to source.

We have engaged external property valuation specialists as audit experts to assist us in our review of the valuation approach and assumptions.

Key observations

We found the methodology and approach in assessing fair value of Investment Property and Property reclassified as held for sale to be in line with IFRS.

Impact of the outbreak of COVID 19 on the assessment of going concern

The financial statements have been prepared on a going concern basis (See Basis of Preparation Page 56)

The risk

Since the outbreak of COVID 19 in the UK, the Directors have considered the impact this could have on the Group's and Parent Company's ability to continue as a going concern.

In performing this assessment, they considered a range of stress scenarios which included the impact of reductions in the Bank of England base rate to zero per cent, significant falls in residential and commercial property values and the impact of substantial falls in equity markets could have on revenue. Furthermore, reverse stress scenarios were examined to understand the limitations of the Group.

Consideration has also been given to mitigation actions that could be implemented such as reducing bonus payments, altering dividend strategy and reducing lending appetite.

The Directors concluded that the Group can remain viable and the going concern basis is appropriate.

Our response

In forming our conclusions over going concern, we evaluated whether management's going concern assessment robustly considered impacts arising from COVID-19.

We reviewed management's going concern assessment.

We made enquiries of management to understand the potential impact of COVID-19 on the Group and Parent Company's financial performance, business operations, and regulatory and liquidity positions.

We reviewed the Group's most recent Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Process which contain the results of the company's latest stress tests.

We challenged key assumptions and substantively re-performed key calculations.

Our reporting on Going Concern is set out above.

Independent Auditor's Report to the members of Arbuthnot Banking Group PLC *continued*

Our application of materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and on the financial statements as a whole. Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	Group: £1,042,000 Parent Company: £800,000
How we determined it	Group and Parent Company: 0.5% of Net Assets.
Rationale for benchmark applied	We selected a Net Assets benchmark because the principle activity of the Group and Parent Company is the investment of capital.
Performance materiality	Group: £625,000 Parent Company: £480,000
Reporting threshold	Group: £31,000 Parent Company: £24,000

An overview of the scope of our audit, including extent to which the audit was considered capable of detecting irregularities, including fraud

As part of designing our audit, we determined materiality and assessed the risk of material misstatement in the financial statements, whether due to fraud or error, and then designed and performed audit procedures responsive to those risks. In particular, we looked at where the Directors made subjective judgements such as making assumptions on significant accounting estimates.

We tailored the scope of our audit to ensure that we performed sufficient work to be able to give an opinion on the financial statements as a whole. We used the outputs of a risk assessment, our understanding of the Group and Parent Company, its environment, controls and critical business processes, to consider qualitative factors in order to ensure that we obtained sufficient coverage across all financial statement line items.

Our audit procedures were designed to respond to those identified risks, including non-compliance with laws and regulations (irregularities) and fraud that are material to the financial statements.

In identifying and assessing risks of material misstatement in respect to irregularities including non-compliance with laws and regulations, our procedures included but were not limited to:

- at planning stage, we gained an understanding of the legal and regulatory framework applicable to the Group and Parent Company, the structure of the Group, the industry in which they operate and considered the risk of acts by the Group and Parent Company which were contrary to the applicable laws and regulations;
- during the audit, we focused on 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 and through discussions with the Directors (as required by auditing standards), from inspection of the Group's regulatory and legal correspondence and review of minutes of Directors' meetings in the year. We identified that the principal risks of non-compliance with laws and regulations related to breaches of regulatory requirements of the Group's regulators, the Prudential Regulatory Authority and the Financial Conduct Authority. We also considered those other laws and regulations that have a direct impact on the preparation of financial statements, such as the Companies Act 2006 and UK tax legislation;

- we discussed with the Directors the policies and procedures in place regarding compliance with laws and regulations. We discussed amongst the engagement team the identified laws and regulations, and remained alert to any indications of non-compliance.

Our procedures in relation to fraud included but were not limited to:

- inquiries of management whether they have knowledge of any actual, suspected or alleged fraud;
- gaining an understanding of the internal controls established to mitigate risk related to fraud;
- discussion amongst the engagement team regarding risk of fraud such as opportunities for fraudulent manipulation of financial statements, and determined that the principal risks were related to posting manual journal entries to manipulate financial performance, management bias through judgements and assumptions in significant accounting estimates, in particular in relation loan impairments, and the effective interest rate method of income recognition, and significant one-off or unusual transactions; and
- addressing the risk of fraud through management override of controls by performing journal entry testing.

The primary responsibility for the prevention and detection of irregularities including fraud rests with both those charged with governance and management. As with any audit, there remained a risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal controls.

As a result of our procedures, we did not identify any "Key audit matters" relating to irregularities. The risks of material misstatement that had the greatest effect on our audit, including fraud, are discussed under "Key audit matters" within this report.

As a result of the directors' voluntary reporting on how the UK Corporate Governance Code (the "Code") has been applied, we are required to report to you if we have anything material to add or draw attention to regarding:

- the disclosures in the annual report set out on pages 20 to 22 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 28 in the annual report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 27 in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group and the Parent Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; or
- the directors' explanation set out on page 26 in the annual report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report in this regard.

As a result of the directors' voluntary reporting on how the Code has been applied, we are required to report on the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- Fair, balanced and understandable set out on page 29 – the statement by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit committee reporting set out on pages 33 and 34 – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

We have nothing to report in this regard.

Independent Auditor's Report to the members of Arbuthnot Banking Group PLC *continued*

Other information

The Directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In light of the knowledge and understanding of the Group and the Parent Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company 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.

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement set out on pages 28 and 29, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent 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 the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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 an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a 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 the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters which we are required to address

Following the recommendation of the audit committee, we were appointed by the Board of Directors on 6 December 2019 to audit the financial statements for the year ending 31 December 2019. The period of total uninterrupted engagement is 1 year, covering the year ending 31 December 2019.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company and we remain independent of the Group and the Parent Company in conducting our audit.

Our audit opinion is consistent with the additional report to the audit committee.

Use of the audit report

This report is made solely to the Parent 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 Parent 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 Parent Company and the Parent Company's members as a body for our audit work, for this report, or for the opinions we have formed.

Greg Simpson
(Senior Statutory Auditor)
for and on behalf of Mazars LLP,

Chartered Accountants and Statutory Auditor
Tower Bridge House, St Katherine's Dock
London

26 March 2020

Consolidated Statement of Comprehensive Income

	Note	Year ended 31 December 2019 £000	Year ended 31 December 2018 £000
Interest income	8	76,870	65,290
Interest expense		(18,233)	(10,107)
Net interest income		**58,637**	**55,183**
Fee and commission income	9	13,935	12,956
Fee and commission expense		(107)	(234)
Net fee and commission income		**13,828**	**12,722**
Operating income		**72,465**	**67,905**
Net impairment loss on financial assets	10	(867)	(2,731)
Other income	11	5,599	6,588
Operating expenses	12	(70,186)	(64,982)
Profit before tax from continuing operations		**7,011**	**6,780**
Income tax expense	13	(835)	(1,121)
Profit after tax from continuing operations		6,176	5,659
Loss from discontinued operations after tax	14	–	(25,692)
Profit/(loss) for the year		**6,176**	**(20,033)**
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Changes in fair value of equity investments at fair value through other comprehensive income		10,707	(13,893)
Tax on other comprehensive income		(77)	(26)
Other comprehensive income/(loss)for the period, net of tax		**10,630**	**(13,919)**
Total comprehensive income/(loss) for the period		**16,806**	**(33,952)**
Profit attributable to:			
Equity holders of the Company		6,176	(20,033)
Profit/(loss) for the year		**6,176**	**(20,033)**
Total comprehensive income attributable to:			
Equity holders of the Company		16,806	(33,952)
Total comprehensive income/(loss)for the period		**16,806**	**(33,952)**
Earnings per share for profit attributable to the equity holders of the Company during the year (expressed in pence per share):			
Basic earnings per share – Continuing operations	16	41.2	38.0
Basic earnings per share – Discontinued operations	16	–	(172.5)
Basic earnings per share	16	**41.2**	**(134.5)**
Diluted earnings per share – Continuing operations	16	41.2	38.0
Diluted earnings per share – Discontinued operations	16	–	(172.5)
Diluted earnings per share	16	**41.2**	**(134.5)**

The notes on pages 56 to 128 are an integral part of these consolidated financial statements

Consolidated Statement of Financial Position

	Note	At 31 December 2019 £000	At 31 December 2018 £000
ASSETS			
Cash and balances at central banks	17	325,908	405,325
Loans and advances to banks	18	46,258	54,173
Debt securities at amortised cost	19	442,960	342,691
Assets classified as held for sale	20	7,617	8,002
Derivative financial instruments	21	1,804	1,846
Loans and advances to customers	22	1,599,053	1,224,656
Other assets	24	86,443	12,716
Financial investments	25	30,919	35,351
Deferred tax asset	26	1,815	1,490
Intangible assets	27	20,082	16,538
Property, plant and equipment	28	5,813	5,304
Right-of-use assets	29	19,944	–
Investment property	30	6,763	67,081
Total assets		**2,595,379**	**2,175,173**
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	37	154	153
Retained earnings	38	209,171	209,083
Other reserves	38	(990)	(13,280)
Total equity		**208,335**	**195,956**
LIABILITIES			
Deposits from banks	31	230,421	232,675
Derivative financial instruments	21	319	188
Deposits from customers	32	2,084,903	1,714,286
Current tax liability		633	236
Other liabilities	33	13,500	18,549
Lease liabilities	34	20,431	–
Debt securities in issue	35	36,837	13,283
Total liabilities		**2,387,044**	**1,979,217**
Total equity and liabilities		**2,595,379**	**2,175,173**

The financial statements on pages 48 to 128 were approved and authorised for issue by the Board of directors on 26 March 2020 and were signed on its behalf by:

A.A. Salmon
Director

J.R. Cobb
Director

Registered Number: 1954085

The notes on pages 56 to 128 are an integral part of these consolidated financial statements

Company Statement of Financial Position

	Note	At 31 December 2019 £000	At 31 December 2018 £000
ASSETS			
Loans and advances to banks	18	15,316	17,008
Debt securities at amortised cost	19	24,239	–
Financial investments	25	25,913	19,313
Current tax asset		–	52
Deferred tax asset	26	391	113
Intangible assets	27	5	6
Property, plant and equipment	28	184	208
Other assets	24	115	42
Interests in subsidiaries	43	134,004	134,614
Total assets		**200,167**	**171,356**
EQUITY AND LIABILITIES			
Equity			
Share capital	37	154	153
Other reserves	38	(1,618)	(8,133)
Retained earnings	38	161,556	162,729
Total equity		**160,092**	**154,749**
LIABILITIES			
Current tax liability		175	–
Other liabilities	33	3,063	3,324
Debt securities in issue	35	36,837	13,283
Total liabilities		**40,075**	**16,607**
Total equity and liabilities		**200,167**	**171,356**

The Company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the Parent Company profit and loss account. The profit for the Parent Company for the year is presented in the Statement of Changes in Equity.

The financial statements on pages 48 to 128 were approved and authorised for issue by the Board of directors on 26 March 2020 and were signed on its behalf by:

A.A. Salmon
Director

J.R. Cobb
Director

Registered Number: 1954085

The notes on pages 56 to 128 are an integral part of these consolidated financial statements

Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Group					
	Share capital £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 31 December 2018	**153**	**20**	**(12,169)**	**(1,131)**	**209,083**	**195,956**
Total comprehensive income for the period						
Profit for 2019	–	–	–	–	6,176	6,176
Other comprehensive income, net of tax						
Changes in fair value of equity investments at fair value through other comprehensive income*	–	–	10,707	–	–	10,707
Tax on other comprehensive income	–	–	(77)	–	–	(77)
Total other comprehensive income	**–**	**–**	**10,630**	**–**	**–**	**10,630**
Total comprehensive income for the period	**–**	**–**	**10,630**	**–**	**6,176**	**16,806**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Unwind Employee Trust	–	–	–	–	1,083	1,083
Sale of Secure Trust Bank shares	–	–	1,744	–	(1,744)	–
Issue non-voting shares	1	(1)	–	–	(44)	(44)
Purchase of own shares	–	–	–	(83)	–	(83)
Final dividend relating to 2018	–	–	–	–	(2,978)	(2,978)
Interim dividend relating to 2019	–	–	–	–	(2,405)	(2,405)
Total contributions by and distributions to owners	**1**	**(1)**	**1,744**	**(83)**	**(6,088)**	**(4,427)**
Balance at 31 December 2019	**154**	**19**	**205**	**(1,214)**	**209,171**	**208,335**

* Mainly relate to movement in STB share price. There is currently no tax implications to the movement as the shareholding still qualifies for significant shareholding exemption.

Consolidated Statement of Changes in Equity *continued*

	Attributable to equity holders of the Group					
	Share capital £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 31 December 2017	**153**	**20**	**162**	**(1,131)**	**237,171**	**236,375**
IFRS 9 adjustment net of tax	–	–	–	–	(2,090)	(2,090)
Balance at 1 January 2018	**153**	**20**	**162**	**(1,131)**	**235,081**	**234,285**
Total comprehensive income for the period						
Loss for 2018	–	–	–	–	(20,033)	(20,033)
Other comprehensive income, net of tax						
Changes in fair value of equity investments at fair value through other comprehensive income*	–	–	(13,893)	–	–	(13,893)
Tax on other comprehensive income	–	–	(26)	–	–	(26)
Total other comprehensive income	**–**	**–**	**(13,919)**	**–**	**–**	**(13,919)**
Total comprehensive income for the period	**–**	**–**	**(13,919)**	**–**	**(20,033)**	**(33,952)**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Unwind Employee Trust	–	–	–	–	685	685
Sale of Secure Trust Bank shares	–	–	1,588	–	(1,588)	–
Final dividend relating to 2017	–	–	–	–	(2,829)	(2,829)
Interim dividend relating to 2018	–	–	–	–	(2,233)	(2,233)
Total contributions by and distributions to owners	**–**	**–**	**1,588**	**–**	**(5,965)**	**(4,377)**
Balance at 31 December 2018	**153**	**20**	**(12,169)**	**(1,131)**	**209,083**	**195,956**

* Mainly relate to movement in STB share price. There is currently no tax implications to the movement as the shareholding still qualifies for significant shareholding exemption.

Company Statement of Changes in Equity

	Attributable to equity holders of the Company					
	Share capital £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 1 January 2018	**153**	**20**	**–**	**(1,131)**	**124,659**	**123,701**
Total comprehensive income for the period						
Profit for 2018	–	–	–	–	46,049	46,049
Other comprehensive income, net of income tax	–	–	–	–	–	–
Changes in fair value of equity investments at fair value through other comprehensive income*	–	–	(10,624)	–	–	(10,624)
Total other comprehensive income	**–**	**–**	**(10,624)**	**–**	**–**	**(10,624)**
Total comprehensive income for the period	**–**	**–**	**(10,624)**	**–**	**46,049**	**35,425**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Equity settled share based payment transactions	–	–	–	–	685	685
Sale of Secure Trust Bank shares	–	–	1,588	–	(1,588)	–
Transfer of Secure Trust Bank shares to AL	–	–	2,014	–	(2,014)	–
Final dividend relating to 2017	–	–	–	–	(2,829)	(2,829)
Interim dividend relating to 2018	–	–	–	–	(2,233)	(2,233)
Total contributions by and distributions to owners	**–**	**–**	**3,602**	**–**	**(7,979)**	**(4,377)**
Balance at 31 December 2018	**153**	**20**	**(7,022)**	**(1,131)**	**162,729**	**154,749**
Total comprehensive income for the period						
Profit for 2019	–	–	–	–	3,170	3,170
Other comprehensive income, net of income tax	–	–	–	–	–	–
Changes in fair value of equity investments at fair value through other comprehensive income*	–	–	6,599	–	–	6,599
Total other comprehensive income	**–**	**–**	**6,599**	**–**	**–**	**6,599**
Total comprehensive income for the period	**–**	**–**	**6,599**	**–**	**3,170**	**9,769**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Unwind Employee Trust	–	–	–	–	1,083	1,083
Issue of non-voting shares	1	(1)	–	–	(43)	(43)
Purchase of own shares	–	–	–	(83)	–	(83)
Final dividend relating to 2018	–	–	–	–	(2,978)	(2,978)
Interim dividend relating to 2019	–	–	–	–	(2,405)	(2,405)
Total contributions by and distributions to owners	**1**	**(1)**	**–**	**(83)**	**(4,343)**	**(4,426)**
Balance at 31 December 2019	**154**	**19**	**(423)**	**(1,214)**	**161,556**	**160,092**

* Mainly relate to movement in STB share price. There is currently no tax implications to the movement as the shareholding still qualifies for significant shareholding exemption.

Consolidated Statement of Cash Flows

	Note	Year ended 31 December 2019 £000	Year ended 31 December 2018 £000
Cash flows from operating activities			
Interest received		63,500	73,879
Interest paid		(15,088)	(8,290)
Fees and commissions received		13,757	13,669
Other income		5,599	6,588
Cash payments to employees and suppliers		(63,887)	(84,216)
Taxation paid		(841)	(1,217)
Cash flows from operating profits before changes in operating assets and liabilities		3,040	413
Changes in operating assets and liabilities:			
– net decrease/(increase) in derivative financial instruments		173	(38)
– net increase in loans and advances to customers		(372,612)	(180,600)
– net (increase)/decrease in other assets		(10,123)	4,758
– net increase in amounts due to customers		370,617	323,505
– net (decrease)/increase in other liabilities		(5,049)	2,310
Net cash (outflow)/inflow from operating activities		**(13,954)**	**150,348**
Cash flows from investing activities			
Acquisition of financial investments		(182)	–
Disposal of financial investments		15,330	9,301
Purchase of computer software	27	(5,552)	(2,294)
Purchase of property, plant and equipment	28	(1,950)	(2,482)
Proceeds from sale of property, plant and equipment	28	–	97
Purchase of investment property	30	(2,901)	(879)
Purchase of debt securities		(815,223)	(467,772)
Proceeds from redemption of debt securities		719,737	356,883
Net cash outflow from investing activities		**(90,741)**	**(107,146)**
Cash flows from financing activities			
Issue subordinated debt		25,000	–
(Decrease)/Increase in borrowings		(2,254)	37,578
Dividends paid		(5,383)	(5,062)
Net cash inflow from financing activities		**17,363**	**32,516**
Net (decrease)/increase in cash and cash equivalents		(87,332)	75,718
Cash and cash equivalents at 1 January		459,498	383,780
Cash and cash equivalents at 31 December	41	**372,166**	**459,498**

The notes on pages 56 to 128 are an integral part of these consolidated financial statements

Company Statement of Cash Flows

	Note	Year ended 31 December 2019 £000	Year ended 31 December 2018 £000
Cash flows from operating activities			
Dividends received from subsidiaries		3,766	3,056
Interest received		65	84
Interest paid		(1,829)	(559)
Other income		10,605	52,260
Cash payments to employees and suppliers		(8,129)	(50,316)
Taxation paid		(370)	(402)
Cash flows from operating profits before changes in operating assets and liabilities		4,108	4,123
Changes in operating assets and liabilities:			
– net (increase)/decrease in group company balances		(742)	155
– net increase in other assets		(73)	(1)
– net increase in other liabilities		481	187
Net cash inflow from operating activities		**3,774**	**4,464**
Cash flows from investing activities			
Increase investment in subsidiary	43	–	(18,500)
Issue of subordinated debt to Arbuthnot Latham		(25,000)	–
Disposal of property, plant and equipment		–	97
Purchase of property, plant and equipment	28	–	(94)
Net cash outflow from investing activities		**(25,000)**	**(18,497)**
Cash flows from financing activities			
Purchase of treasury shares		(83)	–
Issue subordinated debt		25,000	–
Dividends paid		(5,383)	(5,062)
Net cash used in financing activities		**19,534**	**(5,062)**
Net decrease in cash and cash equivalents		(1,692)	(19,095)
Cash and cash equivalents at 1 January		17,008	36,103
Cash and cash equivalents at 31 December	41	**15,316**	**17,008**

The notes on pages 56 to 128 are an integral part of these consolidated financial statements

Notes to the Consolidated Financial Statements

1. Reporting entity

Arbuthnot Banking Group PLC is a company domiciled in the United Kingdom. The registered address of Arbuthnot Banking Group PLC is 7 Wilson Street, London, EC2M 2SN. The consolidated financial statements of Arbuthnot Banking Group PLC as at and for the year ended 31 December 2019 comprise Arbuthnot Banking Group PLC and its subsidiaries (together referred to as the "Group" and individually as "subsidiaries"). The Company is the holding company of a group primarily involved in banking and financial services.

2. Basis of preparation

(a) Statement of compliance

The Group's consolidated financial statements and the Company's financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted and endorsed by the EU and the Companies Act 2006 applicable to companies reporting under IFRS.

The consolidated financial statements were authorised for issue by the Board of Directors on 26 March 2020.

(b) Basis of measurement

The consolidated and company financial statements have been prepared under the historical cost convention, as modified by investment property and derivatives, financial assets and financial liabilities at fair value through profit or loss or other comprehensive income.

(c) Functional and presentational currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Pounds Sterling, which is the Company's functional and the Group's presentational currency.

(d) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

(e) Going concern

After making appropriate enquiries which assessed strategy, profitability, funding, risk management (see Note 6) and capital resources (see Note 7), the directors are satisfied that the Company and the Group have adequate resources to continue in operation for the foreseeable future. The financial statements are therefore prepared on the going concern basis.

(f) Accounting developments

The accounting policies adopted are consistent with those of the previous financial year, except for the following:

IFRS 16 'Leases'

The Group has adopted IFRS 16 under the modified retrospective transition approach from 1 January 2019 and has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The Group's accounting as a lessor under IFRS 16 is substantially unchanged from its approach under IAS 17. However, for lessee accounting there is no longer a distinction between finance and operating leases. The total impact of IFRS 16 over the life of a lease will be neutral on the income statement, however, its implementation will result in a higher charge in the earlier years following implementation with a lower charge in later years.

On adoption of IFRS 16, the Group recognised a right-of-use asset and a corresponding liability in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17 Leases.

These liabilities were measured at present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The Group has calculated an incremental borrowing rate for each individual lease and only used a single incremental borrowing rate where the leases shared reasonably similar characteristics. The aggregate of the Group's leases equates to a weighted incremental borrowing rate of 4.8%.

The associated right-of-use assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Statement of Financial Position as at 31 December 2018. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The recognised right-of-use assets relate to the following types of assets:

Group	1 January 2019 £000
Investment properties	8,108
Properties	14,036
Total right-of-use assets	**22,144**

Lease liability:

Group	£000
Operating lease commitment as at 31 December 2018	16,654
Discount using the incremental borrowing rate at 1 January 2019	(1,906)
Investment property finance leases	8,108
Exemption for leases with terms less than 12 months at transition	(124)
Total lease liability as at 1 January 2019	**22,732**

There was no impact to retained earnings due to the modified retrospective approach being used.

Practical expedients

In applying IFRS 16 for the first time, the Group has used the following practical expedients permitted by the Standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous immediately before 1 January 2019 as an alternative to performing an impairment review of the right-of-use asset;
- the accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases;
- low-value assets where the value of the underlying asset is less than £5,000;
- the exclusion of initial direct costs for the measurement of the right-of-use asset immediately before 1 January 2019; and
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The Group has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Group relied on its assessment made applying IAS 17 and IFRS 4 Determining whether an Arrangement contains a Lease.

The Group's leasing activities

The Group has leasehold investment property, offices and equipment all under operating leases. Rental contracts are typically made for fixed periods but may have extension or termination options. Extension and termination options are included in a number of property and equipment leases across the Group. These terms are used to maximise operational flexibility in terms of managing contracts. The extension and termination options held are exercisable only by the Group and not by the respective lessor.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants, but leased assets may not be used as security for borrowing purposes.

Until the 2018 financial year, leases of investment property and property, plant and equipment were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

Notes to the Consolidated Financial Statements *continued*

2. Basis of preparation (continued)

From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments less any lease incentives receivable;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the lessee's incremental borrowing rate, being the rate that the Group would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date less any lease incentives received; and
- any restoration costs payable.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less.

3. Significant accounting policies

The accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

3.1. Consolidation

(a) Subsidiaries

Subsidiaries are all investees (including special purpose entities) controlled by the Group. The Group controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired, liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition over the fair value of the Group's shares of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Statement of Comprehensive Income as a gain on bargain purchase. Contingent consideration related to an acquisition is initially recognised at the date of acquisition as part of the consideration transferred, measured at its acquisition date fair value and recognised as a liability. The fair value of a contingent consideration liability recognised on acquisition is remeasured at key reporting dates until it is settled, changes in fair value are recognised in the profit or loss.

The Company's investments in subsidiaries are recorded at cost less, where appropriate, provisions for impairment in value.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Changes in ownership and non-controlling interests
Changes in ownership interest in a subsidiary that do not result in the loss of control are accounted for as equity transactions and no gain or loss is recognised. Adjustments to non-controlling interests are based on a proportionate amount of the net assets of the subsidiary.

When control of a subsidiary is lost, the Group derecognises the assets, liabilities, non-controlling interest and all other components of equity relating to the former subsidiary from the consolidated statement of financial position. Any resulting gain or loss is recognised in profit or loss. Any investment retained in the former subsidiary is recognised at its fair value at the date when control is lost.

(c) Special purpose entities
Special purpose entities ("SPEs") are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets or the execution of a specific borrowing or lending transaction. SPEs are consolidated when the investor controls the investee. The investor would only control the investee if it had all of the following:

- power over the investee;
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the investor's returns.

The assessment of whether the Group has control over an SPE is carried out at inception and the initial assessment is only reconsidered at a later date if there were any changes to the structure or terms of the SPE, or there were additional transactions between the Group and the SPE.

3.2. Foreign currency translation
Foreign currency transactions are translated into the functional currency using the spot exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Statement of Comprehensive Income. Foreign exchange differences arising from translation of equity instruments, where an election has been made to present subsequent fair value changes in Other Comprehensive Income ("OCI"), will also be recognised in OCI.

3.3. Financial assets and financial liabilities
IFRS 9 requires financial assets and liabilities to be measured at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through the profit and loss ("FVPL"). Liabilities are measured at amortised cost or FVPL. The Group classifies financial assets and financial liabilities in the following categories: financial assets and financial liabilities at FVPL, FVOCI and financial assets and liabilities at amortised cost. Management determines the classification of its financial instruments at initial recognition.

A financial asset or financial liability is measured initially at fair value plus, transaction costs that are directly attributable to its acquisition or issue with the exception of financial assets at FVPL where these costs are charged to the income statement.

(a) Financial instruments measured at amortised cost
Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding. Financial assets measured at amortised cost are predominantly loans and advances and debt securities.

Loans and advances
Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable and the SPPI criteria are met. Loans are recognised when cash is advanced to the borrowers inclusive of transaction costs. Loans and advances, other than those relating to assets leased to customers, are carried at amortised cost using the effective interest rate method.

Debt securities at amortised cost
Debt securities at amortised cost are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has determined meets the SPPI criteria. Debt security investments are carried at amortised cost using the effective interest rate method, less any impairment loss.

Notes to the Consolidated Financial Statements *continued*

3. Significant accounting policies (continued)

(b) Financial assets and financial liabilities at FVPL

Financial assets and liabilities are classified at FVPL where they do not meet the criteria to be measured at amortised cost or FVOCI or where financial assets are designated at FVPL to reduce an accounting mismatch. They are measured at fair value in the Statement of Financial Position, with fair value gains/losses recognised in the income statement.

Financial assets that are held for trading or managed within a business model that is evaluated on a fair value basis are measured at FVPL, because the business objective is neither hold-to-collect contractual cash flows nor hold-to-collect-and-sell contractual cash flows.

This category comprises derivative financial instruments and financial investments. Derivative financial instruments utilised by the Group include structured notes and derivatives used for hedging purposes.

Financial assets and liabilities at FVPL are initially recognised on the date from which the Group becomes a party to the contractual provisions of the instrument, including any acquisition costs. Subsequent measurement of financial assets and financial liabilities held in this category are carried at FVPL until the investment is sold.

(c) Financial instruments at FVOCI

These include investments in special purpose vehicles and equity investments. They may be sold in response to liquidity requirements, interest rate, exchange rate or equity price movements. Financial investments are initially recognised at cost, which is considered as the fair value of the investment including any acquisition costs. The securities are subsequently measured at fair value in the Statement of Financial Position.

Fair value changes in the securities are recognised directly in equity (OCI).

A debt instrument is measured at fair value through OCI if it meets both of the following conditions:

- the asset is held within a business model whose objective is achieved by collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset meet the SPPI criterion.

There is a rebuttable presumption that all equity investments are FVPL, however, on initial recognition the Group may make an irrevocable election to present the fair value movement of equity investments that are not held for trading within OCI. The election can be made on an instrument by instrument basis.

For debt instruments, changes in fair value are recognised in OCI. The assets are subject to impairment testing under IFRS 9 and a loss allowance provision is recognised for such assets. The portion of changes in fair value which reflect ECL shall be taken to the profit or loss.

For equity instruments, there are no reclassifications of gains and losses to the profit or loss statement on derecognition and no impairment recognised in the profit or loss. Equity fair value movements are not reclassified from OCI under any circumstances.

(d) Financial guarantees and loan commitments

Financial guarantees represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards, where the amount of loss exceeds the total unused commitments an ECL is recognised. Liabilities under financial guarantee contracts are initially recorded at their fair value, and the initial fair value is amortised over the life of the financial guarantee. Subsequently, the financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the ECL of the obligations.

(e) Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities with fixed or determinable payments. These liabilities are recognised when cash is received from the depositors and carried at amortised cost using the effective interest rate method. The fair value of these liabilities repayable on demand is assumed to be the amount payable on demand at the Statement of Financial Position date.

Basis of measurement for financial assets and liabilities

Amortised cost measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, minus principal payments, plus or minus the cumulative amortisation using the effective interest rate method of any difference between the initial amount recognised and the maturity amount, less any reduction for impairment.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or when the Group has transferred substantially all risks and rewards of ownership. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability in the Statement of Financial Position.
In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset. There have not been any instances where assets have only been partially derecognised.

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled, expire, are modified or exchanged.

Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the Statement of Financial Position when, and only when, the Group currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as the Group's trading activity.

3.4 Impairment for financial assets and liabilities

IFRS 9 impairment model adopts a three stage expected credit loss ("ECL") approach based on the extent of credit deterioration since origination.

The three stages under IFRS 9 are as follows:

- Stage 1 – entities are required to recognise a loss allowance for financial assets at an amount equal to 12 months credit losses, where there is no indication of significant increase in credit risk since initial recognition and are not credit impaired.
- Stage 2 – a lifetime loss allowance is held for financial assets where a significant increase in credit risk has been identified since initial recognition for financial assets that are not credit impaired. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period for the life of the loan.
- Stage 3 – a lifetime ECL allowance is required for financial assets that are credit impaired at the reporting date.

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability weighted. ECL is measured on either a 12 month (Stage 1) or lifetime (Stage 2) basis depending on whether a significant increase in credit risk has occurred since initial recognition or where an account meets the Group's definition of default (Stage 3).

The ECL calculation is a product of an individual loan's probability of default ("PD"), exposure at default ("EAD") and loss given default ("LGD") discounted at the effective interest rate ("EIR").

Notes to the Consolidated Financial Statements *continued*

3. Significant accounting policies (continued)

Significant increase in credit risk ("SICR") (movement to Stage 2)

The Group's transfer criteria determines what constitutes a significant increase in credit risk, which results in a financial asset being moved from Stage 1 to Stage 2. The Group has determined that a significant increase in credit risk arises when an individual borrower is more than 30 days past due or if forbearance measures have been put in place.

The Group monitors the ongoing appropriateness of the transfer criteria, where any proposed amendments will be reviewed and approved by the Group's Credit Committees at least annually and more frequently if required.

A borrower will move back into Stage 1 conditional upon both a minimum of 6 months' good account conduct and the improvement of the Client's situation to the extent that the probability of default has receded sufficiently and a full repayment of the loan, without recourse to the collateral, is likely.

Definition of default (movement to Stage 3)

The Group uses a number of qualitative and quantitative criteria to determine whether an account meets the definition of default and as a result moves into Stage 3. The criteria are as follows:

- The rebuttable assumption that more than 90 days past due is an indicator of default. The Group therefore deems more than 90 days past due as an indicator of default except for cases where the customer is already within forbearance. This will ensure that the policy is aligned with the Basel/Regulatory definition of default.
- The Group has also deemed it appropriate to classify accounts in default where there has been a breach in agreed forbearance arrangements, recovery action is in hand or bankruptcy proceedings or similar insolvency processes were initiated against a client, or director of a company.

A borrower will move out of Stage 3 when their credit risk improves such that they are no longer past due and remain up to date for an internally approved period.

Forward looking macroeconomic scenarios

IFRS 9 requires the entity to consider the risk of default and impairment loss taking into account expectations of economic changes that are reasonable.

The Group uses a bespoke macroeconomic model to determine the most significant factors which may influence the likelihood of an exposure defaulting in the future. At present, the most significant macroeconomic factor relates to property prices. The Group currently consider five probability weighted scenarios. The model adopts five probability weighted scenarios: severe decline, moderate decline, decline, no change and growth. The Group has derived an approach for factoring probability weighted macroeconomic forecasts into ECL calculations, adjusting PD and LGD estimates.

Expected life

IFRS 9 requires lifetime expected credit losses to be measured over the expected life. Currently the Group considers the loans' expected life is equal to the contractual loan term. This approach will continue to be monitored and enhanced if and when deemed appropriate.

3.5. Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Impairment for goodwill is discussed in more detail under note 27(a).

3.6. Fiduciary activities

The Group commonly acts as trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets and income arising thereon are excluded from these financial statements, as they do not belong to the Group.

3.7. New standards and interpretations not yet adopted

There are no standards, interpretations and amendments to existing standards that have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2020 or later periods, that will have any material impact on the Group's financial statements.

4. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Estimation uncertainty

(a) Expected credit losses ("ECL") on financial assets

The Group reviews its loan portfolios and debt security investments to assess impairment at least on a quarterly basis. The basis for evaluating impairment losses is described in note 10. The measurement of ECL required by IFRS 9, necessitates a number of significant judgements. Specifically judgements and estimation uncertainties relate to assessment of whether credit risk on the financial asset has increased significantly since initial recognition, incorporation of forward-looking information ("FLI") in the measurement of ECLs and key assumptions used in estimating recoverable cash flows. These estimates are driven by a number of factors that are subject to change which may result in different levels of ECL allowances.

The Group incorporates FLI into the assessment of whether there has been a significant increase in credit risk. Forecasts for key macroeconomic variables that most closely correlate with the Bank's portfolio are used to produce five economic scenarios, comprising of a severe decline, moderate decline, decline, no change and growth, and the impacts of these scenarios are then probability weighted. The estimation and application of this FLI will require significant judgement supported by the use of external information.

12 month ECLs on loans and advances (loans within Stage 1) are calculated using a statistical model on a collective basis, grouped together by product and geographical location. The key assumptions are the probability of default, the economic scenarios and loss given default having consideration for collateral. Life time ECLs on loans and advances (loans within Stage 2 and 3) are calculated based on an individual valuation of the underlying asset and other expected cash flows.

For financial assets in Stage 2 and 3, ECL is calculated on an individual basis and all relevant factors that have a bearing on the expected future cash flows are taken into account. These factors can be subjective and can include the individual circumstances of the borrower, the realisable value of collateral, the Group's position relative to other claimants, and the likely cost to sell and duration of the time to collect. The level of ECL is the difference between the value of the recoverable amount (which is equal to the expected future cash flows discounted at the loan's original effective interest rate), and its carrying amount.

During the year, the ECL model and the assumptions were reviewed resulting in a revised basis for estimating LGD after taking account of collateral values. This has resulted in a release of ECL provision of £1.3m in Stage 1 and an increase in ECL provision in Stage 3 of £0.2m.

Management considered a range of variables in determining the level of future ECL. Two of the key judgements were in relation to "time to collect" and "collateral valuations". Sensitivity analysis was carried out based on what was considered reasonably possible in the current market conditions.

If time to collect increased by six months across all client exposures, this would lead to a negative £0.6m (2018: negative £0.4m) impact through the Profit or Loss. A six month reduction in time to collect would lead to a £0.1m favourable (2018: £0.3m favourable) impact on Profit or Loss.

If the collateral valuations increased by 10% across client exposures, this would lead to a positive £1.4m (2018: positive £1.3m) impact through Profit or Loss. If the collateral valuations decreased by 10% across all Stage 3 client exposures, this would lead to a £2.1m adverse (2018: £1.9m adverse) impact on Profit or Loss.

Five economic scenarios were modelled. A probability was assigned to each scenario to arrive at an overall weighted impact on ECL. Management judgement is required in the application of the probability weighting for each scenario.

The Group considered the impact of various assumptions on the calculation of ECL (changes in GDP, unemployment rates, inflation, exchange rates, equity prices, wages and collateral values/property prices) and concluded that only collateral values/property prices have a material impact on ECL.

Notes to the Consolidated Financial Statements *continued*

4. Critical accounting estimates and judgements in applying accounting policies (continued)

The five macroeconomic scenarios modelled on future property prices were as follows:

- Severe decline
- Moderate decline
- Decline
- No change
- Growth

Other than collateral values/property prices, no other assumptions were assessed to have a material impact on ECL. The table below therefore reflects the expected changes in collateral/property prices in each of the macroeconomic scenarios and the probability weighting applied for each scenario:

	Probability weighting		Change in property prices		
	2019	2018	London	Rest of UK	Overseas
Economic Scenarios					
Severe decline	1.0%	1.0%	(40.0%)	(40.0%)	(40.0%)
Moderate decline	3.0%	3.0%	(20.0%)	(20.0%)	(20.0%)
Decline	50.0%	50.0%	(2.0%)	(1.5%)	(1.0%)
No Change	26.0%	21.0%	–	–	–
Growth	20.0%	25.0%	0.5%	0.5%	2.3%

The above table reflects the 5 year average expected change in collateral values/property prices in each economic scenario, which were applied over the full term the Group is exposed to credit risk (also an average of 5 years). The expected change in property prices under each scenario, were weighted according to the probability of each scenario, to arrive at a probability weighted change in property prices. These adjusted property values are then used to assess the future expected cash flows, which are considered along with the loan exposures at default to calculate the expected credit loss. No other long term averages are used in the calculation of ECL, as the above changes are in effect modelled over the full term of the Group's exposure to credit risk.

Management assess a range of scenarios and in the current economic climate it is reasonably possible that the severe decline scenario could increase to 5%, the moderate decline scenario could increase to 20% probability and the decline scenario increase to 65% probability. This would lead to a negative £1.4m (2018: negative £0.2m) impact through Profit or Loss.

Management have additionally assessed the impact of assigning a 100% probability to of each of the economic scenarios, which would have the following impact on the Profit or Loss of the Group:

- Severe decline (£30.4m)
- Moderate decline (£7.4m)
- Decline -
- No change £0.4m
- Growth £0.6m

(b) Effective Interest Rate

Acquired loan books are initially recognised at fair value. Subsequently, they are measured under the effective interest rate method. Management review the expected cash flows against actual cash flows to ensure future assumptions on customer behaviour and future cash flows remain valid. If the estimates of future cash flows are revised, the gross carrying value of the financial asset is recalculated as the present value of the estimated future contractual cash flows discounted at the original effective interest rate, or in the case of the acquired books the credit-adjusted effective interest rate. The adjustment to the carrying value of the loan book is recognised in the Statement of Comprehensive Income.

Management must therefore use judgement to estimate the expected life of each instrument. The accuracy of the effective interest rate would therefore be affected by unexpected market movements resulting in altered customer behaviour, inaccuracies in the models used compared to actual outcomes and incorrect assumptions.

If customer loans repaid 6 months earlier than anticipated on the originated loan book, interest income would increase by £0.4m (2018: £0.8m), due to acceleration of fee income.

In 2019 the Group recognised £0.4m (2018: £0.9m) of additional interest income to reflect actual cash flows received on the acquired mortgage books being in excess of forecast cash flows.

The key judgements in relation to calculating the net present value of the acquired mortgage books relate to the timing of future cash flows and loss rates on principal repayments. Management have considered an early and delayed 6 month sensitivity on the timing of repayment and a 10% increase and decrease of principal repayments to be reasonably possible.

If the acquired loan books were modelled to accelerate cash flows by 6 months, it would increase interest income in 2019 by £0.3m (2018: £0.3m), while a 10% increase in principal repayments will increase interest income in 2019 by £0.8m (2018: £0.3m) through a cash flow reset adjustment.

(c) Investment property

The valuations that the Group places on its investment properties are subject to a degree of uncertainty and are calculated on the basis of assumptions in relation to prevailing market rents and effective yields. These assumptions may not prove to be accurate, particularly in periods of market volatility. The uncertainty due to Brexit has had the effect of reducing the activity in the property market, which, has in turn resulted in less market evidence being available for Management in making its judgement on the key assumptions of property yield and market rent. The Group currently owns one (2018: three) investment property, as outlined in note 30.

During 2019, two properties were reclassified to inventory due to being under development with the intention to sell.

Management valued the investment property utilising externally sourced market information and property specific knowledge. The valuations were reviewed by the Group's in-house surveyor.

Crescent Office Park in Bath with value of £6.8m (2018: £6.8m)

In December 2017, the office building was acquired with the intention to be included within a new property fund initiative that the Group had planned to start-up. The property had tenants in situ with the Fund recognising rental income.

It was recognised as held for sale under IFRS 5 and therefore not consolidated in the financial statements in 2017. In 2018 the launch of the property fund was placed on hold and as a result it was reclassified as an investment property as the property no longer met the IFRS 5 criteria. The property remained occupied as at 31 December 2019 with the Group receiving rental income.

In accordance with IAS 40, the property is recognised at fair value, with its carrying value at year end of £6.8m equal to its fair value.

The valuation of the property has the following key inputs:

- yield: 6.50%
- future rent increases (every five years): 4.00%

		Revised fair value gain/(loss)	
	Variable	£m	%
Model Yield	**6.50%**		
– Yield 0.25% lower	6.25%	0.2	2.8%
– Yield 0.25% higher	6.75%	(0.1)	(1.6%)
Model Future Rent Increases (Every 5 Years)	**4.00%**		
– Positive 25%	5.00%	0.1	0.8%
– Negative 25%	3.00%	–	0.2%

(d) Inventory

During 2019, two properties were reclassified from investment property to inventory due to being under development with the intention to sell. The properties are transferred at fair value and subsequently measured at the lower of cost and net realisable value ("NRV") less costs to sell. Cost is deemed to be fair value on the date of transfer. The properties are valued at the reporting date to assess for impairment.

Notes to the Consolidated Financial Statements *continued*

4. Critical accounting estimates and judgements in applying accounting policies (continued)

The valuations that the Group places on its properties are subject to a degree of uncertainty and are calculated on the basis of assumptions in relation to prevailing market rents and effective yields. These assumptions may not prove to be accurate, particularly in periods of market volatility. The uncertainty due to Brexit has had the effect of reducing the activity in the property market, which has in turn resulted in less market evidence being available for Management in making its judgement on the key assumptions of property yield and market rent.

Management valued the investment property utilising externally sourced market information and property specific knowledge. The valuations were reviewed by the Group's in-house surveyor.

King Street, London with value of £53.7m (2018: £53.7m);

The King Street property's main lease ended in 2019 at which point a comprehensive refurbishment development was started on the office space. The valuation assessment considers the gross development value of the property less expected development costs. The gross development value is discounted using risk-adjusted discount rates. Among other factors, the discount rate estimation considers the quality of a building and its location, and potential lease terms. Management judgement is required for the inputs used in the gross development value assessment, which have been assessed as follows:

- yield: 3.67%
- future rent forecast (per square ft.) £95.40 (Office space £110.80 and Retail space £45.75)
- estimated refurbishment costs: £8.1m

		Change to carrying value	
	Variable	£'m	%
Forecast yield	**3.67%**		
– Yield 0.17% lower	3.50%	3.3	6.2%
– Yield 0.42% lower	3.25%	8.4	15.6%
– Yield 0.08% higher	3.75%	(1.0)	(1.9%)
– Yield 0.33% higher	4.00%	(4.8)	(8.9%)
Future forecast rent (Per Square Foot)	**£95.4**		
– Positive 5%	£100.2	3.5	6.5%
– Negative 5%	£90.6	(2.7)	(5.1%)

4 St Philips Place in Birmingham with value of £9.5m (2018: £7m)

The St Philips Place property was acquired on 24 November 2017. The property has recently completed a comprehensive refurbishment and was partially tenanted at the end of the financial year.

The gross development has the following key inputs:

- forecast yield: 6.5%
- future rent forecast (per square ft.) £30.20

		Change in carrying value	
	Variable	£'m	%
Forecast yield	**6.50%**		
– Yield 0.25% lower	6.25%	0.5	4.9%
– Yield 0.25% higher	6.75%	(0.3)	(2.9%)
Future forecast rent (Per Square Foot)	**£30.20**		
– Positive 5%	£31.71	0.6	6.4%
– Negative 5%	£28.69	(0.4)	(4.7%)

5. Maturity analysis of assets and liabilities

The table below shows the maturity analysis of assets and liabilities of the Group as at 31 December 2019:

At 31 December 2019	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Cash and balances at central banks	325,908	–	325,908
Loans and advances to banks	46,258	–	46,258
Debt securities at amortised cost	337,807	105,153	442,960
Assets classified as held for sale	7,617	–	7,617
Derivative financial instruments	105	1,699	1,804
Loans and advances to customers	659,176	939,877	1,599,053
Other assets	86,262	181	86,443
Financial investments	3,203	27,716	30,919
Deferred tax asset	–	1,815	1,815
Intangible assets	7,037	13,045	20,082
Property, plant and equipment	1,458	4,355	5,813
Right-of-use assets	2,757	17,187	19,944
Investment property	–	6,763	6,763
	1,477,588	**1,117,791**	**2,595,379**
LIABILITIES			
Deposits from banks	5,421	225,000	230,421
Derivative financial instruments	101	218	319
Deposits from customers	1,873,326	211,577	2,084,903
Current tax liability	633	–	633
Other liabilities	13,500	–	13,500
Lease liabilities	63	20,368	20,431
Debt securities in issue	–	36,837	36,837
	1,893,044	**494,000**	**2,387,044**

Notes to the Consolidated Financial Statements *continued*

5. Maturity analysis of assets and liabilities (continued)

The table below shows the maturity analysis of assets and liabilities of the Group as at 31 December 2018:

At 31 December 2018	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Cash and balances at central banks	405,325	–	405,325
Loans and advances to banks	54,173	–	54,173
Debt securities at amortised cost	203,211	139,480	342,691
Assets classified as held for sale	8,002	–	8,002
Derivative financial instruments	192	1,654	1,846
Loans and advances to customers	388,603	836,053	1,224,656
Other assets	8,257	4,459	12,716
Financial investments	14,976	20,375	35,351
Deferred tax asset	–	1,490	1,490
Intangible assets	–	16,538	16,538
Property, plant and equipment	–	5,304	5,304
Investment property	–	67,081	67,081
	1,082,739	**1,092,434**	**2,175,173**
LIABILITIES			
Deposits from banks	7,675	225,000	232,675
Derivative financial instruments	188	–	188
Deposits from customers	1,624,978	89,308	1,714,286
Current tax liability	236	–	236
Other liabilities	18,549	–	18,549
Debt securities in issue	–	13,283	13,283
	1,651,626	**327,591**	**1,979,217**

The table below shows the maturity analysis of assets and liabilities of the Company as at 31 December 2019:

At 31 December 2019	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Loans and advances to banks	6	–	6
Loans and advances to banks – due from subsidiary undertakings	15,310	–	15,310
Debt securities at amortised cost	–	24,239	24,239
Financial investments	–	25,913	25,913
Deferred tax asset	–	391	391
Intangible assets	–	5	5
Property, plant and equipment	25	159	184
Other assets	115	–	115
Interests in subsidiaries	–	134,004	134,004
	15,456	**184,711**	**200,167**
LIABILITIES			
Current tax liability	175	–	175
Other liabilities	3,063	–	3,063
Debt securities in issue	–	36,837	36,837
	3,238	**36,837**	**40,075**

The table below shows the maturity analysis of assets and liabilities of the Company as at 31 December 2018:

At 31 December 2018	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Loans and advances to banks	6	–	6
Loans and advances to banks – due from subsidiary undertakings	17,002	–	17,002
Financial investments	–	19,313	19,313
Current tax asset	52	–	52
Deferred tax asset	–	113	113
Intangible assets	–	6	6
Property, plant and equipment	–	208	208
Other assets	42	–	42
Interests in subsidiaries	–	134,614	134,614
	17,102	**154,254**	**171,356**
LIABILITIES			
Other liabilities	3,324	–	3,324
Debt securities in issue	–	13,283	13,283
	3,324	**13,283**	**16,607**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management

Strategy

By their nature, the Group's activities are principally related to the use of financial instruments. The Directors and senior management of the Group have formally adopted a Group Risk and Controls Policy which sets out the Board's attitude to risk and internal controls. Key risks identified by the Directors are formally reviewed and assessed at least once a year by the Board, in addition to which key business risks are identified, evaluated and managed by operating management on an ongoing basis by means of procedures such as physical controls, credit and other authorisation limits and segregation of duties. The Board also receives regular reports on any risk matters that need to be brought to its attention. Significant risks identified in connection with the development of new activities are subject to consideration by the Board. There are budgeting procedures in place and reports are presented regularly to the Board detailing the results of each principal business unit, variances against budget and prior year, and other performance data.

The principal non-operational risks inherent in the Group's business are credit, market, liquidity and capital.

(a) Credit risk

The Company and Group take on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Company and Group's portfolio, could result in losses that are different from those provided for at the balance sheet date. Credit risk is managed through the Credit Committee of the banking subsidiary.

The Company and Group structure the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to products, and one borrower or groups of borrowers. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. The limits are approved periodically by the Board of Directors and actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral, and corporate and personal guarantees.

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of collateral to secure advances, which is common practice. The principal collateral types for loans and advances include, but are not limited to:

- Charges over residential and commercial properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities;
- Charges over other chattels; and
- Personal guarantees

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In order to minimise any potential credit loss the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances. Repossessed collateral, not readily convertible into cash, is made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness, or held as inventory where the Group intends to develop and sell in the future. Where excess funds are available after the debt has been repaid, they are available either for other secured lenders with lower priority or are returned to the customer.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The key inputs into the measurement of the ECL are:

- future economic scenarios
- probability of default
- loss given default
- exposure at default

The Group's maximum exposure to credit risk before collateral held or other credit enhancements is as follows:

Group Credit risk exposures (all Stage 1, unless otherwise stated)	2019 Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
On-balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	325,800	325,800
Loans and advances to banks	–	–	–	–	–	–	46,258	46,258
Debt securities at amortised cost	–	–	–	–	–	–	442,960	442,960
Derivative financial instruments	–	–	–	–	–	–	1,804	1,804
Loans and advances to customers (net of ECL)	567,767	527,620	306,044	102,888	75,871	7,352	11,511	1,599,053
Stage 1	498,220	505,518	306,044	100,981	75,871	7,352	11,511	1,505,497
Stage 2	43,491	22,079	–	755	–	–	–	66,325
Stage 3	26,056	23	–	1,152	–	–	–	27,231
Other assets	–	–	–	–	–	–	4,625	4,625
Financial investments	–	–	–	–	–	–	30,919	30,919
Off-balance sheet:								
Guarantees	2,610	3,791	–	–	–	–	–	6,401
Loan commitments and other credit related liabilities	88,226	47,372	–	–	53,494	972	–	190,064
At 31 December	**658,603**	**578,783**	**306,044**	**102,888**	**129,365**	**8,324**	**863,877**	**2,647,844**

Group Credit risk exposures (all Stage 1, unless otherwise stated)	2018 Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
On-balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	405,325	405,325
Loans and advances to banks	–	–	–	354	–	–	53,819	54,173
Debt securities at amortised cost	–	–	–	–	–	–	342,691	342,691
Derivative financial instruments	–	–	–	–	–	–	1,846	1,846
Loans and advances to customers (net of ECL)	670,464	443,108	–	85,957	–	–	25,127	1,224,656
Stage 1	618,487	431,630	–	84,275	–	–	25,127	1,159,519
Stage 2	20,033	11,478	–	1,180	–	–	–	32,691
Stage 3	31,944	–	–	502	–	–	–	32,446
Other assets	–	–	–	443	–	–	2,533	2,976
Financial investments	–	–	–	–	–	–	35,351	35,351
Off-balance sheet:								
Guarantees	435	1,309	–	–	–	–	–	1,744
Loan commitments and other credit related liabilities	51,950	15,930	–	–	–	–	18,122	86,002
At 31 December	**722,849**	**460,347**	**–**	**86,754**	**–**	**–**	**884,814**	**2,154,764**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

The Company's maximum exposure to credit risk (all Stage 1) before collateral held or other credit enhancements is as follows:

	2019 £000	2018 £000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Loans and advances to banks	15,316	17,008
Debt securities at amortised cost	24,239	–
Financial investments	25,913	19,313
At 31 December	**65,468**	**36,321**

The above tables represent the maximum credit risk exposure (net of impairment) to the Group and Company at 31 December 2019 and 2018 without taking account of any collateral held or other credit enhancements attached. For financial assets, the balances are based on gross carrying amounts as reported in the Statement of Financial Position. For guarantees and loan commitments, the amounts in the table represent the amounts for which the Group is contractually committed.

The table below represents an analysis of the loan to values of the exposures secured by property for the Group:

	2019							
	Private Banking		Commercial Banking		Mortgage Portfolios		Total	
Group	Loan Balance £000	Collateral £000	Loan Balance £000	Collateral £000	Loan Balance £000	Collateral £000	Loan Balance £000	Collateral £000
Less than 60%	294,018	678,051	300,510	634,912	93,454	318,010	687,982	1,630,973
Stage 1	266,706	620,496	299,642	631,792	93,454	318,010	659,802	1,570,298
Stage 2	17,785	35,150	868	3,120	–	–	18,653	38,270
Stage 3	9,527	22,405	–	–	–	–	9,527	22,405
60%-80%	197,907	302,202	204,798	320,687	46,333	67,372	449,038	690,261
Stage 1	178,117	273,038	194,442	304,127	46,333	67,372	418,892	644,537
Stage 2	18,132	26,565	10,356	16,560	–	–	28,488	43,125
Stage 3	1,658	2,599	–	–	–	–	1,658	2,599
80%-100%	32,209	36,435	6,299	6,670	56,967	66,421	95,475	109,526
Stage 1	20,670	23,340	4,871	4,920	56,967	66,421	82,508	94,681
Stage 2	8,434	9,800	1,428	1,750	–	–	9,862	11,550
Stage 3	3,105	3,295	–	–	–	–	3,105	3,295
Greater than 100%*	25,150	12,512	1,250	740	108,276	69,235	134,676	82,487
Stage 1	5,133	2,410	1,250	740	108,276	69,235	114,659	72,385
Stage 2	4,775	2,000	–	–	–	–	4,775	2,000
Stage 3	15,242	8,102	–	–	–	–	15,242	8,102
Total	**549,284**	**1,029,200**	**512,857**	**963,009**	**305,030**	**521,038**	**1,367,171**	**2,513,247**

* In addition to property, other security is taken, including charges over Arbuthnot Latham Investment Management portfolios, other chattels and personal guarantees. The increase in loan to values greater than 100% is due to an increase in exposures collateralised by other assets.

The table below represents an analysis of the loan to values of the exposures secured by property for the Group:

	2018							
	Private Banking		Commercial Banking		Mortgage Portfolios		Total	
Group	Loan Balance £000	Collateral £000	Loan Balance £000	Collateral £000	Loan Balance £000	Collateral £000	Loan Balance £000	Collateral £000
Less than 60%	300,807	632,854	249,446	559,271	11,671	65,767	561,924	1,257,892
Stage 1	286,003	593,883	238,071	532,671	11,671	65,767	535,745	1,192,321
Stage 2	8,701	25,830	11,375	26,600	–	–	20,076	52,430
Stage 3	6,103	13,141	–	–	–	–	6,103	13,141
60%-80%	204,689	281,487	165,954	259,917	20,093	27,842	390,736	569,246
Stage 1	191,644	261,152	165,954	259,917	20,093	27,842	377,691	548,911
Stage 2	9,458	14,535	–	–	–	–	9,458	14,535
Stage 3	3,587	5,800	–	–	–	–	3,587	5,800
80%-100%	31,397	48,119	6,540	9,400	33,252	38,029	71,189	95,548
Stage 1	19,716	35,540	6,540	9,400	33,252	38,029	59,508	82,969
Stage 2	531	550	–	–	–	–	531	550
Stage 3	11,150	12,029	–	–	–	–	11,150	12,029
Greater than 100%	25,124	24,222	8,918	7,614	3,404	2,825	37,446	34,661
Stage 1	13,250	15,607	8,918	7,614	3,404	2,825	25,572	26,046
Stage 3	11,874	8,615	–	–	–	–	11,874	8,615
Total	**562,017**	**986,682**	**430,858**	**836,202**	**68,420**	**134,463**	**1,061,295**	**1,957,347**

The table below represents an analysis of loan commitments compared to the values of properties for the Group (all Stage 1):

	2019					
	Private Banking		Commercial Banking		Total	
Group	Loan Commitment £000	Collateral £000	Loan Commitment £000	Collateral £000	Loan Commitment £000	Collateral £000
Less than 60%	63,934	185,639	19,583	193,616	83,517	379,255
60%-80%	7,821	12,143	3,808	5,810	11,629	17,953
80%-100%	1,587	1,623	–	–	1,587	1,623
Greater than 100%	282	235	676	592	958	827
Total	**73,624**	**199,640**	**24,067**	**200,018**	**97,691**	**399,658**

	2018					
	Private Banking		Commercial Banking		Total	
Group	Loan Commitment £000	Collateral £000	Loan Commitment £000	Collateral £000	Loan Commitment £000	Collateral £000
Less than 60%	30,289	83,603	14,880	32,097	45,169	115,700
60%-80%	15,467	23,295	1,050	1,615	16,517	24,910
Total	**45,756**	**106,898**	**15,930**	**33,712**	**61,686**	**140,610**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

Renegotiated loans and forbearance

The contractual terms of a loan may be modified due to factors that are not related to the current or potential credit deterioration of the customer (changing market conditions, customer retention, etc.). In such cases, the modified loan may be derecognised and the renegotiated loan recognised as a new loan at fair value.

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects the comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Group renegotiates loans to customers in financial difficulties (referred to as 'forbearance') to maximise collection opportunities and minimise the risk of default. Under the Group's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt, or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms can include changing the timing of interest payments, extending the date of repayment of the loan, transferring a loan to interest only payments and a payment holiday. Both retail and corporate loans are subject to the forbearance policy. The Group Credit Committee regularly reviews reports on forbearance.

For financial assets modified as part of the Group's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Group's ability to collect interest and principal and the Group's previous experience of similar forbearance action. As part of this process, the Group evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators. Whilst the customer is under forbearance, the customer will be classified as Stage 2 and the Group recognise a lifetime ECL. The customer will transfer to Stage 1 and revert to a 12 month ECL when they exit forbearance. This is conditional upon both a minimum six months' good account conduct and the improvement to the client's situation to the extent that the probability of default has receded sufficiently and full repayment of the loan, without recourse to the collateral, is likely.

Generally, the forbearance is a qualitative indicator of a SICR (see note 10)

As at 31 December 2019, loans for which forbearance measures were in place totalled 3.1% (2018: 2.2%) of the total value of loans to customers for the Group. These are set out in the following table:

	2019		2018	
	Number	Loan Balance £000	Number	Loan Balance £000
Transfer to interest only	–	–	1	175
Assistance with property sale	4	231	–	–
Move historic arrears to capital	1	1,719	–	–
Covenant waived	6	7,473	–	–
Term extension	18	32,780	17	25,814
Payment holiday	32	6,795	16	1,189
Total forbearance	**61**	**48,998**	**34**	**27,178**

Concentration risk

The tables below show the concentration in the loan book based on the most significant type of collateral held for each loan.

	Loans and advances to customers		Loan Commitments	
	2019 £000	2018 £000	2019 £000	2018 £000
Concentration by product				
Asset based lending*	75,871	25,128	53,494	18,122
Asset finance	103,193	85,958	972	–
Cash collateralised	11,526	5,379	1,781	–
Commercial lending	269,590	248,042	3,941	4,806
Investment portfolio secured	40,127	45,182	2,984	3,136
Mixed collateral**	45,432	91,167	17,282	4,867
Residential mortgages	1,035,395	713,095	93,749	54,346
Unsecured	17,919	10,705	15,861	725
At 31 December	**1,599,053**	**1,224,656**	**190,064**	**86,002**
Concentration by location				
East Anglia	39,997	32,960	10	294
London	554,183	455,567	77,960	28,096
Midlands	108,635	69,686	4,392	3,538
North East	53,294	18,448	641	1,050
North West	111,500	59,045	1,826	1,275
Northern Ireland	9,061	2,813	–	–
Scotland	28,197	10,793	1,064	–
South East	224,915	219,890	7,188	15,522
South West	169,343	140,560	4,513	9,201
Wales	18,493	7,521	98	426
Overseas	11,150	30,486	–	1,400
Non-property collateral	270,285	176,887	92,372	25,200
At 31 December	**1,599,053**	**1,224,656**	**190,064**	**86,002**

* In 2018 Q1, the Group began its asset based lending business including invoice discounting, supported by stock, plant & machinery, property and cash flow lending.

** Mixed collateral is where there is no single, overall majority collateral type.

(b) Operational risk (unaudited)

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiatives and creativity. The Group is exposed to operational risks from its Information Technology and Operations platforms. There are additional internal controls in these processes that are designed to protect the Group from these risks. The Group's overall approach to managing internal control and financial reporting is described in the Corporate Governance section of the Annual Report.

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of the Internal Audit reviews are discussed with senior management, with summaries submitted to the Arbuthnot Banking Group Audit Committee.

Cyber risk

Cyber risk is an increasing risk that the Group is subject to within its operational processes. This is the risk that the Group is subject to some form of disruption arising from an interruption to its IT and data infrastructure. The Group regularly test the infrastructure to ensure that it remains robust to a range of threats, and has continuity of business plans in place including a disaster recovery provision.

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

Conduct risk

As a financial services provider we face conduct risk, including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; and exhibiting behaviours which do not meet market or regulatory standards.

The Group adopts a zero risk appetite for any unfair customer outcomes. It maintains clear compliance guidelines and provides ongoing training to all staff. Periodic spot checks and internal audits are performed to ensure these guidelines are being followed. The Group also has insurance policies in place to provide some cover for any claims that may arise.

(c) Market risk

Price risk

The Company and Group are exposed to price risk from equity investments and derivatives held by the Group. The Group is not exposed to commodity price risk.

Based upon the financial investment exposure in Note 25, a stress test scenario of a 10% (2018: 10%) decline in market prices, would result in a £16,000 (2018: £17,000) decrease in the Group's income and a decrease of £3.1m (2018: £3.5m) in the Group's equity. The Group considers a 10% stress test scenario appropriate after taking the current values and historic data into account.

Based upon the financial investment exposure given in Note 25, a stress test scenario of a 10% (2018: 10%) decline in market prices, would result in a £nil (2018: £nil) decrease in the Company's income and a decrease of £2.6m (2018: £1.9m) in the Company's equity.

Currency risk

The Company and Group take on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. This is managed through the Group entering into forward foreign exchange contracts. The Board sets limits on the level of exposure for both overnight and intra-day positions, which are monitored daily. The table below summarises the Group's exposure to foreign currency exchange rate risk at 31 December 2019. Included in the table below are the Group's assets and liabilities at carrying amounts, categorised by currency.

At 31 December 2019	GBP (£) £000	USD ($) £000	Euro (€) £000	Other £000	Total £000
ASSETS					
Cash and balances at central banks	325,844	20	41	3	325,908
Loans and advances to banks	5,364	10,028	18,892	11,974	46,258
Debt securities at amortised cost	336,079	106,881	–	–	442,960
Derivative financial instruments	1,713	1	3	87	1,804
Loans and advances to customers	1,563,536	7,957	27,574	(14)	1,599,053
Other assets	4,625	–	–	–	4,625
Financial investments	29,113	1,637	169	–	30,919
	2,266,274	**126,524**	**46,679**	**12,050**	**2,451,527**
LIABILITIES					
Deposits from banks	230,421	–	–	–	230,421
Derivative financial instruments	233	–	2	84	319
Deposits from customers	1,897,857	126,220	49,049	11,777	2,084,903
Other liabilities	2,023	–	–	–	2,023
Debt securities in issue	24,239	–	12,598	–	36,837
	2,154,773	**126,220**	**61,649**	**11,861**	**2,354,503**
Net on-balance sheet position	**111,501**	**304**	**(14,970)**	**189**	**97,024**
Credit commitments	**190,064**	**–**	**–**	**–**	**190,064**

The table below summarises the Group's exposure to foreign currency exchange risk at 31 December 2018:

At 31 December 2018	GBP (£) £000	USD ($) £000	Euro (€) £000	Other £000	Total £000
ASSETS					
Cash and balances at central banks	405,244	30	47	4	405,325
Loans and advances to banks	8,856	13,794	19,714	11,809	54,173
Debt securities at amortised cost	243,680	99,011	–	–	342,691
Derivative financial instruments	1,655	4	3	184	1,846
Loans and advances to customers	1,169,157	16,122	39,377	–	1,224,656
Other assets	2,861	–	115	–	2,976
Financial investments	34,219	954	178	–	35,351
	1,865,672	**129,915**	**59,434**	**11,997**	**2,067,018**
LIABILITIES					
Deposits from banks	232,675	–	–	–	232,675
Derivative financial instruments	3	4	1	180	188
Deposits from customers	1,526,623	130,061	46,068	11,534	1,714,286
Other liabilities	1,782	–	–	–	1,782
Debt securities in issue	–	–	13,283	–	13,283
	1,761,083	**130,065**	**59,352**	**11,714**	**1,962,214**
Net on-balance sheet position	**104,589**	**(150)**	**82**	**283**	**104,804**
Credit commitments	**86,002**	**–**	**–**	**–**	**86,002**

Derivative financial instruments (see note 21) are in place to mitigate foreign currency risk on net exposures for each currency. A 10% strengthening of the pound against the US dollar would lead to a £30,000 decrease (2018: £5,000 increase) in Group profits and equity, while a 10% weakening of the pound against the US dollar would lead to the same decrease in Group profits and equity. Additionally the Group holds £7.6m of properties as held for sale, while £7.8m has been classified as inventory. These properties are located in the EU and relate to Euro denominated loans where the properties were repossessed and are either held for sale or are being developed with a view to sell. Including these Euro assets, the net Euro exposure is positive £431k.

The table below summarises the Company's exposure to foreign currency exchange rate risk at 31 December 2019:

At 31 December 2019	GBP (£) £000	Euro (€) £000	Total £000
ASSETS			
Loans and advances to banks	2,414	12,902	15,316
Debt securities at amortised cost	24,239	–	24,239
Financial investments	25,913	–	25,913
	52,566	**12,902**	**65,468**
LIABILITIES			
Other liabilities	1,113	–	1,113
Debt securities in issue	24,239	12,598	36,837
	25,352	**12,598**	**37,950**
Net on-balance sheet position	**27,214**	**304**	**27,518**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

The table below summarises the Company's exposure to foreign currency exchange rate risk at 31 December 2018:

At 31 December 2018	GBP (£) £000	Euro (€) £000	Total £000
ASSETS			
Loans and advances to banks	3,437	13,571	17,008
Financial investments	19,313	–	19,313
	22,750	**13,571**	**36,321**
LIABILITIES			
Other liabilities	1,838	–	1,838
Debt securities in issue	–	13,283	13,283
	1,838	**13,283**	**15,121**
Net on-balance sheet position	**20,912**	**288**	**21,200**

A 10% strengthening of the pound against the Euro would lead to £11,000 (2018: £3,000) decrease in the Company profits and equity, conversely a 10% weakening of the pound against the Euro would lead to a £13,000 (2018: £3,000) increase in the Company profits and equity.

Interest rate risk

Interest rate risk is the potential adverse impact on the Company and Group's future cash flows from changes in interest rates, and arises from the differing interest rate risk characteristics of the Company and Group's assets and liabilities. In particular, fixed rate savings and borrowing products expose the Group to the risk that a change in interest rates could cause either a reduction in interest income or an increase in interest expense relative to variable rate interest flows. The Group seeks to "match" interest rate risk on either side of the Statement of Financial Position. However, this is not a perfect match and interest rate risk is present in: Money market transactions of a fixed rate nature, fixed rate loans, fixed rate savings accounts and floating rate products dependent on when they re-price at a future date.

Interest rate risk is measured throughout the maturity bandings of the book on a parallel shift scenario for a 200 basis points movement. Interest rate risk is managed to limit value at risk to be less than £1.5m. The current position of the balance sheet is such that it results in a favourable impact on the economic value of equity of £3.1m (2018: £1.3m) for a positive 200bps shift and an adverse impact of £3.2m (2018: £1.4m) for a negative 200bps movement. The negative movement is capped at the Bank of England base rate of 75bps at year end (2018: 75bps), which result in a negative impact of £1.2m (2018: £0.5m). The Company has no fixed rate exposures, but an upward change of 50bps on variable rates would increase pre-tax profits and equity by £13,000 (2018: increase pre-tax profits and equity by £10,000), while a downward change of 50bps would increase pre-tax profits and equity by £54,000.

The following tables summarise the re-pricing periods for the assets and liabilities in the Company and Group, including derivative financial instruments which are principally used to reduce exposure to interest rate risk. Items are allocated to time bands by reference to the earlier of the next contractual interest rate re-price and the maturity date.

Group As at 31 December 2019	Within 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000	Non interest bearing £000	Total £000
ASSETS							
Cash and balances at central banks	325,908	–	–	–	–	–	325,908
Loans and advances to banks	45,836	188	234	–	–	–	46,258
Debt securities at amortised cost	287,608	151,555	3,797	–	–	–	442,960
Derivative financial instruments	105	–	–	1,699	–	–	1,804
Loans and advances to customers	1,351,549	11,101	25,963	209,811	629	–	1,599,053
Other assets*	–	–	–	–	–	148,477	148,477
Financial investments	–	–	–	–	–	30,919	30,919
	2,011,006	**162,844**	**29,994**	**211,510**	**629**	**179,396**	**2,595,379**
LIABILITIES							
Deposits from banks	230,421	–	–	–	–	–	230,421
Derivative financial instruments	319	–	–	–	–	–	319
Deposits from customers	1,403,728	233,716	211,956	235,503	–	–	2,084,903
Other liabilities**	–	–	–	–	–	34,564	34,564
Debt securities in issue	36,837	–	–	–	–	–	36,837
Equity	–	–	–	–	–	208,335	208,335
	1,671,305	**233,716**	**211,956**	**235,503**	**–**	**242,899**	**2,595,379**
Impact of derivative instruments	25,531	–	–	(25,531)	–	–	
Interest rate sensitivity gap	**365,232**	**(70,872)**	**(181,962)**	**(49,524)**	**629**	**(63,503)**	
Cumulative gap	**365,232**	**294,360**	**112,398**	**62,874**	**63,503**	**–**	

* Other assets include all remaining assets in the Statement of Financial Position, which are not shown separately above.

** Other liabilities include all remaining liabilities in the Statement of Financial Position, which are not shown separately above.

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

Group As at 31 December 2018	Within 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000	Non interest bearing £000	Total £000
ASSETS							
Cash and balances at central banks	405,325	–	–	–	–	–	405,325
Loans and advances to banks	54,115	–	58	–	–	–	54,173
Debt securities at amortised cost	269,026	27,846	41,896	3,923	–	–	342,691
Derivative financial instruments	304	–	–	1,542	–	–	1,846
Loans and advances to customers	1,030,316	6,107	17,502	170,525	206	–	1,224,656
Other assets*	–	–	–	–	–	111,131	111,131
Financial investments	–	–	–	–	–	35,351	35,351
	1,759,086	**33,953**	**59,456**	**175,990**	**206**	**146,482**	**2,175,173**
LIABILITIES							
Deposits from banks	232,675	–	–	–	–	–	232,675
Derivative financial instruments	188	–	–	–	–	–	188
Deposits from customers	1,255,488	197,785	95,868	165,145	–	–	1,714,286
Other liabilities**	–	–	–	–	–	18,785	18,785
Debt securities in issue	13,283	–	–	–	–	–	13,283
Equity	–	–	–	–	–	195,956	195,956
	1,501,634	**197,785**	**95,868**	**165,145**	**–**	**214,741**	**2,175,173**
Impact of derivative instruments	25,762	–	–	(25,762)	–	–	
Interest rate sensitivity gap	**283,214**	**(163,832)**	**(36,412)**	**(14,917)**	**206**	**(68,259)**	
Cumulative gap	**283,214**	**119,382**	**82,970**	**68,053**	**68,259**	**–**	

* Other assets include all remaining assets in the Statement of Financial Position, which are not shown separately above.

** Other liabilities include all remaining liabilities in the Statement of Financial Position, which are not shown separately above.

Company As at 31 December 2019	Within 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000	Non interest bearing £000	Total £000
ASSETS							
Debt securities at amortised cost	24,239	–	–	–	–	–	24,239
Loans and advances to banks	15,296	–	–	–	–	20	15,316
Other assets*	–	–	–	–	–	134,699	134,699
Financial investments	–	–	–	–	–	25,913	25,913
	39,535	**–**	**–**	**–**	**–**	**160,632**	**200,167**
LIABILITIES							
Other liabilities**	–	–	–	–	–	3,238	3,238
Debt securities in issue	36,837	–	–	–	–	–	36,837
Equity	–	–	–	–	–	160,092	160,092
	36,837	**–**	**–**	**–**	**–**	**163,330**	**200,167**
Interest rate sensitivity gap	**2,698**	**–**	**–**	**–**	**–**	**(2,698)**	
Cumulative gap	**2,698**	**2,698**	**2,698**	**2,698**	**2,698**	**–**	

* Other assets include all remaining assets in the Statement of Financial Position, which are not shown separately above.

** Other liabilities include all remaining liabilities in the Statement of Financial Position, which are not shown separately above.

Company As at 31 December 2018	Within 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000	Non interest bearing £000	Total £000
ASSETS							
Loans and advances to banks	16,977	–	–	–	–	31	17,008
Other assets*	–	–	–	–	–	135,035	135,035
Financial investments	–	–	–	–	–	19,313	19,313
	16,977	**–**	**–**	**–**	**–**	**154,379**	**171,356**
LIABILITIES							
Other liabilities**	–	–	–	–	–	3,324	3,324
Debt securities in issue	13,283	–	–	–	–	–	13,283
Equity	–	–	–	–	–	154,749	154,749
	13,283	**–**	**–**	**–**	**–**	**158,073**	**171,356**
Interest rate sensitivity gap	**3,694**	**–**	**–**	**–**	**–**	**(3,694)**	
Cumulative gap	**3,694**	**3,694**	**3,694**	**3,694**	**3,694**	**–**	

* Other assets include all remaining assets in the Statement of Financial Position, which are not shown separately above.

** Other liabilities include all remaining liabilities in the Statement of Financial Position, which are not shown separately above.

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

(d) Liquidity risk

Liquidity risk is the risk that the Group, although solvent, either does not have sufficient financial resources to enable it to meet its obligations as they fall due, or can only secure such resources at excessive cost.

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The liquidity requirements of the Group are met through withdrawing funds from its Bank of England Reserve Account to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

The Group has formal governance structures in place to manage and mitigate liquidity risk on a day to day basis. The Board of Arbuthnot Latham & Co., Limited ("AL") sets and approves the liquidity risk management strategy. The Assets and Liabilities Committee ("ALCO"), comprising senior executives of the Group, monitors liquidity risk. Key liquidity risk management information is reported by the finance teams and monitored by the Chief Executive Officer, Finance Director and Deputy CEO on a daily basis. The ALCO meets monthly to review liquidity risk against set thresholds and risk indicators including early warning indicators, liquidity risk tolerance levels and Internal Liquidity Adequacy Assessment Process ("ILAAP") metrics.

The PRA requires the Board to ensure that the Group has adequate levels of liquidity resources and a prudent funding profile, and that it comprehensively manages and controls liquidity and funding risks. The Group maintains deposits placed at the Bank of England and highly liquid unencumbered assets that can be called upon to create sufficient liquidity to meet liabilities on demand, particularly in a period of liquidity stress.

AL has a Board approved ILAAP and maintains liquidity buffers in excess of the minimum requirements. The ILAAP is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. At a minimum, the ILAAP is updated annually. The Liquidity Coverage Ratio ("LCR") regime has applied to the Group from 1 October 2015, requiring management of net 30 day cash outflows as a proportion of high quality liquid assets. The actual LCR at 269% (2018: 282%) has significantly exceeded the regulatory minimum of 100% throughout the year.

The Group is exposed to daily calls on its available cash resources from current accounts, maturing deposits and loan draw-downs. The Group maintains significant cash resources to meet all of these needs as they fall due. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates.

The tables below show the undiscounted contractual cash flows of the Group's financial liabilities and assets as at 31 December 2019:

At 31 December 2019	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial liability by type						
Non-derivative liabilities						
Deposits from banks	230,421	(230,421)	(230,421)	–	–	–
Deposits from customers	2,084,903	(2,105,676)	(1,243,332)	(550,128)	(312,216)	–
Other liabilities	2,023	(2,023)	(2,023)	–	–	–
Debt securities in issue	36,837	(63,292)	(626)	(1,893)	(12,325)	(48,448)
Issued financial guarantee contracts	–	(6,401)	(6,401)	–	–	–
Unrecognised loan commitments	–	(190,064)	(190,064)	–	–	–
	2,354,184	**(2,597,877)**	**(1,672,867)**	**(552,021)**	**(324,541)**	**(48,448)**
Derivative liabilities						
Risk management:	319					
– Outflows	–	(319)	(319)	–	–	–
	319	**(319)**	**(319)**	**–**	**–**	**–**

At 31 December 2019	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial asset by type						
Non-derivative assets						
Cash and balances at central banks	325,908	325,908	325,908	–	–	–
Loans and advances to banks	46,258	46,270	45,844	426	–	–
Debt securities at amortised cost	442,960	447,424	141,897	197,811	107,716	–
Loans and advances to customers	1,599,053	1,764,491	337,215	168,224	1,117,246	141,807
Other assets	4,624	4,624	4,624	–	–	–
Financial investments	30,919	30,919	5,007	–	25,912	–
	2,449,722	**2,619,637**	**860,495**	**366,461**	**1,250,874**	**141,807**
Derivative assets						
Risk management:	1,804					
– Inflows	–	1,804	–	–	–	1,804
	1,804	**1,804**	**–**	**–**	**–**	**1,804**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

The tables below show the undiscounted contractual cash flows of the Group's financial liabilities and assets as at 31 December 2018:

At 31 December 2018	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial liability by type						
Non-derivative liabilities						
Deposits from banks	232,675	(232,675)	(232,675)	–	–	–
Deposits from customers	1,714,286	(1,719,600)	(1,274,190)	(355,512)	(89,898)	–
Other liabilities	1,782	(1,782)	(1,775)	–	–	(7)
Debt securities in issue	13,283	(19,431)	(90)	(271)	(1,447)	(17,623)
Issued financial guarantee contracts	–	(1,744)	(1,744)	–	–	–
Unrecognised loan commitments	–	(86,002)	(86,002)	–	–	–
	1,962,026	**(2,061,234)**	**(1,596,476)**	**(355,783)**	**(91,345)**	**(17,630)**
Derivative liabilities						
Risk management:	188					
– Outflows	–	(188)	(188)	–	–	–
	188	**(188)**	**(188)**	**–**	**–**	**–**

At 31 December 2018	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial asset by type						
Non-derivative assets						
Cash and balances at central banks	405,325	405,325	405,325	–	–	–
Loans and advances to banks	54,173	54,173	54,115	58	–	–
Debt securities at amortised cost	342,691	346,694	129,604	101,449	115,641	–
Loans and advances to customers	1,224,656	1,382,857	46,646	173,077	1,038,465	124,669
Other assets	2,976	2,976	2,976	–	–	–
Financial investments	35,351	35,351	16,038	–	19,313	–
	2,065,172	**2,227,376**	**654,704**	**274,584**	**1,173,419**	**124,669**
Derivative assets						
Risk management:	1,846					
– Inflows	–	1,846	–	–	–	1,846
	1,846	**1,846**	**–**	**–**	**–**	**1,846**

The table below sets out the components of the Group's liquidity reserves:

Liquidity reserves	31 December 2019 Amount £000	31 December 2019 Fair value £000	31 December 2018 Amount £000	31 December 2018 Fair value £000
Cash and balances at central banks	325,908	325,908	405,325	405,325
Loans and advances to banks	46,258	46,258	54,173	54,173
Debt securities at amortised cost	442,960	442,926	342,691	344,001
Undrawn credit lines	–	–	10,000	10,000
	815,126	**815,092**	**812,189**	**813,499**

Assets pledged as collateral or encumbered

The total financial assets recognised in the Statement of Financial Position that had been pledged as collateral for liabilities at 31 December 2019 were £259m (2018: £308.9m). Assets are encumbered due to the Term Funding Scheme (note 31).

Financial assets can be pledged as collateral as part of repurchases transactions under terms that are usual and customary for such activities.

The table below analyses the contractual cash flows of the Company's financial liabilities and assets as at 31 December 2019:

At 31 December 2019	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial liability by type						
Non-derivative liabilities						
Other liabilities	1,113	(1,113)	477	–	–	(1,590)
Debt securities in issue	36,837	(63,292)	(626)	(1,893)	(12,325)	(48,448)
	37,950	**(64,405)**	**(149)**	**(1,893)**	**(12,325)**	**(50,038)**

At 31 December 2019	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial liability by type						
Non-derivative liabilities						
Loans and advances to banks	15,316	15,316	15,316	–	–	–
Debt securities at amortised cost	24,239	45,068	544	1,644	11,001	31,879
Financial investments	25,913	25,913	–	–	25,913	–
	65,468	**86,297**	**15,860**	**1,644**	**36,914**	**31,879**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

The table below analyses the contractual cash flows of the Company's financial liabilities and assets as at 31 December 2018:

At 31 December 2018	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial liability by type						
Non-derivative liabilities						
Other liabilities	1,838	(1,838)	(248)	–	–	(1,590)
Debt securities in issue	13,283	(19,431)	(90)	(271)	(1,447)	(17,623)
	15,121	**(21,269)**	**(338)**	**(271)**	**(1,447)**	**(19,213)**

At 31 December 2018	Carrying amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Financial asset by type						
Non-derivative assets						
Loans and advances to banks	17,008	17,008	17,008	–	–	–
Financial investments	19,313	19,313	–	–	19,313	–
	36,321	**36,321**	**17,008**	**–**	**19,313**	**–**

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

Fiduciary activities

The Group provides investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements. These services give rise to the risk that the Group may be accused of maladministration or underperformance. At the balance sheet date, the Group had investment management accounts amounting to approximately £1,107m (2018: £985m). Additionally, the Group provides investment advisory services.

(e) Financial assets and liabilities

The tables below set out the Group's financial assets and financial liabilities into their respective classifications:

At 31 December 2019	FVPL £000	FVOCI £000	Amortised cost £000	Total carrying amount £000	Fair value £000
ASSETS					
Cash and balances at central banks	–	–	325,908	325,908	325,908
Loans and advances to banks	–	–	46,258	46,258	46,258
Debt securities at amortised cost	–	–	442,960	442,960	442,926
Derivative financial instruments	1,804	–	–	1,804	1,804
Loans and advances to customers	–	–	1,599,053	1,599,053	1,566,715
Other assets	4,625	–	–	4,625	4,625
Financial investments	165	30,754	–	30,919	30,919
	6,594	**30,754**	**2,414,179**	**2,451,527**	**2,419,155**
LIABILITIES					
Deposits from banks	–	–	230,421	230,421	230,421
Derivative financial instruments	319	–	–	319	319
Deposits from customers	–	–	2,084,903	2,084,903	2,084,903
Other liabilities	2,023	–	–	2,023	2,023
Debt securities in issue	–	–	36,837	36,837	36,837
	2,342	**–**	**2,352,161**	**2,354,503**	**2,354,503**

At 31 December 2018	FVPL £000	FVOCI £000	Amortised cost £000	Total carrying amount £000	Fair value £000
ASSETS					
Cash and balances at central banks	–	–	405,325	405,325	405,325
Loans and advances to banks	–	–	54,173	54,173	54,173
Debt securities at amortised cost	–	–	342,691	342,691	344,001
Derivative financial instruments	1,846	–	–	1,846	1,846
Loans and advances to customers	–	–	1,224,656	1,224,656	1,187,408
Other assets	2,976	–	–	2,976	2,976
Financial investments	165	35,186	–	35,351	35,351
	4,987	**35,186**	**2,026,845**	**2,067,018**	**2,031,080**
LIABILITIES					
Deposits from banks	–	–	232,675	232,675	232,675
Derivative financial instruments	188	–	–	188	188
Deposits from customers	–	–	1,714,286	1,714,286	1,714,286
Other liabilities	1,782	–	–	1,782	1,782
Debt securities in issue	–	–	13,283	13,283	13,283
	1,970	**–**	**1,960,244**	**1,962,214**	**1,962,214**

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

Valuation of financial instruments

The Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions. If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis. The objective of valuation techniques is to determine the fair value of the financial instrument at the reporting date as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. In the event that fair values of assets and liabilities cannot be reliably measured, they are carried at cost.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making measurements:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads assists in the judgement as to whether a market is active. If, in the opinion of management, a significant proportion of the instrument's carrying amount is driven by unobservable inputs, the instrument in its entirety is classified as valued using significant unobservable inputs. 'Unobservable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

The tables below analyse assets and liabilities measured at fair value by the level in the fair value hierarchy into which the measurement is categorised:

At 31 December 2019	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	1,804	–	1,804
Financial investments	29,117	–	1,802	30,919
Investment properties	–	–	6,763	6,763
	29,117	**1,804**	**8,565**	**39,486**
LIABILITIES				
Derivative financial instruments	–	319	–	319
Other liabilities (contingent consideration)	–	–	1,528	1,528
	–	**319**	**1,528**	**1,847**

At 31 December 2018	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	1,846	–	1,846
Financial investments	34,223	–	1,128	35,351
Investment properties	–	–	67,081	67,081
	34,223	**1,846**	**68,209**	**104,278**
LIABILITIES				
Derivative financial instruments	–	188	–	188
Other liabilities (contingent consideration)	–	–	3,643	3,643
	–	**188**	**3,643**	**3,831**

There were no transfers between level 1 and level 2 during the year.

The following table reconciles the movement in level 3 financial instruments measured at fair value (financial investments) during the year:

Movement in level 3	2019 £000	2018 £000
At 1 January	68,209	61,642
Consideration received	3,083	7,805
Disposals	–	(1,403)
Transfer to inventory	(63,219)	–
Movements recognised in Other Comprehensive Income	502	135
Movements recognised in the Income Statement	(10)	30
At 31 December	**8,565**	**68,209**

Secure Trust bank investment

The Group currently holds equity shares in Secure Trust Bank plc, valued at £29.1m (2018: £34.2m). The shares are recognised at fair value using quoted prices on the London Stock Exchange.

Visa Inc. investment

Arbuthnot Latham currently holds preference shares in Visa Inc., valued at £1.2m (2018: £0.9m) as at 31 December 2019. These shares have been valued at their future conversion value into Visa Inc. common stock. The valuation includes a 31% haircut, comprising 25% due to a contingent liability disclosed in Visa Europe's accounts in relation to litigation and 6% based on a liquidity discount.

Investment in overseas property company

Arbuthnot Latham currently holds a debt and equity investment classified as FVPL in a property company which owns an office building through its 100% owned subsidiary. During 2018 the subsidiary company was sold. Under the terms of the sale agreement the buyer agreed to purchase 100% of the share capital and reimburse all outstanding loans. The proceeds of the sale have been distributed to the investors, except for the amount withheld for the general and specific warranties (which will be released in three instalments at 18 month intervals) included as a condition of the sale agreement. A loss of £8k (2018: gain of £75k) has been recognised in profit or loss during the year. The investment has been valued at £156k (2018: £165k) based on the discounted consideration outstanding less 11% hair cut for the warranties.

Hetz Ventures, L.P.

Arbuthnot Latham currently holds an equity investment in Hetz Ventures, L.P. which was launched in January 2018. The primary objective was to generate attractive risk-adjusted returns for its Partners, principally through long-term capital appreciation, by making, holding and disposing of equity and equity-related investments in early stage revenue generating Israeli technology companies, primarily in cyber, fin-tech and the disruptive software sectors. The company has committed to a capital contribution of USD $1.0m of the total closing fund capital of USD$55.0m. At 31 December 2019 the company had made capital contributions into the Fund of $394k (2018: $168k).

Notes to the Consolidated Financial Statements *continued*

6. Financial risk management (continued)

The investment is classified as FVOCI and is valued at fair value by Hetz Ventures, L.P. at £0.5m (2018: £0.1m). As at year end the fair value is deemed to be cost less management fees due to the immature stage of investments that have been made by the Fund.

The tables below analyse financial instruments not measured at fair value by the level in the fair value hierarchy:

Group At 31 December 2019	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	325,908	–	325,908
Loans and advances to banks	–	46,258	–	46,258
Debt securities at amortised cost	–	442,960	–	442,960
Loans and advances to customers	–	1,296,427	302,626	1,599,053
Other assets	–	–	4,625	4,625
	–	**2,111,553**	**307,251**	**2,418,804**
LIABILITIES				
Deposits from banks	–	230,421	–	230,421
Deposits from customers	–	2,084,903	–	2,084,903
Other liabilities	–	–	2,023	2,023
Debt securities in issue	–	–	36,837	36,837
	–	**2,315,324**	**38,860**	**2,354,184**

Group At 31 December 2018	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	405,325	–	405,325
Loans and advances to banks	–	54,173	–	54,173
Debt securities at amortised cost	–	342,691	–	342,691
Loans and advances to customers	–	996,198	228,458	1,224,656
Other assets	–	–	2,976	2,976
	–	**1,798,387**	**231,434**	**2,029,821**
LIABILITIES				
Deposits from banks	–	232,675	–	232,675
Deposits from customers	–	1,714,286	–	1,714,286
Other liabilities	–	–	1,782	1,782
Debt securities in issue	–	–	13,283	13,283
	–	**1,946,961**	**15,065**	**1,962,026**

Company At 31 December 2019	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Loans and advances to banks	–	6	15,310	15,316
Debt securities at amortised cost	–	–	24,239	24,239
	–	**6**	**39,549**	**39,555**
LIABILITIES				
Other liabilities	–	–	1,113	1,113
Debt securities in issue	–	–	36,837	36,837
	–	**–**	**37,950**	**37,950**

Company At 31 December 2018	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Loans and advances to banks	–	6	17,002	17,008
	–	**6**	**17,002**	**17,008**
LIABILITIES				
Other liabilities	–	–	1,838	1,838
Debt securities in issue	–	–	13,283	13,283
	–	**–**	**15,121**	**15,121**

7. Capital management (unaudited)

The Group's capital management policy is focused on optimising shareholder value. There is a clear focus on delivering organic growth and ensuring capital resources are sufficient to support planned levels of growth. The Board regularly reviews the capital position.

The Group, and individual banking operation, are authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and are subject to EU Capital Requirement Regulation (EU No.575/2013) ("CRR") and the PRA Rulebook for CRR firms. One of the requirements for the Group and the individual banking operation is that capital resources must be in excess of capital requirements at all times.

In accordance with the EU's Capital Requirements Directive (EU No.36/2013) and the required parameters set out in the PRA Rulebook, the ICAAP is embedded in the risk management framework of the Group. The ICAAP identifies and assesses the risks to the Group, considers how these risks can be mitigated and demonstrates that the Group has sufficient resources, after mitigating actions, to withstand all reasonable scenarios.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar 1 plus" approach to determine the level of capital the Group needs to hold. This method takes the Pillar 1 capital requirement for credit, market and operational risk as a starting point, and then considers whether each of the calculations delivers a sufficient amount of capital to cover risks to which the Group is, or could be, exposed. Where the Board considers that the Pillar 1 calculations do not adequately cover the risks an additional Pillar 2A capital requirement is applied. The PRA will set a Pillar 2A capital requirement in light of the calculations included within the ICAAP. The Group's Total Capital Requirement, as issued by the PRA, is the sum of the minimum capital requirements under the CRR (Pillar 1) and the Pillar 2A requirement. The current TCR of the Group is 9.12%.

The Group's regulatory capital is divided into two tiers:

- Common equity Tier 1 which comprises shareholder funds less regulatory deductions for intangible assets, including goodwill, deferred tax assets that do not arise from temporary differences, and a portion of the Group's non-significant investment in a financial institution (STB). The portion of the STB investment deducted from common equity tier 1 capital is calculated in accordance with EU CRR thresholds.
- Tier 2 comprises qualifying subordinated loans.

Notes to the Consolidated Financial Statements *continued*

7. Capital management (unaudited) (continued)

The following table shows the regulatory capital resources as managed by the Group:

	2019 £000	2018 £000
CET1 Capital		
Share capital	154	153
Capital redemption reserve	19	20
Treasury shares	(1,214)	(1,131)
Retained earnings*	209,171	209,083
IFRS 9 – Transitional add back	1,109	1,986
Fair value reserve	205	(12,169)
Deduction for goodwill	(5,202)	(5,202)
Deduction for other intangibles	(14,880)	(11,336)
Deduction for deferred tax asset that do not arise from temporary differences	(1,502)	–
Deduction for significant investment**	–	(16,082)
Deduction for non-significant investment**	(10,183)	–
Deduction for Prudent valuation	(33)	(38)
CET1 capital resources	**177,644**	**165,284**
Tier 2 Capital		
Debt securities in issue	36,837	13,283
Total Tier 2 capital resources	**36,837**	**13,283**
Own Funds (sum of Tier 1 and Tier 2)	**214,481**	**178,567**
CET1 Capital Ratio (CET1 Capital/Total Risk Exposure)*	**14.4%**	**15.9%**
Total Capital Ratio (Own Funds/Total Risk Exposure)*	**17.3%**	**17.2%**

* Includes year-end verified profit.

** At 31 December 2019 the Group's investment in STB is a non-significant investment in accordance with the CRR (2018: significant investment).

The ICAAP includes a summary of the capital required to mitigate the identified risks in the Group's regulated entities and the amount of capital that the Group has available. The PRA sets a Pillar 2A capital requirement in light of the calculations included within the ICAAP. The Group's Total Capital Requirement, as issued by the PRA, is the sum of the minimum capital requirements under the CRR (Pillar 1) and the Pillar 2A requirement.

Capital ratios are reviewed on a monthly basis to ensure that external requirements are adhered to. During the period all regulated entities have complied with all of the externally imposed capital requirements to which they are subject.

Pillar 3 complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). Its aim is to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes. Our Pillar 3 disclosures for the year ended 31 December 2019 are published as a separate document on the Group website under Investor Relations (Announcements & Shareholder Info).

8. Net interest income

Interest income and expense are recognised in the Statement of Comprehensive Income for all instruments measured at amortised cost using the effective interest rate ("EIR") method.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance. When calculating the effective interest rate, the Group takes into account all contractual terms of the financial instrument but does not consider expected credit losses.

The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

For financial assets that have become credit impaired following initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit impaired, then the calculation of interest income reverts to the gross basis.

The Group monitors the actual cash flows for each acquired book and where they diverge significantly from expectation, the future cash flows are reset. Expectation may diverge due to factors such as one-off payments or expected credit losses. In assessing whether to adjust future cash flows on an acquired portfolio, the Group considers the cash variance on an absolute and percentage basis. The Group also considers the total variance across all acquired portfolios. Where cash flows for an acquired portfolio are reset, they are discounted at the EIR to derive a new carrying value, with changes taken to the Statement of Comprehensive Income as interest income. The EIR rate is adjusted for events where there is a change to the reference interest rate (e.g. Bank of England base rate) affecting portfolios with a variable interest rate which will impact future cash flows. The revised EIR is the rate which exactly discounts the revised cash flows to the net carrying value of the loan portfolio.

	2019 £000	2018 £000
Cash and balances at central banks	3,112	2,264
Loans and advances to banks	418	2,703
Debt securities at amortised cost	5,265	3,303
Loans and advances to customers	68,075	57,020
Interest Income	**76,870**	**65,290**
Deposits from banks	(1,687)	(1,517)
Deposits from customers	(13,516)	(8,224)
Debt securities in issue	(2,054)	(366)
Interest on lease assets	(976)	–
Interest expense	**(18,233)**	**(10,107)**
Net interest income	**58,637**	**55,183**

Notes to the Consolidated Financial Statements *continued*

9. Fee and commission income

Fee and commission income which is integral to the EIR of a financial asset are included in the effective interest rate (see note 8).

All other fee and commission income is recognised as the related services are performed, under IFRS 15, revenues from Contracts with Customers. Fee and commission income is reported in the below segments.

Types of fee	Description
Banking commissions	– Banking Tariffs are charged monthly for services provided.
Investment management fees	– Annual asset management fees relate to a single performance obligation that is continuously provided over an extended period of time.
Wealth planning fees	– Provision of bespoke, independent Wealth Planning solutions to Arbuthnot Latham's clients to help them achieve their long-term financial goals.
Foreign exchange fees	– Provides foreign currencies for our clients to purchase/sell.

The principles in applying IFRS 15 to fee and commission use the following 5 step model:

- identify the contract(s) with a customer;
- identify the performance obligations in the contract;
- determine the transaction price;
- allocate the transaction price to the performance obligations in the contract; and
- recognise revenue when or as the Group satisfies its performance obligations.

Asset and other management, advisory and service fees are recognised, under IFRS 15, as the related services are performed. The same principle is applied for wealth planning services that are continuously provided over an extended period of time.

The Group includes the transaction price of variable consideration only when it is highly probable that a significant reversal in the amount recognised will not occur or when the variable element becomes certain.

Fee and commission income is disaggregated below and includes a total for fees in scope of IFRS 15:

Group At 31 December 2019	Private Banking £000	Commercial Banking £000	RAF £000	ACABL £000	ASFL £000	All other divisions £000	Total £000
Banking commissions	716	820	219	1,380	1	–	3,136
Foreign exchange fees	494	342	–	–	–	444	1,280
Investment management fees	8,474	–	–	–	–	–	8,474
Wealth planning fees	1,043	–	–	–	–	2	1,045
Total fee and commission income	**10,727**	**1,162**	**219**	**1,380**	**1**	**446**	**13,935**

Group At 31 December 2018	Private Banking £000	Commercial Banking £000	RAF £000	ACABL £000	ASFL £000	All other divisions £000	Total £000
Banking commissions	747	617	151	220	–	–	1,735
Foreign exchange fees	558	232	–	–	–	537	1,327
Investment management fees	8,177	–	–	–	–	1	8,178
Wealth planning fees	1,404	–	–	–	–	312	1,716
Total fee and commission income	**10,886**	**849**	**151**	**220**	**–**	**850**	**12,956**

10. Net impairment loss on financial assets

(a) Assets carried at amortised cost

The Group recognises loss allowances on an expected credit loss basis for all financial assets measured at amortised cost, including loans and advances, debt securities and loan commitments.

Credit loss allowances are measured as an amount equal to lifetime ECL, except for the following assets, for which they are measured as 12 month ECL:

- Financial assets determined to have a low credit risk at the reporting date. The assets to which the low credit risk exemption applies, include cash and balances at central banks (note 17), loans and advances to banks (note 18) and debt securities at amortised cost (note 19). These assets are all considered investment grade.
- Financial assets which have not experienced a significant increase in credit risk since their initial recognition.

Impairment model

The IFRS 9 impairment model adopts a three stage approach based on the extent of credit deterioration since origination:

Stage 1: 12-month ECL applies to all financial assets that have not experienced a significant increase in credit risk ("SICR") since origination and are not credit impaired. The ECL will be computed based on the probability of default events occurring over the next 12 months. Stage 1 includes the current performing loans (up to date and in arrears of less than 10 days) and those within Heightened Business Monitoring ("HBM"). Accounts requiring HBM are classified as a short-term deterioration in financial circumstances and are tightly monitored with additional proactive client engagement, but not deemed SICR.

A financial asset is within HBM where:

- A loan is in arrears between 10 and 30 days;
- Bankers become aware of signs of potential future difficulties, such as
  - cash flow difficulties
  - unexpected hard core borrowing
  - regular requests for excesses
  - returned cheques
  - lack of engagement/failure to respond to information requests
  - breach of covenants/conditions
  - county court judgements

Stage 2: When a financial asset experiences a SICR subsequent to origination, but is not in default, it is considered to be in Stage 2. This requires the computation of ECL based on the probability of all possible default events occurring over the remaining life of the financial asset. Provisions are higher in this stage (except where the value of charge against the financial asset is sufficient to enable recovery in full) because of an increase in credit risk and the impact of a longer time horizon being considered (compared to 12 months in Stage 1).

Evidence that a financial asset has experienced a SICR includes the following considerations:

- A loan is in arrears between 31 and 90 days;
- Forbearance action has been undertaken;

Stage 3: Financial assets that are credit impaired are included in this stage. Similar to Stage 2, the allowance for credit losses will continue to capture the lifetime expected credit losses. At each reporting date, the Group will assess whether financial assets carried at amortised cost are in default. A financial asset will be considered to be in default when an event(s) that has a detrimental impact on estimated future cash flows have occurred.

Evidence that a financial asset is within Stage 3 includes the following data:

- A loan is in arrears in excess of 90 days;

Notes to the Consolidated Financial Statements *continued*

10. Net impairment loss on financial assets (continued)

- Breach of terms of forbearance;
- Recovery action is in hand; or
- Bankruptcy proceedings or similar insolvency process of a client, or director of a company.

The credit risk of financial assets that become credit impaired are not expected to improve such that they are no longer considered credit impaired.

A borrower will move back into Stage 1 conditional upon both a minimum of 6 months' good account conduct and the improvement of the client's situation to the extent that the credit risk has receded sufficiently and a full repayment of the loan, without recourse to the collateral, is likely.

Presentation of allowance for ECL in the Statement of Financial Position

For financial assets measured at amortised cost, these are presented as the gross carrying amount of the assets minus a deduction for the ECL.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the outstanding amount due.

(b) Renegotiated loans

Loans that are not individually significant, and whose terms have been renegotiated, are no longer considered to be past due and are treated as new loans.

(c) Forbearance

Under certain circumstances, the Group may use forbearance measures to assist borrowers who are experiencing significant financial hardship. Any forbearance support is assessed on a case by case basis in line with best practice and subject to regular monitoring and review. The Group seeks to ensure that any forbearance results in a fair outcome for both the customer and the Group.

(d) Assets classified as financial investments

Equity instruments at fair value through Other Comprehensive Income

Equity investments are not subject to impairment charges recognised in the Income Statement. Any fair value gains and losses are recognised in OCI which are not subject to reclassification to the Income Statement on derecognition.

Debt instruments at FVOCI

Changes in fair value are recognised in OCI, the loss allowance will be recognised in OCI and shall not reduce the carrying amount of the financial asset in the Statement of Financial Position. Impairment costs will be recognised in the profit or loss with a corresponding entry to OCI. On derecognition, cumulative gains and losses in OCI are reclassified to the profit or loss.

	2019 £000	2018 £000
Net Impairment losses on loans and advances to customers	867	2,731
Of which:		
Stage 1	(1,099)	821
Stage 2	(37)	–
Stage 3	1,929	1,910
	867	**2,731**

During the year, the Group recovered £103k (2018: £41k) of loans which had previously been written off.

11. Other income

Other income includes a fair value adjustment of £1.5m (2018: £2.6m), to the contingent consideration for the acquisition of Renaissance Asset Finance Ltd. The fair value adjustment is based on management's assessment of the underlying performance of the business and reflects a reduction in the estimated future liability payable under the sale and purchase agreement.

Other items reflected in other income include rental income from the investment properties (see Note 30) of £2.1m (2018: £2.6m), premises recharges of £0.2m (2018: £0.7m) to STB for office space occupied and dividends received on the shares held in STB of £1.5m (2018: £0.7m), since de-recognition as an associate undertaking.

Accounting for rental income

Rental income is recognised on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income over the term of the lease.

12. Operating expenses

Operating expenses comprise:	2019 £000	2018 £000
Staff costs, including Directors:		
Wages, salaries and bonuses	39,169	37,051
Social security costs	4,313	4,176
Pension costs	1,980	1,842
Share based payment transactions (note 39)	249	(318)
Amortisation of intangibles (note 27)	2,008	1,752
Depreciation (note 28)	1,441	1,122
Financial Services Compensation Scheme Levy	228	113
Operating lease rentals	368	3,143
Operating expenses for investment property	–	282
Acquisitions costs	–	378
Other administrative expenses	20,430	15,441
Total operating expenses from continuing operations	**70,186**	**64,982**

Details on Directors remuneration are disclosed in the Remuneration Report on page 37.

Remuneration of the auditor and its associates, excluding VAT, was as follows:	2019 £000	2018 £000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	105	112
Fees payable to the Company's auditor and its associates for other services:		
Audit of the accounts of subsidiaries	285	323
Audit related assurance services	100	160
Other assurance services	–	10
Other non-audit services	–	10
Total fees payable	**490**	**615**

The 2019 fee is payable to Mazars LLP and the 2018 fee was payable to KPMG LLP.

Notes to the Consolidated Financial Statements *continued*

13. Income tax expense

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise. Income tax recoverable on tax allowable losses is recognised as an asset only to the extent that it is regarded as recoverable by offset against current or future taxable profits.

United Kingdom corporation tax at 19% (2018: 19%)	2019 £000	2018 £000
Current taxation		
Corporation tax charge – current year	1,000	620
Corporation tax charge – adjustments in respect of prior years	148	132
	1,148	**752**
Deferred taxation		
Origination and reversal of temporary differences	(105)	350
Adjustments in respect of prior years	(208)	19
	(313)	**369**
Income tax expense	**835**	**1,121**
Tax reconciliation		
Profit before tax	7,011	6,780
Tax at 19% (2018: 19%)	1,332	1,288
Permanent difference – Tax on associate income	–	(854)
Other permanent differences	(437)	536
Prior period adjustments	(60)	151
Corporation tax charge for the year	**835**	**1,121**

Permanent differences mainly relate to deferred consideration adjustments for RAF and dividends received from STB.

The tax charge on discontinuing operations in 2018 is disclosed in note 14.

On 6 September 2016 the Government substantively enacted a reduction in the UK corporation tax rate from 19% to 17% (effective from 1 April 2020). However, before the general election that took place on 12 December 2019, the Conservative Party said that the corporation tax rate will no longer reduce, if they remained in government. It is expected that this will be enacted in early 2020, after being confirmed in the Budget speech on 11 March 2020.

14. Discontinued operations

A discontinued operation is a component of the Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Group and which:

- represents a separate major line of business or geographical area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to re-sale.

Classification as a discontinued operation occurs on disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative Statement of Comprehensive Income is re-presented as if the operation had been discontinued from the start of the comparative year.

The profit after tax from discontinued operations is made up as follows:

Discontinued operations	Year ended 31 December 2019 £000	Year ended 31 December 2018 £000
Profit after tax from discontinued operations – STB associate income (up to 8 August 2018)	–	2,971
Loss after tax on de-recognition of STB	–	(28,663)
Loss after tax from discontinued operations	**–**	**(25,692)**

During 2018 Sir Henry Angest and Andrew Salmon resigned their positions on the board of Secure Trust Bank PLC ("STB") and the Group does not have the right to appoint any future directors to the board of STB. As a result of this the Group was deemed to no longer have significant influence over the associated company and thus the shareholding was recognised as a financial investment. This required the investment to be marked to market since 2018. Given the decline in the share price of STB over the previous years, this assessment resulted in a mark to market loss of £28.7m. This loss, together with the profit from associate for the period up to 8 August 2018, was reflected as a discontinued operation as the income was previously shown as a separately reported operating segment.

15. Average number of employees

	2019	2018
Private Banking	134	135
Commercial Banking	57	46
RAF	31	26
All Other Divisions	229	182
Group Centre	19	17
	470	**406**

Accounting for employee benefits

(a) Post-retirement obligations

The Group contributes to a defined contribution scheme and to individual defined contribution schemes for the benefit of certain employees. The schemes are funded through payments to insurance companies or trustee-administered funds at the contribution rates agreed with individual employees.

The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

There are no post-retirement benefits other than pensions.

(b) Share-based compensation – cash settled

The Group adopts a Black-Scholes valuation model in calculating the fair value of the share options as adjusted for an attrition rate for members of the scheme and a probability of pay-out reflecting the risk of not meeting the terms of the scheme over the vesting period. The number of share options that are expected to vest are reviewed at least annually.

The fair value of cash settled share-based payments is recognised as personnel expenses in the profit or loss with a corresponding increase in liabilities over the vesting period. The liability is remeasured at each reporting date and at settlement date based on the fair value of the options granted, with a corresponding adjustment to personnel expenses.

(c) Deferred cash bonus scheme

The Bank has a deferred cash bonus scheme for senior employees. The cost of the award is recognised to the Income Statement over the period to which the performance relates.

(d) Short-term incentive plan

The Group has a short-term incentive plan payable to employees of one of its subsidiary companies. The award of a profit share is based on a percentage of the net profit of a Group subsidiary.

Notes to the Consolidated Financial Statements *continued*

16. Earnings per ordinary share

Basic

Basic earnings per ordinary share are calculated by dividing the profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares 14,979,812 (2018: 14,889,048) in issue during the year (this includes Ordinary shares and Ordinary Non-Voting shares). On 17 May 2019 the Company issued 152,621 Ordinary Non-Voting shares, of which 3,902 were allocated to treasury shares. On 10 September the Company purchased another 7,408 Ordinary Non-Voting shares into treasury.

Diluted

Diluted earnings per ordinary share are calculated by dividing the dilutive profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, as well as the number of dilutive share options in issue during the year. The number of dilutive share options in issue at the year end was nil (2018: nil).

Profit & dilutive profit attributable	2019 £000	2018 £000
Total profit/(loss) after tax attributable to equity holders of the Company	6,176	(20,033)
Profit after tax from continuing operations attributable to equity holders of the Company	6,176	5,659
Loss after tax from discontinued operations attributable to equity holders of the Company	–	(25,692)

Basic & Diluted Earnings per share	2019 p	2018 p
Total Basic Earnings per share	41.2	(134.5)
Basic Earnings per share from continuing operations	41.2	38.0
Basic Earnings per share from discontinued operations	–	(172.5)

17. Cash and balances at central banks

Group	2019 £000	2018 £000
Cash and balances at central banks	**325,908**	**405,325**

ECL has been assessed to be immaterial.

Surplus funds are mainly held in the Bank of England reserve account, with the remainder held in certificates of deposit, fixed and floating rate notes and money market deposits in investment grade banks.

18. Loans and advances to banks

Group	2019 £000	2018 £000
Placements with banks included in cash and cash equivalents (note 41)	**46,258**	**54,173**

The table below presents an analysis of loans and advances to banks by rating agency designation as at 31 December, based on Moody's short and long term ratings:

Group	2019 £000	2018 £000
Aaa	–	709
Aa3	30,834	42,230
A1	306	8,880
A2	13,961	1,906
A3	20	10
Baa1	393	430
Baa2	736	–
Unrated	8	8
	46,258	**54,173**

None of the loans and advances to banks are past due (2018: nil). ECL has been assessed as immaterial.

Company	2019 £000	2018 £000
Placements with banks included in cash and cash equivalents (note 41)	**15,316**	**17,008**

Loans and advances to banks include bank balances of £15.3m (2018: £17.0m) with Arbuthnot Latham & Co., Ltd. ECL has been assessed as immaterial.

19. Debt securities at amortised cost

Debt securities represent certificates of deposit.

The movement in debt securities may be summarised as follows:

Group	2019 £000	2018 £000
At 1 January	342,691	227,019
Exchange difference	(27,372)	4,783
Additions	847,378	467,772
Redemptions	(719,737)	(356,883)
At 31 December	**442,960**	**342,691**

The table below presents an analysis of debt securities by rating agency designation at 31 December, based on Moody's long term ratings:

Group	2019 £000	2018 £000
Aaa	163,788	76,281
Aa1	11,390	84,218
Aa2	205,812	32,325
Aa3	50,238	56,046
A1	11,732	75,657
A2	–	18,164
	442,960	**342,691**

None of the debt securities are past due (2018: nil). ECL has been assessed as immaterial.

Notes to the Consolidated Financial Statements *continued*

19. Debt securities at amortised cost (continued)

The movement in debt securities for the Company may be summarised as follows:

Company	2019 £000	2018 £000
Additions	25,000	-
Interest	1,264	-
Redemptions	(2,025)	-
At 31 December	**24,239**	**-**

The exposure relates to Arbuthnot Latham & Co., Limited, which is unrated. The subordinated loan notes were issued on 3 June 2019 and are denominated in Pound Sterling. The principal amount outstanding at 31 December 2019 was £25,000,000 (2018: £nil). The notes carry interest at 7.75% over the three month LIBOR rate and are repayable at par in June 2029 unless redeemed or repurchased earlier by Arbuthnot Latham & Co., Limited. ECL has been assessed as immaterial.

20. Assets classified as held for sale

Assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale.

The criteria that the Group uses to determine whether an asset is held for sale under IFRS 5 include, but are not limited to the following:

- Management is committed to a plan to sell
- The asset is available for immediate sale
- An active programme to locate a buyer is initiated
- The sale is highly probable, within 12 months of classification as held for sale
- The asset is being actively marketed for sale at a sales price reasonable in relation to its fair value

Current assets held for sale are measured at the lower of their carrying amount and fair value less costs to sell except where measurement and remeasurement is outside the scope of IFRS 5. Where investments that have initially been recognised as current assets held for sale, because the Group has been deemed to hold a controlling stake, are subsequently disposed of or diluted such that the Group's holding is no longer deemed a controlling stake, the investment will subsequently be reclassified as fair value through profit or loss or fair value through other comprehensive income investments in accordance with IFRS 9. Subsequent movements will be recognised in accordance with the Group's accounting policy for the newly adopted classification.

Once classified as held for sale, intangible assets and property, plant and equipment are no longer amortised or depreciated.

	Group	
	2019 £000	2018 £000
Repossessed property held for sale	7,617	8,002
	7,617	**8,002**

Repossessed property held for sale

In 2017 a property in Spain held as collateral on a loan was repossessed. At the time of repossession, it was expected that the property would be sold in 12 months and so it was recognised as held for sale. A sale was not possible during the year, due to factors outside of the Group's control, however, as a sale is assessed to be probable within 12 months, it has been recognised as held for sale with a carrying value of £3.0m (2018: £3.1m).

In 2018 a further property in Spain held as collateral on a loan, valued in 2019 at £4.6m (2018: £4.9m) was repossessed. The Group's policy is to pursue timely realisation of the collateral in an orderly manner. The property is recognised as an asset held for sale.

All repossessed property is expected to be sold within 12 months and is therefore recognised as held for sale.

21. Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained using recent arm's length transactions or calculated using valuation techniques such as discounted cash flow models at the prevailing interest rates, and for structured notes classified as financial instruments fair values are obtained from quoted market prices in active markets. Derivatives are shown in the Statement of Financial Position as assets when their fair value is positive and as liabilities when their fair value is negative.

	2019			2018		
Group	Contract/notional amount £000	Fair value assets £000	Fair value liabilities £000	Contract/notional amount £000	Fair value assets £000	Fair value liabilities £000
Currency swaps	8,671	105	101	4,929	192	188
Interest rate swaps	25,530	–	218	25,762	112	–
Structured notes	1,644	1,699	–	1,607	1,542	–
	35,845	**1,804**	**319**	**32,298**	**1,846**	**188**

The principal derivatives used by the Group are over the counter exchange rate contracts. Exchange rate related contracts include currency swaps and interest rate swaps.

A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; exchange of principal can be notional or actual. The currency swaps are settled net and therefore the fair value is small in comparison to the contract/notional amount. Interest rate swaps are used to hedge against the Profit or Loss impact resulting from the movement in interest rates, due to some exposures having fixed rate terms.

Also included in derivative financial instruments are structured notes. The Group invested in the structured notes, which are maturing in 2021.

The Group only uses investment graded banks as counterparties for derivative financial instruments.

The table below presents an analysis of derivative financial instruments contract/notional amounts by rating agency designation of counterparty bank at 31 December, based on Moody's long term ratings:

Group	2019 £000	2018 £000
A1	35,837	29,601
A2	8	2,635
Baa1	–	62
	35,845	**32,298**

Notes to the Consolidated Financial Statements *continued*

22. Loans and advances to customers

Analyses of loans and advances to customers:

	2019			
Group	**Stage 1 £000**	**Stage 2 £000**	**Stage 3 £000**	**Total £000**
Gross loans and advances at 1 January 2019	**1,161,124**	**32,700**	**37,407**	**1,231,231**
Originations and repayments	147,411	(12,845)	(11,134)	123,432
Write-offs	(49)	–	(2,927)	(2,976)
Acquired portfolio	252,156	–	–	252,156
Transfer to Stage 1	3,659	(3,659)	–	–
Transfer to Stage 2	(50,489)	50,489	–	–
Transfer to Stage 3	(7,788)	(313)	8,101	–
Gross loans and advances at 31 December 2019	**1,506,024**	**66,372**	**31,447**	**1,603,843**
Less allowances for ECLs (see Note 23)	(526)	(47)	(4,217)	(4,790)
Net loans and advances at 31 December 2019	**1,505,498**	**66,325**	**27,230**	**1,599,053**

	2018			
Group	**Stage 1 £000**	**Stage 2 £000**	**Stage 3 £000**	**Total £000**
Gross loans and advances at 1 January 2018	**992,252**	**29,502**	**28,877**	**1,050,631**
Originations	458,825	–	–	458,825
Repayments and write-offs	(266,890)	(8,809)	(2,526)	(278,225)
Transfer to Stage 1	7,975	(7,975)	–	–
Transfer to Stage 2	(27,929)	28,975	(1,046)	–
Transfer to Stage 3	(3,109)	(8,993)	12,102	–
Gross loans and advances at 31 December 2018	**1,161,124**	**32,700**	**37,407**	**1,231,231**
Less allowances for ECLs (see Note 23)	(1,606)	(8)	(4,961)	(6,575)
Net loans and advances at 31 December 2018	**1,159,518**	**32,692**	**32,446**	**1,224,656**

For a maturity profile of loans and advances to customers, refer to note 6.

Loans and advances to customers by division (net of ECL/impairments):

Group	Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
	2019							
Stage 1	498,221	505,518	306,044	100,981	75,871	7,352	11,511	1,505,498
Stage 2	43,491	22,079	–	755	–	–	–	66,325
Stage 3	26,055	23	–	1,152	–	–	–	27,230
At 31 December 2019	**567,767**	**527,620**	**306,044**	**102,888**	**75,871**	**7,352**	**11,511**	**1,599,053**

Group	Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
	2018							
Stage 1	618,486	431,630	–	84,276	–	–	25,126	1,159,518
Stage 2	20,034	11,478	–	1,180	–	–	–	32,692
Stage 3	31,944	–	–	502	–	–	–	32,446
At 31 December 2018	**670,464**	**443,108**	**–**	**85,958**	**–**	**–**	**25,126**	**1,224,656**

Analyses of past due loans and advances to customers by division:

Group	Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
	2019							
Up to 30 days	16,911	15,872	5,196	1,608	–	–	–	39,587
Stage 1	13,525	15,864	5,196	1,395	–	–	–	35,980
Stage 2	3,386	8	–	1	–	–	–	3,395
Stage 3	–	–	–	212	–	–	–	212
30 – 60 days	1,899	35	2,404	526	–	–	–	4,864
Stage 1	–	35	2,404	151	–	–	–	2,590
Stage 2	1,899	–	–	203	–	–	–	2,102
Stage 3	–	–	–	172	–	–	–	172
60 – 90 days	70	–	1,688	342	–	–	–	2,100
Stage 1	–	–	1,688	110	–	–	–	1,798
Stage 2	70	–	–	128	–	–	–	198
Stage 3	–	–	–	104	–	–	–	104
Over 90 days	42,567	19,306	21,516	1,333	–	–	–	84,722
Stage 1	–	–	21,516	69	–	–	–	21,585
Stage 2	19,705	8,959	–	258	–	–	–	28,922
Stage 3	22,862	10,347	–	1,006	–	–	–	34,215
At 31 December	**61,447**	**35,213**	**30,804**	**3,809**	**–**	**–**	**–**	**131,273**

Notes to the Consolidated Financial Statements *continued*

22. Loans and advances to customers (continued)

Analyses of past due loans and advances to customers by division:

Group	Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
	2018							
Up to 30 days	47,766	20,784	–	2,519	–	–	–	71,069
Stage 1	47,766	20,784	–	2,078	–	–	–	70,628
Stage 2	–	–	–	154	–	–	–	154
Stage 3	–	–	–	287	–	–	–	287
30 – 60 days	662	2,300	–	775	–	–	–	3,737
Stage 2	662	2,300	–	565	–	–	–	3,527
Stage 3	–	–	–	210	–	–	–	210
60 – 90 days	385	4,177	–	297	–	–	–	4,859
Stage 2	385	4,177	–	175	–	–	–	4,737
Stage 3	–	–	–	122	–	–	–	122
Over 90 days	49,415	–	–	546	–	–	–	49,961
Stage 2	12,901	–	–	272	–	–	–	13,173
Stage 3	36,514	–	–	274	–	–	–	36,788
At 31 December	**98,228**	**27,261**	**–**	**4,137**	**–**	**–**	**–**	**129,626**

Loans and advances to customers include finance lease receivables as follows:

Group	2019 £000	2018 £000
Gross investment in finance lease receivables:		
– No later than 1 year	40,696	36,609
– Later than 1 year and no later than 5 years	78,013	62,541
– Later than 5 years	676	214
	119,385	99,364
Unearned future finance income on finance leases	(16,497)	(13,406)
Net investment in finance leases	**102,888**	**85,958**
The net investment in finance leases may be analysed as follows:		
– No later than 1 year	32,818	30,657
– Later than 1 year and no later than 5 years	69,441	55,095
– Later than 5 years	629	206
	102,888	**85,958**

(b) Loans and advances renegotiated

Restructuring activities include external payment arrangements, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Renegotiated loans that would otherwise be past due or impaired totalled £nil (2018: £nil).

(c) Collateral held

Collateral is measured at fair value less costs to sell. Most of the loans are secured by property. The fair value of the collateral held against loans and advances in Stage 3 is £38.6m (2018: £43.0m) against loans (net of ECL) of £26.0m (2018: £37.4m). The weighted average loan-to-value is 75% (2018: 72.9%).

23. Allowances for impairment of loans and advances

An analysis of movements in the allowance for ECLs (2019):

Group	Stage 1 £000	Stage 2 £000	Stage 3 £000	Total £000
At 1 January 2019	**1,606**	**8**	**4,961**	**6,575**
Transfer to Stage 2	(2)	2	–	–
Transfer to Stage 3	(5)	(1)	5	(1)
Current year charge	281	42	903	1,226
Adjustment due to variation in expected future cash flows	–	–	134	134
Change in assumptions*	(1,353)	–	223	(1,130)
Financial assets that have been derecognised	–	–	(853)	(853)
Repayments and write-offs	–	(4)	(1,157)	(1,161)
At 31 December 2019	**527**	**47**	**4,216**	**4,790**

* The ECL model and assumptions were reviewed resulting in a revised basis for estimating LGD after taking account of collateral values. This has resulted in a release of ECL provision of £1.3m in Stage 1 and an increase in ECL provision in Stage 3 of £0.2m.

An analysis of movements in the allowance for ECLs (2018):

Group	Stage 1 £000	Stage 2 £000	Stage 3 £000	Total £000
At 1 January 2018	**1,244**	**1,178**	**1,520**	**3,942**
Transfer to Stage 2	(378)	378	–	–
Transfer to Stage 3	(81)	(1,548)	1,629	–
Current year charge	821	–	1,871	2,692
Adjustment due to variation in expected future cash flows	–	–	78	78
Repayments and write-offs	–	–	(137)	(137)
At 31 December 2018	**1,606**	**8**	**4,961**	**6,575**

24. Other assets

Group	2019 £000	2018 £000
Trade receivables	4,625	2,976
Inventory	75,221	4,058
Prepayments and accrued income	6,597	5,682
	86,443	**12,716**

As allowed by IFRS 9, the Group utilises the practical expedient for the stage allocation of particular financial instruments which are deemed 'low credit risk'. This practical expedient permits the Group to assume, without more detailed analysis, that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have 'low credit' at the reporting date. The low credit risk exemption is applied to Trade receivables. ECL has been assessed as immaterial.

Inventory

Land acquired through repossession of collateral which is subsequently held in the ordinary course of business with a view to develop and sell is accounted for as inventory. The land is currently in the process of being redeveloped and will ultimately be sold off as individual residential plots. The proceeds from the sale of these plots will be used to repay the outstanding loans. Pinnacle Universal is a special purpose vehicle, 100% owned by the Group, which owns this land.

Notes to the Consolidated Financial Statements *continued*

24. Other assets (continued)

Inventory is measured at the lower of cost or net realisable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

During the year two properties were reclassified from investment property to inventory due to being under development with a view to sell. At 31 December 2019 they were valued at cost of £63.2m. A further property in Spain, held as collateral on a loan was repossessed. The Group's intention is to develop and sell the property within 12 months and therefore it has been recognised as inventory.

Company	2019 £000	2018 £000
Prepayments and accrued income	115	42
	115	**42**

25. Financial investments

Group	2019 £000	2018 £000
Designated at fair value through profit and loss		
– Debt securities	156	165
Designated at fair value through other comprehensive income		
– Listed securities	29,116	34,222
– Unlisted securities	1,647	964
Total financial investments	**30,919**	**35,351**

Listed securities

The Group holds investments in listed securities which are valued based on quoted prices.

On 8 August 2018, ABG lost significant influence over STB. At this date the interest in associate was de-recognised and the shares held in STB were marked to market and disclosed as a financial investment. Since then the shareholding was reduced from 15.53% to 9.85%. The carrying value at year end is £29.1m (2018: £34.2m) and £1.5m (2018: £0.7m) of dividends were received in the year.

The shares were designated as FVOCI for strategic reasons. The shares are measured at fair value in the Statement of Financial Position with fair value gains/losses recognised in OCI.

Debt securities

The Group has made an investment in an unlisted special purpose vehicle, set up to acquire and enhance the value of a commercial property through its 100% owned subsidiary. During 2018 the subsidiary company was sold and under the terms of the sale agreement the buyer agreed to purchase 100% of the share capital and reimburse all outstanding loans. The proceeds of the sale have been distributed to the investors, except for the amount withheld for the general and specific warranties (which will be released in three instalments at 18 month intervals included as a condition of the sale agreement. A distribution of £nil (2018: £1.6m) was received and a loss of £9k (2018: gain of £75k) recognised in profit or loss during the year. The investment has been valued at £0.2m (2018: £0.2m). These securities are designated at FVPL. They are measured at fair value in the Statement of Financial Position with fair value gains/losses recognised in the profit or loss.

Unlisted securities

On 23 June 2016 Arbuthnot Latham received €1.3m cash consideration following Visa Inc.'s completion of the acquisition of Visa Europe. As part of the deal Arbuthnot Latham also received preference shares in Visa Inc., these have been valued at their future conversion value into Visa Inc. common stock. Management has assessed the fair value of the Group's investment as £1.2m (2018: £863k). This valuation includes a 31% haircut.

The Group has designated its investment in the security as FVOCI. Dividends received during the year amounted to £7k (2018: £7k).

A further investment in an unlisted investment vehicle was made in 2019. The carrying value at year end is £0.5m (2018: £0.1m) and no dividends were received in the year. The increase in value is due to additional contributions to the fund and the successful performance of the underlying investments.

All unlisted securities have been designated as FVOCI as they are held for strategic reasons. These securities are measured at fair value in the Statement of Financial Position with fair value gains/losses recognised in OCI.

Company	2019 £000	2018 £000
Financial investments comprise:		
– Listed securities (at fair value through OCI)	25,913	19,312
– Unlisted securities (at fair value through OCI)	–	1
Total financial investments	**25,913**	**19,313**

26. Deferred taxation

Deferred tax is provided in full on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from the initial recognition of goodwill, the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the Statement of Financial Position date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, when they intend to settle current tax liabilities and assets on a net basis or the tax assets and liabilities will be realised simultaneously.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

The deferred tax asset comprises:

Group	2019 £000	2018 £000
Accelerated capital allowances and other short-term timing differences	(269)	(68)
Movement in fair value of financial investments FVOCI	(48)	(66)
Unutilised tax losses	1,740	1,134
IFRS 9 adjustment	392	490
Deferred tax asset	**1,815**	**1,490**
At 1 January	1,490	1,527
Other Comprehensive Income – FVOCI	18	(26)
Profit and loss account – accelerated capital allowances and other short-term timing differences	(202)	(96)
Profit and loss account – tax losses	729	(405)
IFRS 9 adjustment	(220)	490
Deferred tax asset at 31 December	**1,815**	**1,490**

Notes to the Consolidated Financial Statements *continued*

26. Deferred taxation (continued)

Company	2019 £000	2018 £000
Accelerated capital allowances and other short-term timing differences	1	2
Movement in fair value of financial investments	112	–
Unutilised tax losses	278	111
Deferred tax asset	**391**	**113**
At 1 January	113	641
Profit and loss account – accelerated capital allowances and other short-term timing differences	111	–
Profit and loss account – tax losses	167	(528)
Deferred tax asset at 31 December	**391**	**113**

Deferred tax assets are recognised for tax losses to the extent that the realisation of the related tax benefit through future taxable profits is probable.

27. Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

The Group reviews the goodwill for impairment at least annually or more frequently when events or changes in economic circumstances indicate that impairment may have taken place and carries goodwill at cost less accumulated impairment losses. Assets are grouped together in the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). For impairment testing purposes goodwill cannot be allocated to a CGU that is greater than a reported operating segment. CGUs to which goodwill has been allocated are aggregated so that the level at which impairment is tested reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination. The test for impairment involves comparing the carrying value of goodwill with the present value of pre-tax cash flows, discounted at a rate of interest that reflects the inherent risks of the CGU to which the goodwill relates, or the CGU's fair value if this is higher.

(b) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on a straight line basis over the expected useful lives (three to ten years).

Costs associated with maintaining computer software programs are recognised as an expense as incurred.

Costs associated with developing computer software which are assets in the course of construction, which management has assessed to not be available for use, are not amortised.

(c) Other intangibles

Other intangibles include trademarks, customer relationships, broker relationships, technology and banking licences acquired. These costs are amortised on a straight line basis over the expected useful lives (three to fourteen years).

Group	Goodwill £000	Computer software £000	Other intangibles £000	Total £000
Cost				
At 1 January 2018	5,202	11,148	2,562	18,912
Additions	–	2,294	–	2,294
At 31 December 2018	**5,202**	**13,442**	**2,562**	**21,206**
Additions	–	5,552	–	5,552
At 31 December 2019	**5,202**	**18,994**	**2,562**	**26,758**
Accumulated amortisation				
At 1 January 2018	–	(2,562)	(355)	(2,917)
Amortisation charge	–	(1,483)	(268)	(1,751)
At 31 December 2018	**–**	**(4,045)**	**(623)**	**(4,668)**
Amortisation charge	–	(1,761)	(247)	(2,008)
At 31 December 2019	**–**	**(5,806)**	**(870)**	**(6,676)**
Net book amount				
At 31 December 2018	**5,202**	**9,397**	**1,939**	**16,538**
At 31 December 2019	**5,202**	**13,188**	**1,692**	**20,082**

Significant management judgements are made in estimations, to evaluate whether an impairment of goodwill is necessary. Impairment testing is performed at CGU level and the following two items, with judgements surrounding them, have a significant impact on the estimations used in determining the necessity of an impairment charge:

- Future cash flows – Cash flow forecasts reflect management's view of future business forecasts at the time of the assessment. A detailed three year budget is done every year and management also uses judgement in applying a growth rate. The accuracy of future cash flows is subject to a high degree of uncertainty in volatile market conditions. During such conditions, management would perform impairment testing more frequently than annually to ensure that the assumptions applied are still valid in the current market conditions.
- Discount rate – Management also apply judgement in determining the discount rate used to discount future expected cash flows. The discount rate is derived from the cost of capital for each CGU.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. There are currently two CGUs (2018: two) with goodwill attached; the core Arbuthnot Latham CGU (£1.7m) and RAF CGU (£3.5m).

Management considers the value in use for both CGUs to be the discounted cash flows over 5 years with a terminal value (2018: 5 years with a terminal value). The 5 year discounted cash flows with a terminal value are considered to be appropriate as the goodwill relates to an ongoing well established business and not underlying assets with finite lives. The terminal value is calculated by applying a discounted perpetual growth model to the profit expected in 2022 as per the approved 3 year plan. A growth rate of 8.1% (2018: 8.9%) was used for income and 10.8% (2018: 6.9%) for expenditure from 2020 to 2022 (these rates were the best estimate of future forecasted performance), while a 3% (2018: 3%) percent growth rate for income and expenditure (a more conservative approach was taken for latter years as these were not budgeted for in detail as per the three year plan approved by the Board of Directors) was used for cash flows after the approved three year plan.

Notes to the Consolidated Financial Statements *continued*

27. Intangible assets (continued)

Management considers the value in use for the RAF CGU to be the discounted cash flows over 5 years with a terminal value. The 5 year discounted cash flows with a terminal value are considered to be appropriate as the goodwill relates to an ongoing, well established, business and not underlying assets with finite lives. The terminal value is calculated by applying a discounted perpetual growth model to the profit expected in 2022 as per the approved budget. A growth rate of 3% (2018: 3%) was used (this rate was the best estimate of future forecasted performance).

The growth rates used are above the forecast UK growth rate of 1.5% to reflect the Bank's current growth strategy enabled by capital available at parent level.

Cash flows were discounted at a pre-tax rate of 12% (2018: 12%) to their net present value. The discount rate of 12% is considered to be appropriate after evaluating current market assessments of the time value of money and the risks specific to the assets or CGUs.

Currently, the value in use and fair value less costs to sell of both CGUs exceed the carrying values of the associated goodwill and as a result no sensitivity analysis was performed.

Company	Computer software £000
Cost	
At 1 January 2018	–
Additions	7
At 31 December 2018	**7**
At 31 December 2019	**7**
Accumulated amortisation	
At 1 January 2018	–
Amortisation charge	(1)
At 31 December 2018	**(1)**
Amortisation charge	(1)
At 31 December 2019	**(2)**
Net book amount	
At 31 December 2018	**6**
At 31 December 2019	**5**

28. Property, plant and equipment

Land and buildings comprise mainly branches and offices and are stated at the latest valuation with subsequent additions at cost less depreciation. Plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, applying the following annual rates, which are subject to regular review:

Leasehold improvements	3 to 20 years
Office equipment	3 to 10 years
Computer equipment	3 to 5 years
Motor vehicles	4 years

Leasehold improvements are depreciated over the term of the lease (until the first break clause). Gains and losses on disposals are determined by deducting carrying amount from proceeds. These are included in the Statement of Comprehensive Income.

Group	Leasehold improvements £000	Computer and other equipment £000	Motor Vehicles £000	Total £000
Cost or valuation				
At 1 January 2018	5,015	3,041	97	8,153
Additions	1,764	627	91	2,482
Disposals	–	–	(97)	(97)
At 31 December 2018	**6,779**	**3,668**	**91**	**10,538**
Additions	609	1,341	–	1,950
At 31 December 2019	**7,388**	**5,009**	**91**	**12,488**
At 1 January 2018	(2,177)	(1,943)	(71)	(4,191)
Depreciation charge	(823)	(276)	(23)	(1,122)
Disposals	–	–	79	79
At 31 December 2018	**(3,000)**	**(2,219)**	**(15)**	**(5,234)**
Depreciation charge	(778)	(640)	(23)	(1,441)
At 31 December 2019	**(3,778)**	**(2,859)**	**(38)**	**(6,675)**
Net book amount				
At 31 December 2018	**3,779**	**1,449**	**76**	**5,304**
At 31 December 2019	**3,610**	**2,150**	**53**	**5,813**

Company	Computer and other equipment £000	Motor Vehicles £000	Total £000
Cost or valuation			
At 1 January 2018	214	97	311
Additions	3	91	94
Disposals	–	(97)	(97)
At 31 December 2018	**217**	**91**	**308**
At 31 December 2019	**217**	**91**	**308**
Accumulated depreciation			
At 1 January 2018	(84)	(70)	(154)
Depreciation charge	(1)	(24)	(25)
Disposals	–	79	79
At 31 December 2018	**(85)**	**(15)**	**(100)**
Depreciation charge	(1)	(23)	(24)
At 31 December 2019	**(86)**	**(38)**	**(124)**
Net book amount			
At 31 December 2018	**132**	**76**	**208**
At 31 December 2019	**131**	**53**	**184**

Notes to the Consolidated Financial Statements *continued*

29. Right-of-use assets

The Group has applied IFRS 16 using the modified retrospective approach from 1 January 2019 and has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard.

At inception or on reassessment of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Group assesses whether:

- the contract involves the use of an identified asset. This may be specified explicitly or implicitly, and should be physically distinct or represent substantially all of the capacity of a physically distinct asset. If the supplier has a substantive substitution right, then the asset is not identified;
- the Group has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use; and
- the Group has the right to direct the use of the asset. The Group has this right when it has the decision-making rights that are most relevant to changing how and for what purpose the asset is used.

At inception or on reassessment of a contract that contains a lease component, the Group allocates the consideration in the contract to each lease component on the basis of their relative stand-alone prices.

(a) As a lessee

The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore it or its site, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

Practical exemptions

The Group has elected not to recognise right-of-use assets and lease liabilities for short-term leases of machinery that have a lease term of 12 months or less and leases of low value assets. The Group recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

As a lessee (policy applicable before 1 January 2019)

Rentals made under operating leases are recognised in the Statement of Comprehensive Income on a straight-line basis over the term of the lease.

Leases in which the Group assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets by way of finance leases are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(b) As a lessor

Assets leased to customers under agreements which transfer substantially all the risks and rewards of ownership, with or without ultimate legal title, are classified as finance leases. When assets are held subject to finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

Assets leased to customers under agreements which do not transfer substantially all the risks and rewards of ownership are classified as operating leases. When assets are held subject to operating leases, the underlying assets are held at cost less accumulated depreciation. The assets are depreciated down to their estimated residual values on a straight-line basis over the lease term. Lease rental income is recognised on a straight-line basis over the lease term.

Group	Investment property £000	Properties £000	Equipment £000	Total £000
At 1 January 2019	8,108	14,036	–	22,144
Additions	–	–	543	543
Amortisation	–	(2,654)	(89)	(2,743)
Transfers*	(8,108)	8,108	–	–
At 31 December 2019	**–**	**19,490**	**454**	**19,944**

*The leasehold investment properties were transferred to inventory during 2019 and as a result have been reclassified to properties within right-of-use assets.

The Group recognised £976k of interest expense related to lease liabilities. The Group also recognised £439k of expense in relation to leases with a duration of less than 12 months.

30. Investment property

Investment property is initially measured at cost. Transaction costs are included in the initial measurement. Subsequently, investment property is measured at fair value, with any change therein recognised in profit and loss within other income.

If a change in use occurs and investment property is transferred to owner-occupied property, the property's deemed cost for subsequent reporting is its fair value at the date of change in use.

Group	2019 £000	2018 £000
Opening balance	67,081	59,439
Additions	2,901	879
Transfer	(63,219)	6,763
At 31 December 2019	**6,763**	**67,081**

During the year, two properties were reclassified from investment property to inventory due to being under development with a view to sell. At 31 December 2019 they were valued at cost of £63.2m. £2.9m (2018: £0.9m) of additions relate to development costs of the St Philips Place property, which is one of the properties now reclassified to inventory.

Crescent Office Park, Bath

In November 2017, a Property Fund, based in Jersey and owned by the Group, acquired a freehold office building in Bath. The property comprises 25,528 square ft. over ground and two upper floors with parking spaces. The property was acquired for £6.35m. On the date of acquisition, the property was being multi-let to tenants and was at full capacity.

In 2017, the Fund was recognised as an asset held for sale under IFRS 5 and therefore not consolidated in the financial statements. At 31 December 2019 it was consolidated into the Group as it no longer met the IFRS 5 criteria and is recognised as an investment property. The Group has elected to apply the fair value model.

The Group recognised £0.5m (2018: £0.5m) rental income during the year and incurred £0.1m (2018: £0.5m) of operating expenses.

31. Deposits from banks

Group	2019 £000	2018 £000
Deposits from other banks	**230,421**	**232,675**

The Term Funding Scheme ("TFS") was announced by the Bank of England on 4 August 2016 and became effective from 19 September 2016. The scheme is now closed. The TFS allows participants to borrow central bank reserves in exchange for eligible collateral. Deposits from banks include £225m (2018: £225m) obtained through TFS. For a maturity profile of deposits from banks, refer to Note 6.

Notes to the Consolidated Financial Statements *continued*

32. Deposits from customers

Group	2019 £000	2018 £000
Current/demand accounts	1,134,021	944,564
Notice accounts	102,567	75,879
Term deposits	848,315	693,843
	2,084,903	**1,714,286**

Included in customer accounts are deposits of £33.2m (2018: £24.5m) held as collateral for loans and advances. The fair value of these deposits approximates their carrying value.

For a maturity profile of deposits from customers, refer to Note 6.

33. Other liabilities

Group	2019 £000	2018 £000
Trade payables	2,023	1,782
Accruals and deferred income	11,477	16,767
	13,500	**18,549**

Company	2019 £000	2018 £000
Trade payables	289	272
Due to subsidiary undertakings	824	1,566
Accruals and deferred income	1,950	1,486
	3,063	**3,324**

34. Lease liabilities

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Primarily, the Group uses its incremental borrowing rate as the discount rate.

Lease payments included in the measurement of the lease liability comprise the following:

- fixed payments, including in-substance payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rates as at the commencement date;
- amounts expected to be payable under a residual value guarantee.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in index or rate, if there is a change in the Group's estimate of the amount expected to be payable under a residual value guarantee.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in the Statement of Comprehensive Income if the carrying amount of the right-of-use asset has been reduced to zero.

Group	Properties £000	Equipment £000	Total £000
At 1 January 2019	22,732	–	22,732
Additions	–	539	539
Interest expense	965	(11)	(976)
Lease payments	(3,677)	(139)	(3,816)
At 31 December 2019	**20,020**	**411**	**20,431**

Maturity analysis

Group	2019 £000
Less than one year	111
One to five years	12,174
More than five years	8,146
Total undiscounted lease liabilities at 31 December 2019	**20,431**
Lease liabilities included in the Statement of Financial Position at 31 December 2019	**111**
Current	111
Non-current	20,320

35. Debt securities in issue

Issued financial instruments or their components are classified as liabilities where the contractual arrangement results in the Group having a present obligation to either deliver cash or another financial asset to the holder.

Financial liabilities, other than trading liabilities at fair value, are carried at amortised cost using the effective interest rate method as set out in the policy in Note 3.3.

Group and Company	2019 £000	2018 £000
Subordinated loan notes	**36,837**	**13,283**

Euro subordinated loan notes

The subordinated loan notes were issued on 7 November 2005 and are denominated in Euros. The principal amount outstanding at 31 December 2019 was €15,000,000 (2018: €15,000,000). The notes carry interest at 3% over the interbank rate for three month deposits in euros and are repayable at par in August 2035 unless redeemed or repurchased earlier by the Company.

The contractual undiscounted amount that will be required to be paid at maturity of the above debt securities is €15,000,000.

Given the fact that the Group has never been subject to a published credit rating by any of the relevant agencies and the notes in issue are not quoted, it is not considered possible to estimate a fair value for these notes.

Notes to the Consolidated Financial Statements *continued*

35. Issued debt securities (continued)

Subordinated loan notes

The subordinated loan notes were issued on 3 June 2019 and are denominated in Pound Sterling. The principal amount outstanding at 31 December 2019 was £25,000,000 (2018: £nil). The notes carry interest at 7.75% over the three month LIBOR rate and are repayable at par in June 2029 unless redeemed or repurchased earlier by the Company.

The contractual undiscounted amount that will be required to be paid at maturity of the above debt securities is £25,000,000.

Given the fact that the Group has never been subject to a published credit rating by any of the relevant agencies and the notes in issue are not quoted, it is not considered possible to estimate a fair value for these notes.

36. Contingent liabilities and commitments

Financial guarantees and loan commitments policy

Financial guarantees represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments. However, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards. Liabilities under financial guarantee contracts are initially recorded at their fair value, and the initial fair value is amortised over the life of the financial guarantee. Subsequently, the financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure to settle obligations.

Provisions and contingent liabilities policy

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic resources will be required from the Group and amounts can be reliably measured.

Onerous contract provisions are recognised for losses on contracts where the forecast costs of fulfilling the contract throughout the contract period exceed the forecast income receivable. In assessing the amount of the loss to provide on any contract, account is taken of the Group's forecast results which the contract is servicing. The provision is calculated based on discounted cash flows to the end of the contract.

Contingent liabilities are disclosed when the Group has a present obligation as a result of a past event, but the probability that it will be required to settle that obligation is more than remote, but not probable.

Contingent liabilities

The Group is subject to extensive regulation in the conduct of its business. A failure to comply with applicable regulations could result in regulatory investigations, fines and restrictions on some of the Group's business activities or other sanctions. The Group seeks to minimise this risk through the adoption and compliance with policies and procedures, continuing to refine controls over business practices and behaviour, employee training, the use of appropriate documentation, and the involvement of outside legal counsel where appropriate.

Capital commitments

At 31 December 2019, the Group had capital commitments of US$0.6m (2018: US$0.7m) in respect of a contribution in an equity investment.

Credit commitments

The contractual amounts of the Group's off-balance sheet financial instruments that commit it to extend credit to customers are as follows:

Group	2019 £000	2018 £000
Guarantees and other contingent liabilities	6,401	1,744
Commitments to extend credit:		
– Original term to maturity of one year or less	190,064	86,002
	196,465	**87,746**

Operating lease commitments

Where a Group company is the lessee, the future aggregate lease payments under non-cancellable operating leases are as follows:

Group	2019 £000	2018 £000
Expiring:		
Within 1 year	215	2,995
Later than 1 year and no later than 5 years	–	11,446
Later than 5 years	–	2,213
	215	**16,654**

2018 has been restated to include an omitted lease identified during the implementation of IFRS 16.

On adoption of IFRS 16, the Group recognised a right-of-use asset and a corresponding liability in relation to leases which had previously been classified as “operating leases” under the principles of IAS 17 Leases.

The Group utilised the practical expedient, which allows for the accounting for operating leases, with a remaining lease term of less than 12 months as at 1 January 2019, as short-term leases.

37. Share capital

Ordinary share capital

Group and Company	Number of shares	Share capital £000	Share premium £000
At 1 January 2018	15,279,322	153	–
At 31 December 2018 & December 2019	**15,279,322**	**153**	**–**

Ordinary non-voting share capital

Group and Company	Number of shares	Share capital £000	Share premium £000
At 1 January 2019	–	–	–
Issue of shares	152,621	1	–
At 31 December 2019	**152,621**	**1**	**–**

Total share capital

Group and Company	Number of shares	Share capital £000	Share premium £000
At 1 January 2018	15,279,322	153	–
At 31 December 2018	**15,279,322**	**153**	**–**
Issue of shares	152,621	1	–
At 31 December 2019	**15,431,943**	**154**	**–**

(a) Share issue costs

Incremental costs directly attributable to the issue of new shares or options by Arbuthnot Banking Group, are shown in equity as a deduction, net of tax, from the proceeds.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved.

Notes to the Consolidated Financial Statements *continued*

37. Share capital (continued)

(c) Share buybacks

Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued.

The Ordinary shares have a par value of 1p per share (2018: 1p per share). At 31 December 2019 the Company held 401,584 shares (2018: 390,274) in treasury. This includes 390,274 Ordinary shares and 11,310 Ordinary Non-Voting shares.

38. Reserves and retained earnings

Group	2019 £000	2018 £000
Capital redemption reserve	19	20
Fair value reserve	205	(12,169)
Treasury shares	(1,214)	(1,131)
Retained earnings	209,171	209,083
Total reserves at 31 December	**208,181**	**195,803**

The capital redemption reserve represents a reserve created after the Company purchased its own shares which resulted in a reduction of share capital.

Company	2019 £000	2018 £000
Capital redemption reserve	19	20
Fair value reserve	(423)	(7,022)
Treasury shares	(1,214)	(1,131)
Retained earnings	161,556	162,729
Total reserves as 31 December	**159,938**	**154,596**

39. Share-based payment options

Company – cash settled

Grants were made to Messrs Salmon and Cobb on 14 June 2016 under Phantom Option Scheme introduced on that date, to acquire ordinary 1p shares in the Company at 1591p exercisable in respect of 50% on or after 15 June 2019 and in respect of the remaining 50% on or after 15 June 2021 when a cash payment would be made equal to any increase in market value.

Under this Scheme, Mr. Salmon and Mr. Cobb were granted a phantom option to acquire 200,000 and 100,000 ordinary 1p shares respectively in the Company, which remained outstanding at 31 December 2019. The fair value of these options at the grant date was £1m. At 31 December 2019, the fair value of the options was £0.3m (2018: £0.1m).

The performance conditions of the Scheme are that for the duration of the vesting period, the dividends paid by ABG must have increased in percentage terms when compared to an assumed dividend of 29p per share in respect of the financial year ending 31 December 2016, by a minimum of the increase in the Retail Prices Index during that period.

Also from the grant date to the date the Option is exercised, there must be no public criticism by any regulatory authority on the operation of ABG or any of its subsidiaries which has a material impact on the business of ABG.

Options are forfeited if they remain unexercised after a period of more than 7 years from the date of grant. If the participant ceases to be employed by the Group by reason of injury, disability, ill-health or redundancy; or because his employing company ceases to be a shareholder of the Group; or because his employing business is being transferred out of the Group, his option may be exercised within 6 months after such cessation. In the event of the death of a participant, the personal representatives of a participant may exercise an option, to the extent exercisable at the date of death, within 6 months after the death of the participant.

On cessation of employment for any other reason (or when a participant serves, or has been served with, notice of termination of such employment), the option will lapse although the Remuneration Committee has discretion to allow the exercise of the option for a period not exceeding 6 months from the date of such cessation.

In such circumstances, the performance conditions may be modified or waived as the Remuneration Committee, acting fairly and reasonably and taking due consideration of the circumstances, thinks fit. The number of Ordinary Shares which can be acquired on exercise will be pro-rated on a time elapsed basis, unless the Remuneration Committee, acting fairly and reasonably and taking due consideration of the circumstances, decides otherwise. In determining whether to exercise its discretion in these respects, the Remuneration Committee must satisfy itself that the early exercise of an option does not constitute a reward for failure.

The probability of payout has been assigned based on the likelihood of meeting the performance criteria, which is 100%. The Directors consider that there is some uncertainty surrounding whether the participants will all still be in situ and eligible at the vesting date. Therefore the directors have assumed a 15% attrition rate for the share options vesting in June 2021. The attrition rate will increase by 3% per year until the vesting date. ABG had a £0.2m expense in relation to share based payments during 2019 (2018: £0.3m write back), as disclosed in Note 12.

Measurement inputs and assumptions used in the Black-Scholes model are as follows:

	2019	2018
Expected Stock Price Volatility	21.8%	19.8%
Expected Dividend Yield	2.9%	3.6%
Risk Free Interest Rate	0.7%	0.8%
Average Expected Life (in years)	1.46	1.46

40. Dividends per share

Final dividends are not accounted for until they have been approved at the Annual General Meeting. The second interim dividend in respect of 2019 of 21p per share (2018: actual dividend 20p per share) amounting to a total of £3.16m (2018: actual £2.98m) was also declared after year end. The financial statements for the year ended 31 December 2019 do not reflect the second interim dividend which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2020.

41. Cash and cash equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents comprises cash on hand and demand deposits, and cash equivalents are deemed highly liquid investments that are convertible into cash with an insignificant risk of changes in value with a maturity of three months or less at the date of acquisition.

Group	2019 £000	2018 £000
Cash and balances at central banks (Note 17)	325,908	405,325
Loans and advances to banks (Note 18)	46,258	54,173
	372,166	**459,498**

Company	2019 £000	2018 £000
Loans and advances to banks (Note 18)	**15,316**	**17,008**

Notes to the Consolidated Financial Statements *continued*

42. Related party transactions

Related parties of the Company and Group include subsidiaries, directors, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members.

Other than the directors' remuneration (see Remuneration Report pages 36 to 37), payment of dividends and transactions with subsidiaries and associates, there were no related party transactions within the Parent Company. A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Except for the directors' disclosures, there were no other Key Management Personnel disclosures; therefore the tables below relate to directors and their close family members.

Group – subsidiaries	2019 £000	2018 £000
Loans		
Loans outstanding at 1 January	515	508
Loans advanced during the year	137	126
Loan repayments during the year	(144)	(2)
Transfer to deposits during the year	(5)	(117)
Loans outstanding at 31 December	**503**	**515**
Interest income earned	**17**	**15**

Group – associates	2019 £000	2018 £000
Loans		
Loans outstanding at 1 January	–	1,409
Loans advanced during the year	–	–
Loan repayments during the year	–	(1,409)
Transferred from loans with subsidiaries	–	–
Loans outstanding at 31 December	**–**	**–**
Interest income earned	**–**	**–**

The loans to directors are mainly secured on property, shares or cash and bear interest at rates linked to base rate. No provisions have been recognised in respect of loans given to related parties (2018: £nil).

Group – subsidiaries	2019 £000	2018 £000
Deposits		
Deposits at 1 January	1,884	3,233
Deposits placed during the year	4,529	3,390
Deposits repaid during the year	(3,342)	(4,622)
Transfer to loans during the year	(6)	(117)
Deposits at 31 December	**3,065**	**1,884**
Interest expense on deposits	**6**	**7**

Group – associates	2019 £000	2018 £000

Deposits		
Deposits at 1 January	–	1,403
Deposits placed during the year	–	–
Deposits repaid during the year	–	(1,403)
Transferred from deposits with subsidiaries	–	–
Deposits at 31 December	**–**	**–**
Interest expense on deposits	–	–

Details of directors' remuneration are given in the Remuneration Report. The Directors do not believe that there were any other transactions with key management or their close family members that require disclosure.

Details of principal subsidiaries are given in Note 43. Transactions and balances with subsidiaries are shown below:

	2019		2018	
	Highest balance during the year £000	Balance at 31 December £000	Highest balance during the year £000	Balance at 31 December £000
ASSETS				
Due from subsidiary undertakings – Loans and advances to banks	16,094	15,310	35,483	17,002
Due from subsidiary undertakings – Debt securities at amortised cost	24,741	24,239	–	–
Shares in subsidiary undertakings	134,614	134,004	134,614	134,614
	175,449	**173,553**	**170,097**	**151,616**
LIABILITIES				
Due to subsidiary undertakings	1,039	824	2,097	1,566
	1,039	**824**	**2,097**	**1,566**

The disclosure of the year end balance and the highest balance during the year is considered the most meaningful information to represent the transactions during the year. The above transactions arose during the normal course of business and are on substantially the same terms as for comparable transactions with third parties.

The Company undertook the following transactions with other companies in the Group during the year:

	2019 £000	2018 £000
Arbuthnot Latham & Co., Ltd - Recharge of property and IT costs	930	930
Arbuthnot Latham & Co., Ltd - Recharge for costs paid on the Company's behalf	1,890	1,520
Arbuthnot Latham & Co., Ltd - Recharge of costs paid on behalf of Arbuthnot Latham & Co., Ltd	(1,226)	–
Arbuthnot Latham & Co., Ltd - Group recharges for shared services	(5,219)	(1,200)
Arbuthnot Latham & Co., Ltd - Group recharges for liquidity	(5,326)	–
Secure Trust Bank PLC (from 16 June 2016 to 8 August 2018 as associate) - Group recharges for shared services	–	(751)
Secure Trust Bank PLC (from 16 June 2016 to 8 August 2018 as associate) - Dividends received	–	(2,101)
Total	**(8,951)**	**(1,602)**

Notes to the Consolidated Financial Statements *continued*

43. Interests in subsidiaries

Company	Investment at cost £000	Impairment provisions £000	Net £000
At 1 January 2018	100,366	(2,564)	97,802
Capital contributions to Arbuthnot Latham & Co., Limited	36,812	–	36,812
At 31 December 2018	**137,178**	**(2,564)**	**134,614**
Receipt on dissolution of West Yorkshire Insurance Company Limited	(3,174)	2,564	(610)
At 31 December 2019	**134,004**	**–**	**134,004**

Company	2019 £000	2018 £000
Subsidiary undertakings:		
Bank	132,314	132,314
Other	1,690	2,300
Total	**134,004**	**134,614**

(a) List of subsidiaries

Arbuthnot Latham & Co., Limited is the only significant subsidiary of Arbuthnot Banking Group. Arbuthnot Latham is incorporated in the United Kingdom, has a principal activity of Private and Commercial Banking and is 100% owned by the Group.

The table below provides details of other subsidiaries of Arbuthnot Banking Group PLC at 31 December:

	% shareholding	Country of incorporation	Principal activity
Direct shareholding			
Arbuthnot Fund Managers Limited	100.0%	UK	Dormant
Arbuthnot Investments Limited	100.0%	UK	Dormant
Arbuthnot Limited	100.0%	UK	Dormant
Arbuthnot Properties Limited	100.0%	UK	Dormant
Arbuthnot Unit Trust Management Limited	100.0%	UK	Dormant
Gilliat Financial Solutions Limited	100.0%	UK	Dormant
Peoples Trust and Savings Plc	100.0%	UK	Dormant
Windward Insurance Company PCC Limited	100.0%	Guernsey	Insurance
Indirect shareholding via intermediate holding companies			
Arbuthnot Commercial Asset Based Lending Limited	100.0%	UK	Asset Finance
Arbuthnot Latham (Nominees) Limited	100.0%	UK	Dormant
Arbuthnot Latham Real Estate Holdco Limited	100.0%	Jersey	Property Investment
Arbuthnot Latham Real Estate Holdings Limited	100.0%	UK	Property Investment
Arbuthnot Latham Real Estate PropCo Limited	100.0%	Jersey	Property Investment
Arbuthnot Real Estate Capital Limited	100.0%	Jersey	Property Investment
Arbuthnot Real Estate Capital GP 1 Limited	100.0%	Jersey	Property Investment
Arbuthnot Real Estate Capital Fund 1 Limited	100.0%	Jersey	Property Investment
Arbuthnot Securities Limited	100.0%	UK	Dormant
Arbuthnot Specialist Finance Limited	100.0%	UK	Specialist Finance
John K Gilliat & Co., Limited	100.0%	UK	Dormant
Pinnacle Universal Limited	100.0%	BVI	Property development
Pinnacle Universal Limited	100.0%	UK	Property development
Renaissance Asset Finance Limited	100.0%	UK	Asset Finance

All the subsidiary and related undertakings above are unlisted and none are banking institutions. All entities are included in the consolidated financial statements and have an accounting reference date of 31 December.

All Jersey entities have their registered office as 26 New Street, St Helier, Jersey, JE2 3RA. Pinnacle Universal Limited's (BVI) registered office is 9 Columbus Centre, Pelican Drive, Road Town, Tortola, BVI. All other entities listed above have their registered office as 7 Wilson Street, London, EC2M 2SN.

(b) Non-controlling interests in subsidiaries
There were no non-controlling interests at the end of 2019 or 2018.

(c) Significant restrictions
The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities other than those resulting from the supervisory frameworks within which banking subsidiaries operate. The supervisory frameworks require banking subsidiaries to keep certain levels of regulatory capital and liquid assets, limit their exposure to other parts of the Group and comply with other ratios. The carrying amounts of the banking subsidiary's assets and liabilities are £2,584m and £2,400m respectively (2018: £2,171m and £1,994m respectively).

(d) Risks associated with interests
During the year Arbuthnot Banking Group PLC made £nil (2018: £36.8m) capital contributions to Arbuthnot Latham & Co., Ltd. The contributions were made to assist the Bank during a period of growth to ensure that all regulatory capital requirements were met.

44. Operating segments

The Group is organised into eight operating segments as disclosed below:

1) Private Banking – Provides traditional private banking services as well as offering financial planning and investment management services. This segment includes Dubai.
2) Mortgage Portfolios – Acquired mortgage portfolios.
3) Commercial Banking – Provides bespoke commercial banking services and tailored secured lending against property investments and other assets.
4) RAF – Specialist asset finance lender mainly in high value cars but also business assets.
5) ACABL – Provides finance secured on either invoices, assets or stock of the borrower.
6) ASFL – Provides short term secured lending solutions to professional and entrepreneurial property investors.
7) All Other Divisions – All other smaller divisions and central costs in Arbuthnot Latham & Co., Ltd (Investment property and Central costs)
8) Group Centre – ABG Group management.

During the year the Group changed the way indirect costs are allocated to divisions. Treasury income and expenditure and the cost relating to certain support departments are no longer allocated out to divisions. This is in accordance with how the divisions are managed internally. The Mortgage Portfolios were previously included as part of Private Banking. ACABL and ASFL are now also reported separately (previously included in All Other Divisions). The comparative numbers for the divisions have been restated to reflect the new allocation method.

Notes to the Consolidated Financial Statements *continued*

44. Operating segments (continued)

Transactions between the operating segments are on normal commercial terms. Centrally incurred expenses are charged to operating segments on an appropriate pro-rata basis. Segment assets and liabilities comprise loans and advances to customers and customer deposits, being the majority of the balance sheet.

Year ended 31 December 2019	Private Banking £000	Mortgage Portfolios £000	Commercial Banking £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Group Centre £000	Total £000
Interest revenue	27,366	6,647	22,959	8,659	2,703	102	8,434	68	**76,938**
Inter-segment revenue	–	–	–	–	–	–	–	(68)	**(68)**
Interest revenue from external customers	27,366	6,647	22,959	8,659	2,703	102	8,434	–	**76,870**
Fee and commission income	10,730	–	1,162	219	1,380	1	443	–	**13,935**
Revenue from external customers	**38,096**	**6,647**	**24,121**	**8,878**	**4,083**	**103**	**8,877**	**–**	**90,805**
Interest expense	(2,259)	(2,534)	(2,808)	(2,786)	(1,358)	(31)	(4,696)	(209)	**(16,681)**
Add back inter-segment revenue	–	–	–	–	–	–	–	68	**68**
Subordinated loan note interest	–	–	–	–	–	–	–	(1,620)	**(1,620)**
Fee and commission expense	(43)	–	(48)	(12)	(3)	(1)	–	–	**(107)**
Segment operating income	35,794	4,113	21,265	6,080	2,722	71	4,181	(1,761)	**72,465**
Impairment losses	(485)	–	320	(708)	10	(4)	–	–	**(867)**
Other income	–	–	–	64	–	–	4,955	580	**5,599**
Operating expenses	(32,373)	(807)	(14,312)	(3,577)	(2,708)	(1,275)	(7,170)	(7,964)	**(70,186)**
Segment profit/(loss) before tax	2,936	3,306	7,273	1,859	24	(1,208)	1,966	(9,145)	**7,011**
Income tax (expense)/income	–	–	–	(371)	–	–	133	(597)	**(835)**
Segment profit/(loss) after tax	**2,936**	**3,306**	**7,273**	**1,488**	**24**	**(1,208)**	**2,099**	**(9,742)**	**6,176**
Loans and advances to customers	579,267	306,044	527,620	102,888	75,871	7,352	11,511	(11,500)	**1,599,053**
Other assets	–	–	–	–	–	–	974,241	22,085	**996,326**
Segment total assets	**579,267**	**306,044**	**527,620**	**102,888**	**75,871**	**7,352**	**985,752**	**10,585**	**2,595,379**
Customer deposits	1,039,112	–	824,120	–	–	–	248,965	(27,294)	**2,084,903**
Other liabilities	–	–	–	–	–	–	288,790	13,351	**302,141**
Segment total liabilities	**1,039,112**	**–**	**824,120**	**–**	**–**	**–**	**537,755**	**(13,943)**	**2,387,044**
Other segment items:									
Capital expenditure	–	–	–	–	–	–	(7,503)	–	**(7,503)**
Depreciation and amortisation	–	–	–	–	–	–	(3,424)	(25)	**(3,449)**

The "Group Centre" segment above includes the parent entity and all intercompany eliminations.

Year ended 31 December 2018	Private Banking £000	Mortgage Portfolios £000	Commercial Banking £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Group Centre £000	Total £000
Interest revenue	30,409	3,194	17,388	7,536	487	–	6,276	88	**65,378**
Inter-segment revenue	–	–	–	–	–	–	–	(88)	**(88)**
Interest revenue from external customers	30,409	3,194	17,388	7,536	487	–	6,276	–	**65,290**
Fee and commission income	10,887	–	849	151	219	–	850	–	**12,956**
Revenue from external customers	**41,296**	**3,194**	**18,237**	**7,687**	**706**	**–**	**7,126**	**–**	**78,246**
Interest expense	(2,166)	(1,059)	(2,243)	(2,192)	(263)	–	(1,713)	(199)	**(9,835)**
Add back inter-segment revenue	–	–	–	–	–	–	–	88	**88**
Subordinated loan note interest	–	–	–	–	–	–	–	(360)	**(360)**
Fee and commission expense	(56)	–	(122)	(14)	(7)	–	(35)	–	**(234)**
Segment operating income	39,074	2,135	15,872	5,481	436	–	5,378	(471)	**67,905**
Impairment losses	(1,966)	–	(278)	(437)	(50)	–	–	–	**(2,731)**
Other income	2	–	–	73	–	–	6,683	(170)	**6,588**
Operating expenses	(32,499)	(235)	(12,794)	(3,169)	(1,500)	(345)	(7,287)	(7,153)	**(64,982)**
Segment profit/(loss) before tax	4,611	1,900	2,800	1,948	(1,114)	(345)	4,774	(7,794)	**6,780**
Income tax (expense)/income	–	–	–	(431)	–	–	35	(725)	**(1,121)**
Segment profit/(loss) after tax	**4,611**	**1,900**	**2,800**	**1,517**	**(1,114)**	**(345)**	**4,809**	**(8,519)**	**5,659**
Loss from discontinued operations	–	–	–	–	–	–	–	–	**(25,692)**
Segment profit/(loss) after tax	**4,611**	**1,900**	**2,800**	**1,517**	**(1,114)**	**(345)**	**4,809**	**(8,519)**	**(20,033)**
Loans and advances to customers	601,741	68,723	443,108	85,957	25,341	–	11,286	(11,500)	**1,224,656**
Other assets	–	–	–	–	–	–	936,370	14,147	**950,517**
Segment total assets	**601,741**	**68,723**	**443,108**	**85,957**	**25,341**	**–**	**947,656**	**2,647**	**2,175,173**
Customer deposits	1,041,208	–	566,748	–	–	–	136,092	(29,762)	**1,714,286**
Other liabilities	–	–	–	–	–	–	251,437	13,494	**264,931**
Segment total liabilities	**1,041,208**	**–**	**566,748**	**–**	**–**	**–**	**387,529**	**(16,268)**	**1,979,217**
Other segment items:									
Capital expenditure	–	–	–	–	–	–	(4,675)	(101)	**(4,776)**
Depreciation and amortisation	–	–	–	–	–	–	(2,847)	(26)	**(2,873)**

Segment profit is shown prior to any intra-group eliminations.

Prior year numbers have been represented according to the 2018 operating segments reported to management. The UK private bank has a branch in Dubai, which generated £4.4m (2017: £4.5m) of income and had direct operating costs of £2.9m (2017: £2.7m). All Dubai branch income is booked in the UK. Other than the Dubai branch, all operations of the Group are conducted wholly within the United Kingdom and geographical information is therefore not presented.

Notes to the Consolidated Financial Statements *continued*

45. Country by Country Reporting

Article 89 of the EU Directive 2013/36/EU otherwise known as the Capital Requirements Directive IV ('CRD IV') was implemented into UK domestic legislation through statutory instrument 2013 No. 3118, the Capital Requirements (Country-by-Country Reporting) Regulations 2013 (the Regulations), which were laid before the UK Parliament on 10 December 2013 and which came into force on 1 January 2014.

Article 89 requires credit institutions and investment firms in the EU to disclose annually, specifying, by Member State and by third country in which it has an establishment, the following information on a consolidated basis for the financial year: name, nature of activities, geographical location, turnover, number of employees, profit or loss before tax, tax on profit or loss and public subsidies received.

31 December 2019

Location	Turnover (£m)	Number FTE employees	Profit/(loss) before tax (£m)	Tax paid (£m)
UK	72.5	487	9.8	0.8
Dubai	–	13	(2.8)	–

31 December 2018

Location	Turnover (£m)	Number FTE employees	Profit/(loss) before tax (£m)	Tax paid (£m)
UK	67.9	423	9.7	1.2
Dubai	–	14	(2.9)	–

The Dubai branch income is booked through the UK, hence the turnover is nil in the above analysis. Offsetting this income against Dubai branch costs would result in a £1.6m profit (2018: £0.9m). After indirect cost allocation it results in a loss of £0.3m (2018: loss of £0.5m). No public subsidies were received during 2018

46. Ultimate controlling party

The Company regards Sir Henry Angest, the Group Chairman and Chief Executive Officer, who has a beneficial interest in 56.1% of the issued share capital of the Company, as the ultimate controlling party. Details of his remuneration are given in the Remuneration Report and Note 42 of the consolidated financial statements includes related party transactions with Sir Henry Angest.

47. Non-adjusting events after the balance sheet date

The global economy has been significantly impacted by the spread of the coronavirus, which has had a dramatic effect on financial markets around the world.

The Government along with the Bank of England have implemented a number of measures to boost the economy. The extent to which these prevent the emergence of credit impairments in the Group is unknown.

Five Year Summary

	2015 £000	2016 £000	2017 £000	2018 £000	2019 £000
Profit/(loss) for the year after tax	26,524	227,569	6,523	(20,033)	**6,176**
(Loss)/profit before tax from continuing operations*	(2,606)	(1,966)	2,534	6,780	**7,011**
Total Earnings per share					
Basic (p)	86.3	1,127.2	43.9	(134.5)	**41.2**
Earnings per share from continuing operations*					
Basic (p)	(16.9)	(18.2)	14.0	38.0	**41.2**
Dividends per share (p) – ordinary	29.0	31.0	33.0	35.0	**37.0**
– special	–	325.0	–	–	**–**

Other KPI:

	2015 £000	2016 £000	2017 £000	2018 £000	2019 £000
Net asset value per share (p)	1,252.7	1,533.8	1,547.0	1,282.5	**1,363.5**

* Prior year numbers have been restated for continuing operations.

Corporate Contacts and Advisers

Group Address and Registered Office

Arbuthnot Banking Group PLC
Arbuthnot House
7 Wilson Street
London EC2M 2SN
T 020 7012 2400
E info@arbuthnotgroup.co.uk
www.arbuthnotgroup.com

Corporate Contacts

London

Arbuthnot Latham & Co., Limited
Arbuthnot House
7 Wilson Street
London EC2M 2SN
T 020 7012 2500
F 020 7012 2501
E banking@arbuthnot.co.uk
www.arbuthnotlatham.co.uk

Bristol

St Brandon's House
27-29 Great George Street
Bristol BS1 5QT
T 01392 496061

Exeter

The Senate
Ground Floor
Southernhay Gardens
Exeter
Devon EX1 1UG
T 01392 496061
F 01392 413638

Manchester

8th Floor
82 King Street
Manchester M2 4WQ
T 0161 413 0030

International

Dubai branch
PO Box 482007
Gate Precinct 4
Level 3
Office 308
Dubai International Financial Centre
Dubai
T +971 (4) 3770900

Renaissance Asset Finance Limited

RFC House
137 High Street
Brentwood
Essex CM14 4RZ
T 01277 215355
F 01277 203350
E info@renaissanceaf.com
www.renaissanceaf.com

Arbuthnot Commercial Asset Based Lending Limited

The Beehive
City Place
Gatwick RH6 0PA
E ABL@arbuthnot.co.uk

Arbuthnot Specialist Finance Limited

Manchester
8th Floor
82 King Street
Manchester M2 4WQ
T 0161 413 0030
E ASFLenquiries@arbuthnot.co.uk

Advisers

Auditor

Mazars LLP

Principal Bankers

Barclays Bank PLC
Lloyds Bank PLC

Joint Stockbroker

Numis Securities Limited
Shore Capital Stockbrokers Limited

Nominated Adviser and NEX Exchange Corporate Adviser

Grant Thornton UK LLP

Registrars

Link Asset Services
The Registry
34 Beckenham Road
Beckenham, Kent BR3 4TU

Arbuthnot Banking Group PLC
Arbuthnot House
7 Wilson Street
London EC2M 2SN

T 020 7012 2400
E info@arbuthnotgroup.co.uk

www.arbuthnotgroup.com

Registration No. 1954085