



ARBUTHNOT LATHAM
Private Bankers
Since 1833

Arbuthnot Latham & Co., Limited
Annual Report for the year ended 31 December 2017

Registered Number 00819519



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Company Information

Directors

Sir Henry Angest (Chairman)
Ian A Henderson (Chief Executive)
James R Cobb (Executive Director)
Stephen P Kelly (Finance Director)
Angela A Knight (Independent Non-Executive Director)
Paul Marrow (Independent Non-Executive Director)
Sir Michael C G Peat (Independent Non-Executive Director)
Andrew A Salmon (Executive Director)

Secretary

Nicole Smith

Registered Office

Arbuthnot House
7 Wilson Street
London
EC2M 2SN

Registered Number

00819519

Auditor

KPMG LLP
15 Canada Square
London
E14 5GL

Strategic Report – Business Review

Business Review

The principal business of Arbuthnot Latham & Co., Limited (the “Bank” or the “Company”) and its subsidiaries (together referred to as the “Group”) is private banking, commercial banking and asset financing. The Group’s strategy is to grow its existing business units, and continue to diversify its income streams into other areas of financial services. During 2017, the Group significantly scaled up its commercial banking proposition and diversified into asset finance through the purchase of Renaissance Asset Finance Limited (“RAF”). As a result, the Directors have deemed it appropriate to prepare consolidated accounts for the first time. Further diversification initiatives commenced in 2017 and will launch in 2018. These include an asset based lending business and a direct to consumer savings proposition.

Group Key Metrics

	2017	2016	Variance
	£m	£m	£m
Underlying profit	11.0	7.4	3.6
VISA gain	-	1.6	(1.6)
AL profit before ABG group recharge	11.0	9.0	2.0
ABG group recharge	(1.5)	(1.5)	-
Pre-tax profit for the year	9.5	7.5	2.0
Client loans	1,049.3	758.8	290.5
Client deposits	(1,391.0)	(998.0)	(393.0)
Assets under management ("AUM")	1,044.0	920.0	124.0
Term Funding Scheme / Funding for Lending Scheme	188.0	52.0	136.0
Tier 1 capital	112.3	67.2	45.1
Total capital	112.3	67.2	45.1

Key Performance Indicators

Client loans to client deposits and TFS/FLS ratio	66.5%	72.3%	(5.8%)
Total losses % of year end loans	0.0%	0.1%	(0.1%)
Average LTV on property backed loans	52.3%	45.1%	7.2%
Tier 1 capital ratio	11.9%	12.3%	(0.4%)
Total capital ratio	11.9%	12.3%	(0.4%)

The Group’s reported profit before tax increased by 27% to £9.5m (2016: £7.5m). The underlying profit growth is 49% if the £1.6m one-off gain from the sale of the Visa Europe shares in 2016 is excluded. The increased financial performance of the Group is a lagging indicator of the growth beyond £1bn of each of the three key business metrics: Customer Loans, Deposits and Assets Under Management.

Client loans grew by 38% to £1,049m (2016: £759m), as the Group supported its clients in pursuing their value enhancing and wealth preservation strategies with well-structured lending. The average loan-to-value on property backed lending increased to 52.3% (2016: 45.1%). Client deposits grew by 39% to £1,391m (2016: £998m), reflecting the increase in private and commercial banking clients, whilst AUMs increased by 13% to £1,044m (2016: £920m).

Total income grew by 28% to £58.8m in the year (2016: £46.1m), and operating expenses increased by 28% to £48.9m (2016: £38.1m). Expenses rose year-on-year, principally due to the cost of new staff hired over the last two years to support the continued expansion of the Group.

During the year, the Group selectively recruited experienced staff onto the Executive team and into key leadership positions. High quality staff are the Group’s biggest asset, and are essential to the continued growth and diversification of the business.

Investment in the Bank’s infrastructure continued, reflecting the strategic importance of modern systems and processes to maintain high levels of client service as the Group grows and diversifies. The most significant investment was in the Oracle “Flexcube” product that replaced the old banking system. This went live in May 2017 with the aid of a significant number of employees who showed true dedication and commitment to ensure that this project ran as smoothly as could be expected. Significant MIFID II and GDPR projects also commenced in 2017 to ensure the Group is compliant for the respective 2018 implementation dates.

Strategic Report – Business Review

The Group's prudent approach to liquidity management continued with client loans at 66.5% of the Group's funding base which consists of client deposits and Bank of England Term Funding Scheme borrowings (2016: 72.3%). The Group's drawings under the Term Funding Scheme ("TFS") were £188m at the year-end (2016: TFS £nil; FLS £52m). The TFS funding has a duration of four years, and is supported by property backed loan collateral and debt securities. Access to the TFS closed in early 2018, with the FLS closing during 2017. The Group's deposit book has been gathered over many years from different sources across a range of deposit products. It offers the Group a potential advantage going forward over those banks that are more reliant on "best buy" deposits that have greater exposure to a rising rate environment.

The Group continues to be well capitalised with the Tier 1 and total capital ratios at 11.9% (2016: 12.3%). The parent company, Arbuthnot Banking Group PLC, made tier 1 capital contributions of £43.2m (2016: £22.0m) in the year to support growth. The net assets of the Group have increased by 65% to close the year at £133m (2016: £81m).

The Group paid a management charge of £1.5m (2016: £1.5m) to its parent company, Arbuthnot Banking Group PLC, for management costs.

The Board wish to thank James W Fleming (Vice Chairman), who left the Group during the year, for his service over the years in developing the Private Bank.

Strategic Report – Financial Review

Arbuthnot Latham

The Private Bank increased its levels of loan origination by 22% to record levels of £201m. However, this was not sufficient to offset repayment of loans. Overall, the loan portfolio closed the year at £508m (2016: £524m) with more than half of this reduction due to the natural amortisation of the Duncan Lawrie loan portfolio acquired in December 2016. We expect the private banking loan portfolio to return to growth in 2018 with more emphasis on finding bespoke lending deals rather than vanilla lending that has become increasingly competitive in recent years.

The credit performance of the book remained well within our expected risk tolerance levels with impairments falling during the year to £0.4m (2016: £0.5m), with the portfolio benefiting from cash receipts on loans previously fully written off. This is a reflection of the Group's conservative lending policies, which focus on the standing of the borrower and the quality of the collateral taken as security.

The Private Bank continued to see a good flow of new client introductions and was able to increase the client deposit balances by 12% to £989m (2016: £883m); and in turn many of these new clients transferred funds into the Investment Management service. Income from investment management rose by 9.1% to £7.2m (2016: £6.6m), with wealth planning service income growing to £2.6m (2016: £2.2m). The Bank continued to benefit from its whole-of-market investment management approach and its Chartered Wealth Planning status.

The Private Banking office in Dubai continued to perform well with the client loan portfolio at £94m (2016: £74m), client deposits at £94m (2016: £64m) and AUMs at £95m (2016: £78m). With strong prospects for the AL proposition in the region, the office is expanding with both larger premises and additional private bankers being recruited.

The Commercial Bank grew in scale significantly during 2017. The client loan balances increased by in excess of 300% to close the year at £305m (2016: £76m) as the investment in new bankers manifested itself in good quality commercial lending opportunities. The commercial banking proposition of quality service and old style relationship banking has also proved successful in being able to attract deposits, with the deposit book growing by 503% to close the year at £308m (2016: £51m). The business has established a portfolio and a resultant income stream to support the business overhead. The focus going forward will be on growth and targeting niches that enjoy higher returns. The business saw no impairments in the year.

The Tay Mortgage portfolio performed better than expected, generating interest income of £3.0m in the full year (2016: £3.4m), with £72m of loans at the end of 2017 (2016: £85m). This portfolio of residential mortgage loans was originally acquired from the Administrators of the Dunfermline Building Society in December 2014 at a discounted price of £106m.

Renaissance Asset Finance

In December 2016, Arbuthnot Latham reached agreement with the shareholders of Renaissance Asset Finance to acquire the company, with the transaction completing in April 2017. The asset finance lending business specialises in financing high value cars and other business assets. Prior to the acquisition, it had been an independent business but was wholly reliant on its funding from a single banking line. As a result of this its ability to grow was constrained, and in the period between the announcement of our intention to acquire the operation and the final completion in April, the lending balances declined as the original banking line was gradually withdrawn.

Once the company became part of the Group, this constraint was removed and it was able to return to the market with new vigour. It was quickly able to re-energise its relationships with brokers and business introducers, thus returning to a growth trajectory, and closed the year with loan balances of £71m. During its eight full months of ownership, RAF directly contributed £1.5m to the Group's performance. The business saw no significant change in impairments during the year with losses running at 0.2%. To support the future growth of RAF, and the resultant increase in activities, the business will be moving to new premises in Basildon towards the end of the first quarter of 2018.

Business Development

During 2018, the Group will continue to diversify its income sources by developing further businesses. The first of these is the creation of an asset based lending business. This will provide businesses with a comprehensive asset-based lending suite including confidential invoice discounting, supported by stock, plant & machinery, property and cash flow lending. The initial core team have been hired and are based in offices near Gatwick. This business expects to write its first customer loans in Q3 2018.

The Group plans to launch its first commercial property fund for professional investors in 2018. It will be an income fund focused on good quality regional commercial assets. It was seeded with its first property, located in Bath, in November 2017.

Strategic Report – Financial Review

In November 2017, the Group purchased the freehold of St. Philips House in Birmingham for £6.1m as an investment property. The intention is to refurbish and let out the property for profit. The refurbishment is expected to cost £3.4m and will take place in 2018.

The Group is also developing a direct to consumer retail deposits offering. The proposition will further diversify the Group's sources of funding, with its ability to raise fixed term deposits from the best buy and aggregator platforms. "Arbuthnot Direct" is expected to soft launch in the middle of 2018 and be available to depositors in the third quarter. Initially, the platform will only aim to raise a modest amount of funding, but it will be capable of scaling up quickly if a compelling asset proposition is offered to the Group.

Principal 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 business are strategic, credit, liquidity, market, conduct, operational, cyber and regulatory.

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.

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The lending portfolio is extended to clients, the majority of which is secured against cash, property or other high quality assets. Credit risk is managed by the Credit Committee through annually reviewed policies sanctioned by the Board of Directors.

Liquidity risk

Liquidity risk is the risk that the Group cannot meet its obligations as they fall due. 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 Board annually approves the Individual 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.

Market risk

Market risk arises in relation to movement in interest rates, currencies and equity markets. The 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 interest rate rises.

The Group is exposed to changes in the market value of properties to the extent that it holds Investment Property carried at fair value. Any changes in the market value of the property will be accounted for in the Income Statement and as such could have a significant impact on the profit of the Group.

Conduct risk

Conduct risk for a financial services provider includes selling products to clients that do not meet their needs; failing to deal with clients' complaints effectively; not meeting clients' expectations; and exhibiting behaviours that do not meet market or regulatory standards. The Group adopts a zero tolerance policy regarding unfair client 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 adhered to. The Group also has insurance policies in place to cover any claims that may arise.

Operational risk

Operational risk is the risk that the Group may be exposed to financial losses from conducting its business. 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.

Strategic Report – Financial Review

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 have continuity of business plans in place including a disaster recovery provision.

Regulatory risk

Regulatory risk is 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 Individual Capital Adequacy Assessment Process (“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.

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.

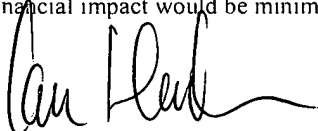
Macroeconomic and competitive environment

The Group is also exposed to indirect risks that may arise from the macroeconomic and competitive environment. The economic environment is relatively stable in the UK. However, the international landscape is increasingly uncertain. The uncertain performance of the economies in the EU and the increasingly protectionist stance being taken by other major economies may have an adverse affect on the UK. In particular, this may cause a further softening of central London property prices, which may spread out further to the South East.

The Group monitors its exposure to future interest rate rises and currently has minimal lending to customers in products that would be directly sensitive to interest rate rises. However, at the current levels of interest rates, the affordability enjoyed by the Group’s customers is beneficial.

Brexit

It is currently difficult to analyse the impacts that Brexit may have on Arbuthnot Latham. However, our only overseas operation is in Dubai, so the vast majority of the Group’s income and expenditure is based in the UK. It is therefore anticipated that the financial impact would be minimal, assuming no significant macro economic shock in the UK.



IA Henderson

Director

27 March 2018

Group Directors' Report

The Directors submit their annual report and the audited consolidated financial statements for the year ended 31 December 2017.

Principal Activities and Review

The principal activities of the Group are banking and financial services. Arbuthnot Latham & Co., Limited is a banking institution which is authorised by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority ("FCA") and Prudential Regulation Authority. It provides full banking, investment management and wealth planning services. A strategic review in accordance with Section 414 C of the Companies Act 2006 forming part of this report is set out on pages 1 to 5.

Results and Dividends

The results for the year are shown on page 22. The profit after tax for the year of £8.9m (2016: £7.3m) is included in reserves.

The Directors propose a final dividend of 2p per share, which will be paid after approval at the Annual General Meeting on 23 May 2018. No dividend was paid in respect of the year 2016.

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.

Financial Risk Management

Details of how the Group manages risk are set out in the Strategic Report and in note 6.

Directors

The Directors of the Company during the year were as follows:

Sir Henry Angest	Chairman
IA Henderson	Chief Executive
JR Cobb	
JW Fleming (retired 31 August 2017)	
SP Kelly	Finance Director
AA Knight	
P Marrow	
Sir Michael Peat	
AA Salmon	

Sir Henry Angest, Sir Michael Peat and Andrew Salmon retire by rotation and, being eligible, offer themselves for re-election.

None of the Directors have a direct share interest in the Bank. Sir Henry Angest is the ultimate controlling party of the parent company, Arbuthnot Banking Group PLC.

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 or associated companies, which was significant in relation to the Group's business.

At 31 December 2017, 2 directors had loans from Arbuthnot Latham & Co., Limited amounting to £0.2m, on normal commercial terms as disclosed in note 38 to the financial statements. At 31 December 2017, 6 directors had deposits with Arbuthnot Latham & Co., Limited amounting to £2.1m, all on normal commercial terms as disclosed in note 38 to the financial statements.

Sir Henry Angest, Andrew Salmon, James Cobb and Ian Henderson are directors of the parent company, Arbuthnot Banking Group PLC, and information on their shareholdings and share options in the overall Group are contained in the Directors' Report of that company.

Board Committees

Information on the Audit, Nomination, Remuneration and Risk Committees is included in the Corporate Governance section of the Annual Report on pages 8 to 13.

The Group maintains insurance to provide liability cover for directors and officers of the Group.

Group Directors' Report

Employees

The Group 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 Group through staff conferences and in other ways.

Articles of Association

The Company has amended its Articles of Association to provide for the appointment of a President but at the date of this report no such appointment has been made.

Political Donations

No political donations were made during the year (2016: £nil).

Branches outside of the UK

During the year, the Group operated a branch in Dubai which is regulated by the Dubai Financial Services Authority.

Events after the balance sheet date

On 3 January 2018, Arbuthnot Latham entered into a 12 year lease (up to 16 October 2029) to occupy the first, second and third floor of 10 Dominion Street London, with a break clause on 16 October 2024. The initial rent is £0.7m per annum.

Auditor

A resolution for the re-appointment of KPMG LLP as auditor will be proposed at the forthcoming Annual General Meeting at a fee to be agreed in due course by the directors.

Statement of Disclosure of Information to the Auditor

The Directors confirm that:

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

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

By order of the Board



IA Henderson

Director

27 March 2018

Corporate Governance

Introduction and Overview

The Group has a strong and effective Corporate Governance framework. This section of the Report and Accounts summarises key elements of the governance arrangements applicable to the Group and its compliance with the UK Corporate Governance Code.

As an unlisted company, the Group is not bound by the UK Corporate Governance Code. However, it is a bank authorised by the Prudential Regulation Authority (“PRA”) and regulated by the Financial Conduct Authority and the PRA. Additionally, the Dubai Financial Services Authority regulates the Company’s DIFC Branch and its subsidiary, Renaissance Asset Finance Limited, is regulated by the Financial Conduct Authority. Accordingly, the Group operates to the high standards of corporate accountability and regulatory compliance appropriate for such a business and the Board endorses the principles of openness, integrity and accountability, which underlie good corporate governance, taking into account both the provisions of the UK Corporate Governance Code in so far as they are considered appropriate to the Group’s size and circumstances and, in particular, the role and overall holding of the ultimate majority shareholder.

The Group is led by an effective Board, which comprises the non-executive Chairman together with four executive directors and three independent non-executive directors.

Sir Henry Angest is the Chairman of the Group. The Chairman sets the long-term focus and customer oriented culture of the Group and his role is to ensure good corporate governance. His responsibilities include leading the Board, ensuring the effectiveness of the Board in all aspects of its role, 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.

The Board membership was unchanged during the year with the exception of the retirement from the Board of James Fleming.

The directors seeking re-election are Sir Henry Angest, Sir Michael Peat and Andrew Salmon, who have served on the Board for 24 years, 3 years and 13 years respectively. Sir Henry Angest, who is the ultimate majority interest shareholder, has led the development of the Arbuthnot Banking Group over the past 24 years. Sir Michael Peat, with a wealth of experience has successfully chaired the Audit Committee, Andrew Salmon as Group Chief Operating Officer and Head of Business Development has contributed significantly to the Group’s expansion in support of its Chief Executive. Accordingly, the Board fully supports the resolutions for their reappointment.

In 2016, the Board commissioned an independent Board Effectiveness Review. The Directors were satisfied with the conduct and outcome of the review and have since implemented its recommendations. In 2017, the Board commissioned an Internal Audit of Corporate Governance. The Directors were satisfied with the outcome of the review and have implemented all recommendations as applicable to a private company of the size and nature of the Group.

The Board

The Board meets regularly throughout the year, holding six formal meetings during the year. 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 determining and overseeing the implementation of the strategy and management of the Group, the Board has determined certain items that are reserved for decision by itself. These matters include the acquisition and disposal of businesses, changes in strategic direction, cessation of business streams and formation of new ones and approval of the Annual Budget and Accounts.

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 Group’s expense.

All directors receive induction training upon joining the Board comprised of regulatory and compliance training provided by the Group Head of Compliance and/or an external firm of lawyers, risk management training (including in relation to the Internal Capital and Liquidity Adequacy Assessment Processes) provided by the Heads of Risk and the Finance Director. Additionally, the Head of Credit Risk provides an overview of Arbuthnot’s governance and mitigation arrangements in relation to credit and its associated risks.

Corporate Governance

Board Committees

The key governance committees established by the Board are the Audit, Nomination, Remuneration and Risk 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.

Audit Committee

Membership and meetings

The Audit Committee comprises three independent non-executive directors Sir Michael Peat (as Chairman), Angela Knight and Paul Marrow. Baroness Simone Finn joined the Audit Committee as an external independent member on 1 January 2018. The Committee met five times during the year.

The Audit Committee oversees, on behalf of the Board, the 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 half-yearly report remains with the Board. The Audit Committee also reviews procedures for detecting fraud and preventing bribery, reviews whistleblowing arrangements for employees to raise concerns in confidence, and reviews, as necessary, arrangements for outsourcing significant operations.

The present auditors, KPMG LLP, have held office since 2009. The senior statutory auditor changed in 2016 and will change again in 2018 following a five-year association with the Parent Company, Arbuthnot Banking Group Plc. The Board is satisfied with the effectiveness of their audit and endorses the comments made by the Committee in relation to the Audit Report set out below. 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.

Activity in 2017

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. It additionally provides assurance to the Board that the culture throughout the business is aligned with the Group's values, incorporating within each internal audit a review of culture in the area under review.

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 is satisfied with Internal Audit arrangements during 2017.

Integrity of Financial Statements and oversight of external audit

In 2017, for the first time, the Group Financial Statements include a long form audit report and with this change, it is appropriate to include further information on the role that the Audit Committee has played in the approval of these accounts. 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;
- In addition, the Committee considered changes to financial reporting requirements that are not yet effective but that are likely to impact on the reported results or financial position of the Group and Company in future. The most notable being the implementation of IFRS 9 from 1 January 2018. The Committee has reviewed Management's methodology, and are satisfied with the disclosures as set out in Note 3.23 to the financial statements.

Corporate Governance

The Audit Committee also receives reports from the external auditors, which 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 ICAAP and ILAAP are key control documents that receive detailed consideration at Board level.

The Committee approved the terms of engagement and 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 £0.4m for the year ended 31 December 2017. 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 2017.

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

Valuation of Investment Property

The two investment properties are held at fair value. The Committee reviewed the assumptions used in the valuation of the properties including capital expenditure, incentive periods, rental income, and yields.

As at 31 December, Arbuthnot Latham's property investment portfolio totalled £59.4m as detailed in Note 29. The disclosures relating to the fair value of investment property are set out in Note 4.1(c) to the financial statements.

Acquisition Accounting

During the year Arbuthnot Latham acquired the entire share capital of Renaissance Asset Finance Limited. The consideration consisted of an upfront and deferred payment based on future profits.

The Committee reviewed the accounting and the disclosures for the acquisition. This included reviewing the assumptions used in the valuation and identification of the separately identifiable intangible assets. An intangible asset relating to goodwill on acquisition was recognised totalling £3.5m (see Note 27).

Refer to Note 4.1(d) of the Notes to the Financial Statements for more information.

Going Concern

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 was appropriate.

Corporate Governance

Other Committee activities

During 2017 the Audit Committee received and reviewed reports from management relating to:

- The procedures for detecting fraud and prevention of bribery, and any instances of non-compliance;
- Whistleblowing arrangements for employees to raise concerns in confidence;
- Arrangements involving outsourcing of significant operations.

The Committee met separately with each of the Finance Director, Head of Internal Audit and the External Audit Partner without any other executives present. There were no issues or concerns raised by them in regard to discharging their responsibilities.

In September 2017, the Committee performed a review of its effectiveness by means of a self-assessment framework and completion of a questionnaire by members of the Committee. The review did not highlight any material concerns.

Nomination Committee

Membership and meetings

The Nomination Committee is chaired by Sir Henry Angest and its other members are Angela Knight, Paul Marrow and Sir Michael Peat. The Committee met three times during the year.

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, along with 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 and beneficial to the Board and Senior Executive Committee members in the future.

Activity in 2017

The Committee reviewed the performance of all directors during the year, together with the Board's individual and collective skills, ensuring the provision of relevant training, where appropriate and its planned integration with the new Board training and development policy. It has also examined the balance of executive and non-executive directors in relation to succession planning and the extent to which the requirements of a board diversity policy are met.

Remuneration Committee

Membership and meetings

The Remuneration Committee is chaired by Sir Henry Angest and its other members are Angela Knight, Paul Marrow and Sir Michael Peat. The Committee met three times 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 Group'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 (other than Group Directors). It additionally approves the remuneration of the Heads of Compliance, Credit, Internal Audit and Risk and reviews the remuneration of all material Risk Takers.

The Committee also deals with remuneration-related issues under the Prudential Regulation Authority's Remuneration Code applicable to the Group.

Risk Committee

Membership and meetings

The Risk Committee is chaired by Paul Marrow and its other members are James Cobb, Ian Henderson and Andrew Salmon. The Committee met nine times during the year.

The Risk Committee's primary responsibilities are to review and recommend to the Board specific risk policies, oversee the development, implementation and maintenance of the Group's overall risk management framework, risk appetite, strategy, principles and policies, oversee the Group's risk exposures, risk and return and propose improvements to the Group's risk management framework, oversee adherence to any risk principles, policies and standards set by Arbutnot Banking Group PLC and to keep it regularly informed of any material risk issues or breaches.

The Risk Committee has five sub-committees (numbers of meetings during 2017 in brackets), the Anti-Money Laundering Committee (twice), the Assets and Liabilities Committee (monthly), the Conduct Risk Committee (six), the Information Security

Corporate Governance

Group (monthly) and the Risk Management Committee (monthly). The first three enable additional specialised focus on key elements of regulatory risk, with material issues reported as standard at all Risk Committee meetings. The Risk Management Committee considers and reviews the risk landscape of the AL Group focusing on conduct, regulatory, credit and operational risks. The Information Security Group reviews all matters relating to the management of operational resilience and information security within the AL Group.

Activity in 2017

The Risk Committee (itself or via its sub-committees) reviewed and monitored, where appropriate for recommendation to the Board of Directors, capital and liquidity limits, including the relevant detail for inclusion in the ICAAP and the ILAAP; the Resolution and Recovery Plans; the expansion of the AL Group risk universe, control environment and the enhancement of the Risk Register; and the effect on credit risk deriving from the implementation of IFRS9.

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 have formally adopted a Risk Appetite Statement which sets out the Board's attitude to risk and internal control. Key risks identified by the business are set out in a Risk Framework, monitored by the Risk Team; this is reviewed by the Risk Committee on an ongoing basis and is formally reviewed and assessed at least once a year by the Board. In addition, 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 well-established 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.

Shareholder Communications

The Group maintains an ongoing dialogue with its Shareholder, Arbutnot Banking Group PLC, of which Sir Henry Angest, Andrew Salmon, James Cobb and Ian Henderson are directors. www.arbutnotgroup.com

Corporate Governance

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 Group and parent Company financial statements in accordance with applicable law and regulations.

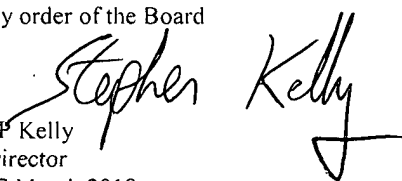
Company law requires the directors to prepare Group and parent Company financial statements for each financial year. Under that law they have elected to prepare the Group and parent Company financial statements in accordance with International Financial Reporting Standards as adopted by the EU (IFRSs as adopted by the EU) and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent Company and of their 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 either intend 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 Group and to prevent and detect fraud and other irregularities.

By order of the Board


SP Kelly
Director
27 March 2018



Independent auditor's report

to the members of Arbuthnot Latham & Co., Limited

1. Our opinion is unmodified

We have audited the financial statements of Arbuthnot Latham & Co., Limited ("the Company") for the year ended 31 December 2017 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 of changes in equity, consolidated statement of cashflows, company statement of cashflows, and the related notes, including the accounting policies in notes 2 & 3.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU);
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU 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 are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were appointed as auditor by the shareholders on 11 August 2009. The period of total uninterrupted engagement is for the 9 financial years ended 31 December 2017. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

Overview

Materiality:	£515,000 (2016:£395,000)
Group financial statements as a whole	5% (2016: 5%) of Group Profit Before Tax normalised to exclude intra-group fees paid to the parent company

Coverage	100% (2016:100%) of Group Profit Before Tax.
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Risks of material misstatement 2016 vs

Recurring risks	Loan Impairment Provisioning	◀▶
	Effective Interest Rate Accounting	◀▶
	Investment Property	◀▶
New risk	Fair value of net assets acquired as part of business combination	▲

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, 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. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
Loan Impairment Provisioning Consolidated allowance for impairment of loans and advances: £1,362,000 (2016: £973,000) Consolidated net impairment loss on financial assets: £394,000 (2016: £474,000) <i>Refer to page 10 (Audit Committee Report), page 33 (accounting policy) and pages 41, 76 & 78 (financial disclosures).</i>	Subjective estimate The impairment provision relating to the Group's loans and advances requires the directors to make significant judgements in relation to the recoverability of loans and advances. Impairment provisions are assessed on an individual and collective basis. <i>Individual impairment:</i> Individual impairment provisions are determined by assessing the quantum and timing of future cashflows on loans identified as impaired on the watchlist. The directors judge individual impairments by reference to loans where the borrower has experienced cash flow difficulties, there has been delinquency in contractual payments of principal or interest or the account is under forbearance. <i>Collective impairment:</i> Collective impairment is assessed by applying judgement in the light of the Group's historical experience and other wider market factors due to there being limited loss experience.	Our procedures included: • Controls: We tested the controls over the acceptance, monitoring and reporting of credit risk; • Independent re-performance: We re-performed the calculations of impairment assessments and agreed the key data inputs to third party documentation; namely projected selling price and discount rates to the effective interest rate of the loan; • Our sector experience: We challenged and assessed the reasonableness of the key judgemental areas of the calculation, being forecast sale value of the collateral and the time to sale of the property, through stress testing by applying our own expectations based on our knowledge of the Group and experience of the industry in which it operates; • Assessing valuers' credentials: We evaluated the competence of the valuers engaged by the directors to support the valuation of collateral. This included consideration of their qualifications and expertise. • Historical comparisons: We critically assessed the Group's assumptions on past payment behaviour, collateral valuations and timing of realisation of cashflows by comparing them to the Group's historical experience; • Sensitivity analysis: We performed sensitivity analysis over the Group's collateral valuations based up our findings from the above procedures; and • Test of details: We performed credit reviews on a risk-based sample of loans; • Assessing transparency: We critically assessed the adequacy of the Group's disclosures in respect of the degree of estimation involved in arriving at the balance and sensitivity of the impairment of loans and advances to changes in key assumptions reflected in the inherent risk. Our results We found the resulting estimate of the allowance for impairment of loans and advances to be acceptable.

	The risk	Our response
Effective Interest Rate Accounting Consolidated interest income: £47,601,000 (2016: £38,425,000) Refer to page 10 (Audit Committee Report), page 30 (accounting policy) and pages 41 & 71 (financial disclosures).	Subjective estimate The recognition of revenue (interest receivable) on loans and advances to customers under the effective interest rate ('EIR') method requires the directors to apply judgement, with the most critical estimate being the loans' expected behavioural life. <i>Originated assets:</i> The expected life assumptions utilise repayment profiles which represent when customers are expected to repay based on past customer behaviour. <i>Acquired loan portfolios:</i> For the Group's acquired loan portfolios, the risk is that future cash collections estimated at acquisition are not reflected in actual cash receipts. Given the nature of the acquired loan portfolios, estimation of future cash collections requires significant estimation with regard to the value and timing of expected future cash flows.	Our procedures included: <i>Originated assets:</i> • Historical comparison: We critically assessed the Group's analysis and key assumptions for the repayment profiles by comparing them to the Group's historical trends and actual portfolio behaviour; • Our sector experience: We challenged the Group's repayment profiles by applying our own expectations based on our knowledge of the Group and experience of the industry in which it operates; <i>Acquired loan portfolios:</i> • Historical comparison: We critically assessed the Group's cash flow forecasts by comparing them to current and past performance of the Group's portfolios, including recent cash collections. • Our sector experience: We compared the profile of future cashflows to our own expectations based on our knowledge of the Group and experience of the industry in which it operates; <i>Both portfolios:</i> • Assessing transparency: We critically assessed the adequacy of the Group's disclosures about the sensitivity of the revenue recognition on loans and advances to changes in key assumptions reflected in the inherent risk. Our results We found the resulting estimate of the revenue recognition on loans and advances to be acceptable.

	The risk	Our response
Investment Property Group Investment Property: £59,439,000 (2016: £53,339,000) <i>Refer to page 10 (Audit Committee Report), page 35 (accounting policy) and pages 42 & 84 (financial disclosures).</i>	Subjective valuation The investment property requires the directors to apply significant judgments and estimates to its fair value assessment. The directors have prepared a model with input from professional advisors to calculate the fair value of the investment property. As a result there is an inherent risk that the data and assumptions used in the calculation are not complete or accurate.	Our procedures included: • Assessing valuer's credentials: We evaluated the competence of the expert engaged by the directors to support the valuation methodology and key assumptions. This included consideration of their qualifications and expertise. • Tests of detail: We performed testing of source documentation provided by the Group. This included agreeing a sample of this documentation back to underlying lease data. • Our property valuation expertise: We included property valuation specialists in our audit team who challenged the valuation approach and assumptions determined by the directors. • Benchmarking assumptions: Our property valuation specialists compared the yields applied to an expected range of yields taking into account market data and asset-specific considerations. They also considered whether the other assumptions applied by the directors, such as the estimated rental values, voids, tenant incentives and refurbishment costs were supported by available market data such as recent lettings and occupancy levels. • Sensitivity analysis: We have undertaken sensitivity analysis over the key valuation assumptions (i.e. yields, renovation costs & post renovation rental uplift). • Historical comparisons: We carried out analytical procedures by comparing assumptions used for the valuation of the property on a year-on-year basis, by reference to our understanding of the UK commercial real estate market and external market data to evaluate the appropriateness of the valuations adopted by the directors. • Assessing transparency: We assessed the adequacy of the investment property disclosures by reference to the requirements in IAS 40. Our results The results of our testing were satisfactory and we considered the valuation of investment property to be acceptable.

	The risk	Our response
Fair value of net assets acquired as part of business combination 2017: £4,420,000 (2016: £nil) <i>Refer to page 10 (Audit Committee Report), page 29 (accounting policy) and pages 42 & 82 (financial disclosures).</i>	Subjective estimate The Company acquired Renaissance Asset Finance Limited during the year. The Group prepared the acquisition balance sheet based on estimates of the fair value of assets and liabilities acquired. In particular, the Group prepared discounted cash flow models to arrive at estimates of the acquired intangible assets including customer relationships, broker relationships and brand. This required the directors to exercise judgement in determining the expected cash flows from the assets and the discount rates to be applied.	Our procedures included: • Assessing valuer's credentials: We evaluated the competence of the expert engaged by the directors to support the valuation methodology and key assumptions. This included consideration of their qualifications and expertise. • Our sector experience: We challenged the assumptions, including value, probability and timing of cash flows, made in calculating the fair value assigned to the acquired intangibles with reference to the business plan, existing customer contracts and actual performance achieved. • Benchmarking assumptions: We assessed whether the discount rate used in calculating the fair value of the acquired intangibles reflected market conditions based on our knowledge of the industry. • Test of details: We tested the prospective financial information utilised in the valuation calculations. • Assessing transparency: We assessed the adequacy of the business combination disclosures by reference to the requirements in IFRS 3. Our results The results of our testing were satisfactory and we considered the RAF acquisition purchase price allocation to be acceptable.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £515,000 (2016: £395,000), determined with reference to a benchmark of Group profit before tax adjusted to exclude the effects of the intra-group fees paid to the Company's parent, of which it represents 5% (2016: 5% of Group profit before tax adjusted to exclude the effects of the intra-group fees paid to the Company's parent). The Group team performed procedures on the intra-group fees.

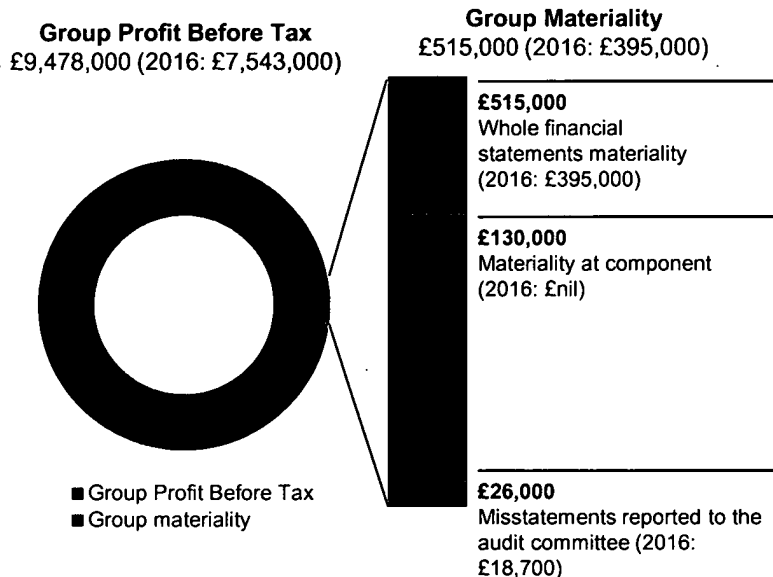
Materiality for the parent Company financial statements as a whole was set at £460,000 (2016: £395,000), determined with reference to a benchmark of parent company profit before tax adjusted to exclude the effects of the intra-group fees paid to the Company's parent, of which it represents 5% (2016: 5% of Group profit before tax adjusted to exclude the effects of the intra-group fees paid to the Company's parent). The Group team performed procedures on the intra-group fees.

We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £26,000 (2016: £18,700), in addition to other identified misstatements that warranted reporting on qualitative grounds.

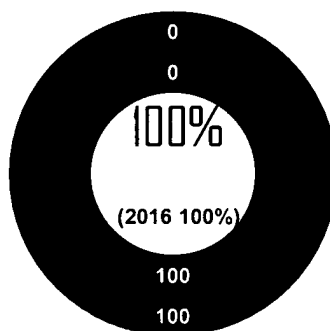
The Group has one (2016: nil) reporting component, we subjected this component to a full scope audit for group purposes. The Group team instructed the component auditor as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved the component materiality of £130,000 (2016: N/A), having regard to the size and risk profile of the components.

The Group audit team managed and co-ordinated the component auditor in the following way:

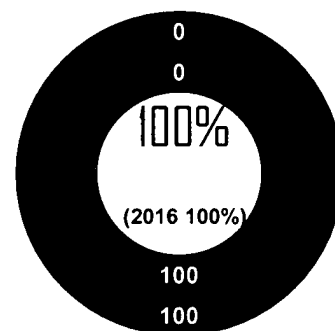
- During the audit the Group audit team held regular telephone calls and face-to-face discussions with the component audit team to challenge audit risks and audit strategy. Through the calls and meetings, the findings and observations reported to the Group audit team were discussed in more detail and any further work required by the Group audit team was then performed by the component auditor.
- In addition, the Group audit team participated in the audit close out meeting with the component team to ensure all material issues affecting the Group were identified and communicated back to the parent company. We challenged and reviewed audit approaches to impairment provisioning and revenue recognition.



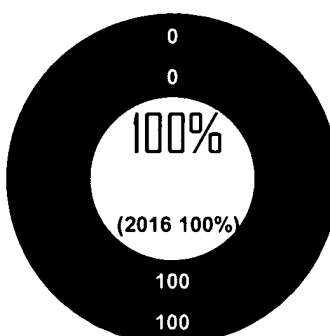
Group revenue



Group profit before tax



Group total assets



- Full scope for group audit purposes 2017
- Full scope for group audit purposes 2016

Scope – Disclosure of IFRS9 Effect

The Group is adopting IFRS 9 Financial Instruments from 1 January 2018 and has included an estimate of the financial impact of the change in accounting standard in accordance with *IAS 8 Changes in Accounting Estimates and Errors* as set out in note 3.23. This disclosure notes that the Group continues to refine its expected credit loss model and embed its operational processes which may change the actual impact on adoption. While further testing of the financial impact will be performed as part of our 2018 year end audit, we have performed sufficient audit procedures for the purposes of assessing the disclosures made in accordance with IAS 8. Specifically we have:

- Considered the appropriateness of key technical decisions, judgements, assumptions and elections made by the Group
- Considered key Classification and Measurement decisions, including Business Model Assessments and Solely Payment of Principal and Interest (SPPI) outcomes
- Considered credit risk modelling decisions and macroeconomic variables, including forward economic guidance and generation of multiple economic scenarios
- Considered transitional controls and governance processes related to the approval of the estimated transitional impact

4. We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

5. We have nothing to report on the strategic report and the directors' report

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

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

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

6. We have nothing to report on the other matters on which we are required to report by exception

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

- adequate accounting records have not been kept 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.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 13, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and 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 they 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

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

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

Irregularities – ability to detect

Our audit aimed to detect non-compliance with relevant laws and regulations (irregularities) that could have a material effect on the annual report. We identified relevant areas of laws and regulations from our sector experience, through discussion with the directors (as required by auditing standards), and from inspection of the group's regulatory correspondence.

We had regard to laws and regulations in areas that directly affect the financial statements including financial reporting (including related company legislation) and taxation legislation. We considered the extent of compliance with those laws and regulations as part of our procedures on the related annual accounts items.

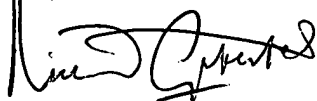
In addition we considered the impact of laws and regulations in the specific areas of regulatory capital & liquidity and conduct recognising the financial and regulated nature of the Groups activities. With the exception of any known or possible non-compliance, and as required by auditing standards, our work in respect of these was limited to enquiry of the directors and other management and inspection of regulatory correspondence. We considered the effect of any known or possible non-compliance in these areas as part of our procedures on the related annual accounts items.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit. This included communication from the group to component audit teams of relevant laws and regulations identified at group level, with a request to report on any indications of potential existence of irregularities in these areas, or other areas directly identified by the component team.

As with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

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

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



Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL
March 2018

Consolidated Statement of Comprehensive Income

	Note	Year ended 31 December	
		2017 £000	2016 £000
Interest income	8	47,601	38,245
Interest expense	8	(6,199)	(7,474)
Net interest income	8	41,402	30,771
Fee and commission income	9	13,805	11,430
Fee and commission expense		(282)	(425)
Net fee and commission income		13,523	11,005
Operating income		54,925	41,776
Net impairment loss on financial assets	10	(394)	(474)
Other income	11	3,870	4,353
Operating expenses	12	(48,924)	(38,112)
Profit before tax		9,477	7,543
Income tax expense	13	(540)	(211)
Profit for the year		8,937	7,332
Other comprehensive income			
Items that are or may be reclassified to profit or loss			
Available-for-sale reserve		128	(1,234)
Tax on other comprehensive income		(26)	247
Other comprehensive income for the period, net of tax		102	(987)
Total comprehensive income for the period		9,039	6,345

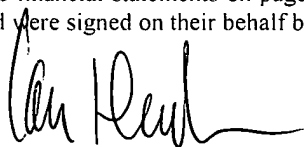
All amounts relate to continuing operations.

The notes on pages 29 to 92 are an integral part of these consolidated financial statements

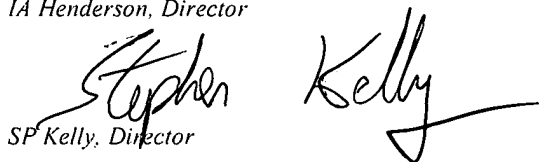
Consolidated Statement of Financial Position

		At 31 December	
		2017	2016
	Note	£000	£000
ASSETS			
Cash and balances at central banks	15	313,101	195,752
Loans and advances to banks	16	70,665	36,937
Debt securities held-to-maturity	17	227,019	107,300
Current assets held for sale	18	2,915	-
Derivative financial instruments	19	2,551	1,516
Loans and advances to customers	20	1,060,769	770,299
Other assets	22	20,589	12,972
Financial investments	23	2,207	2,025
Deferred tax asset	24	886	1,268
Interests in associates	25	-	900
Intangible assets	26	19,728	12,255
Property, plant and equipment	28	3,806	4,599
Investment property	29	59,439	53,339
Total assets		1,783,675	1,199,162
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	34	15,000	15,000
Retained earnings	35	33,575	24,638
Other reserves	35	84,362	41,060
Total equity		132,937	80,698
LIABILITIES			
Deposits from banks	30	195,097	3,200
Derivative financial instruments	19	931	227
Deposits from customers	31	1,439,804	1,099,744
Current tax liability		553	147
Other liabilities	32	14,353	15,146
Total liabilities		1,650,738	1,118,464
Total equity and liabilities		1,783,675	1,199,162

The financial statements on pages 22 to 92 were approved and authorised for issue by the Board of directors on 27 March 2018 and were signed on their behalf by:



IA Henderson, Director



SP Kelly, Director

Registered Number: 00819519

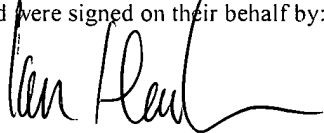
The notes on pages 29 to 92 are an integral part of these consolidated financial statements

Company Statement of Financial Position

		At 31 December	
		2017	2016
	Note	£000	£000
ASSETS			
Cash and balances at central banks	15	313,101	195,752
Loans and advances to banks	16	69,578	36,937
Debt securities held-to-maturity	17	227,019	107,300
Current assets held for sale	18	2,915	-
Derivative financial instruments	19	2,551	1,516
Loans and advances to customers	20	1,058,388	770,299
Other assets	22	20,446	12,967
Financial investments	23	2,207	2,025
Deferred tax asset	24	864	1,268
Interests in subsidiaries	39	7,945	5
Interests in associates	25	-	900
Intangible assets	26	14,024	12,255
Property, plant and equipment	28	3,795	4,599
Investment property	29	59,439	53,339
Total assets		1,782,272	1,199,162
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	34	15,000	15,000
Retained earnings	35	32,425	24,638
Other reserves	35	84,362	41,060
Total equity		131,787	80,698
LIABILITIES			
Deposits from banks	30	195,097	3,200
Derivative financial instruments	19	931	227
Deposits from customers	31	1,440,428	1,099,744
Current tax liability		38	147
Other liabilities	32	13,991	15,146
Total liabilities		1,650,485	1,118,464
Total equity and liabilities		1,782,272	1,199,162

The Group 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 22 to 92 were approved and authorised for issue by the Board of directors on 27 March 2018 and were signed on their behalf by:



IA Henderson, Director



SP Kelly, Director

Registered Number: 00819519

The notes on pages 29 to 92 are an integral part of these consolidated financial statements

Consolidated Statement of Changes in Equity

	Share capital £000	Retained earnings £000	Capital contribution reserve £000	Available for-sale reserve £000	Total £000
Balance at 1 January 2016	15,000	17,306	19,000	1,047	52,353
Total comprehensive income for the period					
Profit for 2016	-	7,332	-	-	7,332
Other comprehensive income, net of tax					
Available-for-sale reserve - net change in fair value	-	-	-	(1,234)	(1,234)
Tax on other comprehensive income	-	-	-	247	247
Total other comprehensive income	-	-	-	(987)	(987)
Total comprehensive income for the period	-	7,332	-	(987)	6,345
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Capital contribution	-	-	22,000	-	22,000
Total contributions by and distributions to owners	-	-	22,000	-	22,000
Balance at 31 December 2016	15,000	24,638	41,000	60	80,698
Total comprehensive income for the period					
Profit for 2017	-	8,937	-	-	8,937
Other comprehensive income, net of tax					
Available-for-sale reserve - net change in fair value	-	-	-	128	128
Tax on other comprehensive income	-	-	-	(26)	(26)
Total other comprehensive income	-	-	-	102	102
Total comprehensive income for the period	-	8,937	-	102	9,039
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Capital contribution	-	-	43,200	-	43,200
Total contributions by and distributions to owners	-	-	43,200	-	43,200
Balance at 31 December 2017	15,000	33,575	84,200	162	132,937

The notes on pages 29 to 92 are an integral part of these consolidated financial statements

Company Statement of Changes in Equity

	Share capital	Retained earnings	Capital contribution reserve	Available-for-sale reserve	Total
	£000	£000	£000	£000	£000
Balance at 1 January 2016	15,000	17,306	19,000	1,047	52,353
Total comprehensive income for the period					
Profit for 2016	-	7,332	-	-	7,332
Other comprehensive income, net of tax					
Available-for-sale reserve - net change in fair value	-	-	-	(1,234)	(1,234)
Tax on other comprehensive income	-	-	-	247	247
Total other comprehensive income	-	-	-	(987)	(987)
Total comprehensive income for the period	-	7,332	-	(987)	6,345
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Capital contribution	-	-	22,000	-	22,000
Total contributions by and distributions to owners	-	-	22,000	-	22,000
Balance at 31 December 2016	15,000	24,638	41,000	60	80,698
Total comprehensive income for the period					
Profit for 2017	-	7,787	-	-	7,787
Other comprehensive income, net of tax					
Available-for-sale reserve - net change in fair value	-	-	-	128	128
Tax on other comprehensive income	-	-	-	(26)	(26)
Total other comprehensive income	-	-	-	102	102
Total comprehensive income for the period	-	7,787	-	102	7,889
Transactions with owners, recorded directly in equity					
Contributions by and distributions to owners					
Capital contribution	-	-	43,200	-	43,200
Total contributions by and distributions to owners	-	-	43,200	-	43,200
Balance at 31 December 2017	15,000	32,425	84,200	162	131,787

The notes on pages 29 to 92 are an integral part of these consolidated financial statements

Consolidated Statement of Cash Flows

		Year ended 31 December 2017 £000	Year ended 31 December 2016 £000
	Note		
Cash flows from operating activities			
Interest received		43,563	34,446
Interest paid		(5,958)	(7,188)
Fees and commissions received		11,113	13,156
Other income		3,870	6,462
Cash payments to employees and suppliers		(44,467)	(37,597)
Taxation paid		(355)	(71)
Cash flows from operating profits before changes in operating assets and liabilities		7,766	9,208
Changes in operating assets and liabilities:			
- net increase in derivative financial instruments		(331)	-
- net increase in loans and advances to customers		(233,175)	(141,381)
- net increase in other assets		(9,191)	(3,362)
- net increase in amounts due to customers		340,060	177,381
- net (decrease)/increase in other liabilities		(1,425)	12,238
Net cash inflow from operating activities		103,704	54,084
Cash flows from investing activities			
Purchase of computer software	26	(2,641)	(5,155)
Purchase of property, plant and equipment	28	(666)	(349)
Purchase of investment property	29	(6,421)	(53,339)
Disposal of Tarn Crag (Holding) Limited	25	900	-
Purchase of Renaissance Asset Finance Limited	27	(2,072)	-
Cash balance acquired through Renaissance Asset Finance Limited acquisition	27	2,815	-
Purchases of debt securities		(211,080)	(89,384)
Proceeds from redemption of debt securities		90,410	66,015
Net cash outflow from investing activities		(128,755)	(82,212)
Cash flows from financing activities			
(Decrease)/Increase in borrowings		132,928	(22,107)
Capital contribution received		43,200	22,000
Net cash inflow/(outflow) from financing activities		176,128	(107)
Net increase/(decrease) in cash and cash equivalents		151,077	(28,235)
Cash and cash equivalents at 1 January		232,689	260,924
Cash and cash equivalents at 31 December	37	383,766	232,689

The notes on pages 29 to 92 are an integral part of these consolidated financial statements

Company Statement of Cash Flows

		Year ended 31 December 2017 £000	Year ended 31 December 2016 £000
	Note		
Cash flows from operating activities			
Interest received		42,287	34,446
Interest paid		(5,932)	(7,188)
Fees and commissions received		11,038	13,156
Other income		3,870	6,462
Cash payments to employees and suppliers		(45,326)	(37,597)
Taxation received/(paid)		32	(71)
Cash flows from operating profits before changes in operating assets and liabilities		5,969	9,208
Changes in operating assets and liabilities:			
- net increase in derivative financial instruments		(331)	-
- net increase in loans and advances to customers		(288,317)	(141,381)
- net increase in other assets		(10,389)	(3,362)
- net increase in amounts due to customers		340,684	177,381
- net (decrease)/increase in other liabilities		(1,155)	12,238
Net cash inflow from operating activities		46,461	54,084
Cash flows from investing activities			
Purchase of computer software	26	(2,641)	(5,155)
Purchase of property, plant and equipment	28	(664)	(349)
Purchase of investment property	29	(6,421)	(53,339)
Disposal of Tarn Crag (holdings) Limited	25	900	-
Purchase of Renaissance Asset Finance Limited	27	(2,072)	-
Purchases of debt securities		(211,080)	(89,384)
Proceeds from redemption of debt securities		90,410	66,015
Net cash outflow from investing activities		(131,568)	(82,212)
Cash flows from financing activities			
(Decrease)/Increase in borrowings		191,897	(22,107)
Capital contribution received		43,200	22,000
Net cash inflow/(outflow) from financing activities		235,097	(107)
Net increase/(decrease) in cash and cash equivalents		149,990	(28,235)
Cash and cash equivalents at 1 January		232,689	260,924
Cash and cash equivalents at 31 December	37	382,679	232,689

- The notes on pages 29 to 92 are an integral part of these consolidated financial statements

Notes to the Consolidated Financial Statements

1. Reporting entity

Arbuthnot Latham & Co., Ltd is a company domiciled in the United Kingdom. The registered address of Arbuthnot Latham & Co., Ltd is 7 Wilson Street, London, EC2M 2SN. The consolidated financial statements of Arbuthnot Latham & Co., Ltd as at and for the year ended 31 December 2017 comprise Arbuthnot Latham & Co., Ltd and its subsidiaries (together referred to as the "Group" and individually as "subsidiaries"). The Bank is primarily involved in banking and financial services.

2. Basis of presentation

(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.

(b) Basis of measurement

The consolidated and company financial statements have been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment property, available-for-sale financial assets, derivatives and financial liabilities measured at fair value through profit or loss.

(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) Accounting developments

The accounting policies adopted are consistent with those of the previous financial year. There were no new or amended standards or interpretations that resulted in a change in accounting policy.

(f) 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.

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.

Notes to the Consolidated Financial Statements

The Parent'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.

(d) Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are initially recognised at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Group's share of the total comprehensive income and equity movements of equity accounted investees, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the investee.

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 available-for-sale equity instruments are recognised in Other Comprehensive Income.

3.3. Interest income and expense

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

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group takes into account all contractual terms of the financial instrument but does not consider future 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

Notes to the Consolidated Financial Statements

amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the impaired carrying amount.

3.4. Fee and commission income

Fees and commissions which are not considered integral to the effective interest rate are generally recognised on an accrual basis when the service has been provided.

Asset and other management, advisory and service fees are recognised on an accruals basis as the related services are performed. The same principle is applied for financial planning and insurance services that are continuously provided over an extended period of time.

3.5. 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.

3.6. Financial assets and financial liabilities

The Group classifies financial assets and financial liabilities in the following categories: financial assets and financial liabilities at fair value through profit or loss; loans and receivables; held-to-maturity investments; available-for-sale financial assets and other financial liabilities. Management determines the classification of its investments at acquisition. A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

(a) Financial assets and financial liabilities at fair value through profit or loss

This category comprises derivative financial instruments. Derivative financial instruments utilised by the Group include embedded derivatives and derivatives used for hedging purposes. Financial assets and liabilities at fair value through profit or loss are initially recognised on the date from which the Group becomes a party to the contractual provisions of the instrument. Subsequent measurement of financial assets and financial liabilities held in this category are carried at fair value through profit or loss.

(b) Loans and receivables

Loans and receivables 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. Loans are recognised when cash is advanced to the borrowers. Loans and receivables, other than those relating to assets leased to customers, are carried at amortised cost using the effective interest rate method. The accounting for assets leased to customers is set out under note 3.16(a).

(c) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intent and ability to hold to maturity and that have not been designated at fair value through profit or loss or as available-for-sale investments. Held-to-maturity investments are carried at amortised cost using the effective interest rate method, less any impairment loss.

(d) Available-for-sale

Available-for-sale ("AFS") investments are those not classified as another category of financial assets. These include investments in special purpose vehicles and equity investments in unquoted vehicles. They may be sold in response to liquidity requirements, interest rate, exchange rate or equity price movements. AFS investments are initially recognised at cost, which is considered as the fair value of the investment including any acquisition costs. AFS securities are subsequently measured at fair value in the statement of financial position. Fair value changes in the AFS securities are recognised directly in equity (AFS reserve) until the investment is sold or impaired. Once sold or impaired, the cumulative gains or losses previously recognised in the AFS reserve are recycled to the profit or loss.

(e) Current financial assets held for sale

Current financial 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

Notes to the Consolidated Financial Statements

current financial 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 classified as fair value through profit or loss investments in accordance with IAS 39. Subsequent movements will be recognised in accordance with the Group's accounting policy for the newly adopted classification.

(f) Other financial liabilities

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

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. In the instance that fair values of assets and liabilities cannot be reliably measured, they are carried at cost.

For measuring derivatives that might change classification from being an asset to a liability or vice versa such as interest rate swaps, fair values take into account both credit valuation adjustment (CVA) and debit valuation adjustment (DVA) when market participants take this into consideration in pricing the derivatives.

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.

3.7. Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent arm's length transactions or using valuation techniques such as discounted cash flow models. 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.

Embedded derivatives

Embedded derivatives arise from contracts ('hybrid contracts') containing both a derivative (the 'embedded derivative') and a non-derivative (the 'host contract'). Where the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contract, and the host contract is not at fair value through profit or loss, the embedded derivative is bifurcated and reported at fair value and gains or losses are recognised in the Statement of Comprehensive Income.

Notes to the Consolidated Financial Statements

3.8. Impairment of financial assets

(a) Assets carried at amortised cost

On an ongoing basis the Group assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. Objective evidence is the occurrence of a loss event, after the initial recognition of the asset, that impacts on the estimated contractual future cash flows of the financial asset or group of financial assets, and can be reliably estimated.

The criteria that the Group uses to determine whether there is objective evidence of an impairment loss include, but are not limited to, the following:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Initiation of bankruptcy proceedings;
- Deterioration in the value of collateral;
- Deterioration of the borrower's competitive position.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Statement of Comprehensive Income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The Group considers evidence of impairment for loans and advances at both a specific asset and collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. In assessing collective impairment the Group uses historical trends of the probability of default, emergence period, the timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be significantly different to historic trends.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the Statement of Comprehensive Income.

A customer's account may be modified to assist customers who are in or have recently overcome financial difficulties and have demonstrated both the ability and willingness to meet the current or modified loan contractual payments. Loans that have renegotiated or deferred terms, resulting in a substantial modification to the cash flows, are no longer considered to be past due but are treated as new loans recognised at fair value, provided the customers comply with the renegotiated or deferred terms.

(b) Assets classified as available-for-sale

The Group assesses at each Statement of Financial Position date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the profit or loss. Impairment losses recognised in the profit or loss on equity instruments are reversed through other comprehensive income.

(c) Renegotiated loans

Loans that are neither subject to collective impairment assessment nor individually significant, and whose terms have been renegotiated, are no longer considered to be past due but are treated as new loans.

(d) 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.

Notes to the Consolidated Financial Statements

3.9. 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 3.13(a).

3.10. Term Funding Scheme

The Term Funding Scheme ("TFS") was announced by the Bank of England on 4 August 2016 and became effective from 19 September 2016. The TFS allows participants to borrow central bank reserves in exchange for eligible collateral. Amounts drawn from the TFS are included within 'Deposits from banks' on the statement of financial position as detailed in Note 30.

3.11. 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.

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.

3.12. 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. These assets and liabilities are subsequently measured at the lower of carrying amount and fair value less costs to sell. Once classified as held for sale, intangible assets and property, plant and equipment are no longer amortised or depreciated.

3.13. 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 or associate at the date of acquisition. Goodwill on acquisitions of subsidiaries or associates 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 the basis of 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 the basis of the expected useful lives (three to fourteen years).

Notes to the Consolidated Financial Statements

3.14. 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

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.

3.15. 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.

3.16. Leases

(a) 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.

(b) As a lessee

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.

3.17. 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.

3.18. 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.

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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

The fair value of equity settled share-based payment awards is calculated at grant date and recognised over the period in which the employees become unconditionally entitled to the awards (the vesting period). The amount is recognised as personnel expenses in the profit and loss, with a corresponding increase in equity. 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.

When share-based payments are changed from equity settled to cash settled and there is no change in the fair value of the replacement award, it is seen as a modification to the terms and conditions on which the equity instruments were granted and is not seen as the settlement and replacement of the instruments. Accordingly, on the date of modification, the Group recognises the entire liability as a reclassification from equity and does not recognise any profit or loss in the Statement of Comprehensive Income.

(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.

3.19. Taxation

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.

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.

3.20. 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 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.

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3.21. 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 are not assets of the Group.

3.22. Provisions and contingent liabilities

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.

3.23. New standards and interpretations not yet adopted

The following standards, interpretations and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2018 or later periods, but the Group has not early adopted them:

• IFRS 9, 'Financial instruments' (effective from 1 January 2018).

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments (IFRS 9). IFRS 9 replaces IAS 39 Financial instruments: 'Recognition and measurement', and is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Bank will initially apply IFRS 9 on 1 January 2018. In October 2017, the IASB issued 'Prepayment Features with Negative Compensation' (Amendment to IFRS 9). The amendments are effective for annual periods beginning on or after 1 January 2019, with early adoption permitted. This Amendment does not have an impact on the Bank's financial assets' classification and measurement. The Bank will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. The changes in measurement arising on initial application of IFRS 9 will be incorporated through an adjustment to the opening reserves and retained earnings position as at 1 January 2018.

The assessment below is preliminary and not all transition work has been finalised yet. The actual impact of adopting IFRS 9 on 1 January 2018 may change because the Bank is still refining its models and methodology for Expected Credit Loss ("ECL") calculations, and revisions of governance and internal controls (including IT systems) required for adoption of IFRS 9 are not yet complete and neither is the testing of these controls. Further, the assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first financial statements that include the date of initial application.

i) Classification and Measurement of Financial Assets and Liabilities

There are three measurement classifications under IFRS 9: amortised cost, fair value through profit and loss ("FVTPL") and for financial assets, fair value through other comprehensive income ("FVOCI"). The existing IAS 39 financial asset categories have been removed. Financial assets are classified into these measurement classifications based on the business model within which they are held, and their contractual cash flow characteristics. The business model reflects how groups of financial assets are managed to achieve a particular business objective.

Financial assets can only be held at amortised cost if the instruments are held in order to collect the contractual cash flow ('held to collect') and where those contractual cash flows are solely payments of principal and interest ("SPPI"). Financial asset debt instruments, where the business model objectives are achieved by both collecting the contractual cash flows and selling the assets ('held to collect and sell'), are held at FVOCI, with unrealised gains and losses deferred within reserves until the asset is derecognised. All financial assets not classified as measured at amortised cost or FVOCI, as described above, are measured at FVTPL.

The Bank has assessed the business models that it operates and most of the loans to banks and customers are held within a 'held to collect' business model. Investment debt securities categorised as held-to-maturity under IAS 39 are held within a 'held to collect' portfolio. The majority of the remaining investment debt securities are held within a 'held to collect and sell' business model or trading portfolio. Where the objective of a business is to hold the assets to collect the contractual cash flows or where the

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objective is to hold the assets to collect contractual cash flows and sell, a further assessment has been undertaken to determine whether the cash flows of the assets are deemed to meet the SPPI criteria.

Where these instruments have cash flows that meet the SPPI criteria, the instruments are measured at amortised cost (for held to collect business models) or FVOCI (for held to collect and sell business models). Instruments that do not meet the SPPI criteria are measured at FVTPL regardless of the business model in which they are held.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities, except for changes in presentation of fair value changes of financial liabilities designated at FVTPL attributable to changes in liability credit risk (under IFRS 9 these changes are presented within other comprehensive income). There has been no change in a way the Bank classifies and measures its financial liabilities.

ii) Impairment of Financial Assets, Loan Commitments and Financial Guarantee Contracts

IFRS 9 introduces a new forward-looking ECL impairment framework for all financial assets not measured at FVTPL and certain off-balance sheet loan commitments and guarantees. It replaces the 'incurred loss model' from IAS 39. The new ECL framework will result in an allowance for expected credit losses being recorded on financial assets regardless of whether there has been an actual loss event. This differs from the current approach where the allowance recorded on performing loans is designed to capture only losses that have been incurred, whether or not they have been specifically identified. The new impairment model applies to the following financial instruments that are not measured at fair value through profit or loss:

- Financial assets that are debt instruments; and
- Loan commitments and financial guarantee contracts issued

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. This Stage 1 approach is different from the current approach which estimates a collective allowance to recognise losses that have been incurred but not reported on performing loans.
- Stage 2: When a financial asset experiences a SICR subsequent to origination, but is not credit impaired, 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 because of an increase in credit risk and the impact of a longer time horizon being considered (compared to 12 months in Stage 1).
- Stage 3: Financial assets that exhibit objective evidence of impairment 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 credit impaired. A financial asset will be considered to be credit impaired when an event(s) that has a detrimental impact on estimated future cash flows have occurred. Evidence that a financial asset is credit impaired includes the following observable data:
 - Initiation of bankruptcy proceedings;
 - Notification of bereavement;
 - Identification of loan meeting debt sale criteria; or
 - Initiation of repossession proceedings.

In addition, a loan that is 90 days or more past due will be considered credit impaired for all portfolios. The credit risk of financial assets that become credit impaired are not expected to improve such that they are no longer considered credit impaired.

The ECL requirements of IFRS 9 are complex and require management judgments, estimates and assumptions, particularly in the areas of assessing whether the credit risk of an instrument has increased significantly since initial recognition and incorporating forward-looking information into the measurement of ECLs.

Under IFRS 9, the Bank will consider a financial asset to be in default when:

- The borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising collateral (if any is held); or
- The borrower is more than 90 days past due on any material credit obligation to the Bank.

This definition is largely consistent with the definition that is used for credit risk management process and for regulatory purposes.

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Significant increase in credit risk

Under IFRS 9, when determining whether the credit risk (risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Bank's historical experience, expert credit assessment and forward-looking information.

The Bank has established a methodology and framework that incorporates both quantitative and qualitative information to determine whether the credit risk on a particular financial instrument has increased significantly since initial recognition and this is aligned to the internal credit risk management process.

The criteria for determining whether credit risk has increased significantly will vary according to the individual circumstances of each loan, given the nature of the loan book, but will also include a backstop based on delinquency of 30 days past due. In certain instances, using its judgement and, where possible, relevant historical experience, the Bank may determine that an exposure has undergone a significant increase in credit risk if particular qualitative factors indicate so, as the quantitative analysis may not always capture this on a timely basis.

Measuring ECL

The key inputs to the measurement of ECLs are the following variables:

- Probability of default ("PD");
- Loss given default ("LGD"); and
- Exposure at default ("EAD").

Off-balance sheet items, such as financial guarantees and loan commitments, are included within the ECL computation.

Forward-looking information ("FLI")

IFRS 9 requires an unbiased and probability weighted estimate of credit losses by evaluating a range of possible outcomes that incorporates forecasts of future economic conditions. FLI is required to be incorporated into the measurement of ECL as well as the determination of whether there has been a significant increase in credit risk since origination. Measurement of ECLs at each reporting period should reflect reasonable and supportable information at the reporting date about past events, current conditions and forecasts of future economic conditions. Forecasts for key macroeconomic variables that most closely correlate with the Bank's portfolio are used to produce five economic scenarios, comprising of a central case, upside case, downside case, moderate stress and severe stress, and the impacts of these scenarios are then probability weighted. The estimation and application of this forward-looking information will require significant judgement. External information is used to produce the forecast information.

iii) Hedge Accounting

IFRS 9 introduces a new hedge accounting model that expands the scope of hedged items and risks eligible for hedge accounting and aligns hedge accounting more closely with risk management. The new model no longer specifies quantitative measures for effectiveness testing and does not permit hedge de-designation.

iv) Transition impact including impact on capital

The Bank will record an adjustment to its opening retained earnings as at 1 January 2018 to reflect the application of the new requirements at the adoption date, and will not restate comparative periods. The Bank estimates the IFRS 9 transition amount will reduce shareholders' equity by between £2.4m and £3.2m before tax as at 1 January 2018.

Under IFRS 9, it is estimated that the Bank's CET1 ratio would reduce by approximately 2 basis points after transitional relief (32 basis points before transitional relief). This is mainly driven by the increase in IFRS 9 ECL for standardised portfolios that directly impacts CET1 as there is no regulatory deduction to absorb the increase.

CET 1 ratio

- 11.93% under IAS 39 at 31 December 2017;
- Between 11.56% and 11.65% under IFRS 9 at 1 January 2018 before transitional relief;
- 11.91% under IFRS 9 at 1 January 2018 after transitional relief.

Transitional relief relates to the phasing of the impact of the initial adoption of ECL as permitted by Regulation (EU) 2017/2395 of the European Parliament and Council. The Bank is planning to adopt the transitional relief. Under this approach, the balance of ECL allowances in excess of the regulatory excess EL and standardised portfolios are phased into the CET1 capital base over 5

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years. The proportion phased in for the balance at each reporting period is 2018: 5%; 2019 15%; 2020 30%; 2021 50%; 2022 75%. From 2023 onwards, there is no transitional relief.

v) Impact on Governance and Controls

The Bank plans to apply its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments to determine the ECL. As part of the implementation, the Bank is in the process of refining existing internal controls and implementing new controls where required in areas that are impacted by IFRS 9, including controls over the development and probability weighting of macroeconomic scenarios, credit risk data and systems, and the determination of a significant increase in credit risk.

• IFRS 15, 'Revenue from contracts with customers' (effective 1 January 2017).

This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC-31 Revenue – Barter of Transactions Involving Advertising Services. IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The model features a contract-based five step analysis of transactions to determine whether, how much and when revenue is recognised. IFRS 15 is not expected to have a significant impact on the Bank, but further analysis is continuing.

• IFRS 16, 'Leases' (effective from 1 January 2019).

This standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). IFRS 16 eliminates the classification of leases as required by IAS 17 and introduces a single lease accounting model. Applying that model, a lessee is required to recognise:

- Assets and liabilities for leases with a term of more than 12 months, unless the underlying asset is of low value;
- Depreciation of lease assets separately from interest on lease liabilities in profit or loss.

The standard is effective for annual periods beginning on or after 1 January 2019. The Bank is currently in the process of assessing the impact that the initial application would have on its business and will adopt the standard for the year ending 31 December 2019.

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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) Credit losses

The Group reviews its loan portfolios and held-to-maturity investments to assess impairment at least on a quarterly basis. The basis for evaluating impairment losses is described in accounting policy 3.8. Where financial assets are individually evaluated for impairment, management uses its best estimates in calculating the net present value of future cash flows. Management has to make judgements on the financial position of the counterparty and the net realisable value of collateral (where held), in determining the expected future cash flows.

The recoverable amount is typically dependent on the sale of the collateral. The amount recoverable is determined with reference to:

- The property valuation, which is typically updated every 12 months.
- The time taken to realise the sale proceeds (UK property is assumed to take 12 months and Non-UK property 24 months).
- The property marketing costs (UK property is assumed to be at 3% of property value and Non-UK at 7%).
- The legal costs of sale (UK legal sales costs are assumed to be £5k, whilst Non-UK are assumed to be €10k).

Any change in timing of estimated future cash flows (other than impairment) will adjust carrying value with gain or loss in profit or loss. The revised carrying amount will be recalculated by discounting the revised estimated future cash flows at the loan's original effective interest rate.

A sensitivity analysis was carried out on the two main assumptions used to calculate the recoverable amount and therefore the impairments required:

- If the value of the collateral increased or decreased by 10%, impairments would decrease or increase by £1.6m (2016: £1.7m);
- If the time taken to sell the properties was increased or decreased by 12 months, impairments would increase or decrease by £0.8m (2016: £0.8m).

In determining whether an impairment loss should be recorded in the Statement of Comprehensive Income, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans or held-to-maturity investments with similar credit characteristics, before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In assessing collective impairment the Group uses historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be significantly different to historic trends. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

(b) Effective Interest Rate

Acquired loan books are initially recognised at fair value. Subsequently, they are measured under the effective interest rate method, based on cash flow models which require significant judgement assumptions on prepayment rates, late payments, the probability and timing of defaults and the amount of incurred losses. 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 adjustment to the carrying value of the loan book is recognised in the Statement of Comprehensive Income.

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If the acquired loan books were modelled to repay 6 months earlier, it would increase interest income in 2017 by £0.4m (2016: £0.1m), while a 10% increase in credit losses would reduce interest income in 2017 by £0.2m (2016: £0.3m), both as a result of AG8 adjustments.

IAS 39 requires interest earned from lending to be measured under the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset.

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, interest income would increase by £0.3m (2016: £0.3m).

(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 Group currently owns two investments properties, as outlined in note 29.

The King Street property is currently fully tenanted, with the main lease ending in 2019 at which point the offices will be refurbished and re-let at prevailing market rents. The valuation model considers the net present value of net cash flows to be generated from the property, taking into account expected rental growth rate, void periods, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discount rates. Among other factors, the discount rate estimation considers the quality of a building and its location, tenant quality and lease terms. Management judgement is required for significant unobservable inputs used in the discounted cash flow model, which have been assessed as follows:

- refurbishment period: 6 months
- void period after refurbishment: 6 months
- rent free period: 18 months
- estimated refurbishment costs: £2.4m
- yield rate: 4%
- expected rental income uplift following re-let: 15%

If the discount rate increased by 25bps, there would be a reduction in fair value of £4.8m, while a decrease in the discount rate would have a positive fair value impact through the Profit or Loss of £4.0m. If the expected rental uplift following the re-let of the building was reduced by 5%, there would be a reduction in fair value through the Profit or Loss of £2.4m, while an increase in the rental uplift by 5%, would have a positive fair value impact through the Profit or Loss of £2.2m.

The St Philips Place property was acquired on 24 November 2017. As the property was bought shortly before the year end, the cost of acquisition is considered to remain a good estimate of fair value.

(d) Acquisition accounting

The Group recognises identifiable assets and liabilities at their acquisition date fair values. The exercise of attributing a fair value to the balance sheet of the acquired entity requires the use of a number of assumptions and estimates, which are documented at the time of the acquisition. These fair value adjustments are determined from the estimated future cash flows generated by the assets.

Loans and advances to customers

The methodology of attributing a fair value to the loans and advances to customers involves discounting the estimated future cash flows after impairment losses, using a risk adjusted market rate. A fair value adjustment is then applied to the carrying value in the acquirer's balance sheet.

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Intangible assets

Identifying the separately identifiable intangible assets of an acquired company is subjective and based upon discussions with management and a review of relevant documentation. During the year, there were three separately identifiable intangible assets which met the criteria for separation from goodwill, these being Customer Relationships, Broker Relationships and Brand.

Customer Relationships are valued through the application of a discounted cash flow methodology to net anticipated renewal revenues. The valuation of Broker Relationships is derived from a costs avoided methodology, by reviewing costs incurred on non-broker platforms versus costs which are incurred in broker commission. The Brand is valued considering a market participant's view on the likely period over which it might be utilised, and its fair value was estimated using the relief from royalty methodology.

In calculating the fair value of the assets and liabilities acquired, management judgement is required as discussed above, in particular for the discount rate applied to the economic life of the intangible assets of £2.3m. A 1% movement in the discount rate applied, would result in a £0.06m increase or decrease in the intangible recognised with an equal and opposite increase or decrease in goodwill on acquisition.

4.2 Judgements

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).

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The tables below analyse financial instruments measured at fair value by the level in the fair value hierarchy into which the measurement is categorised:

Group and Company At 31 December 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	-	2,551	-	2,551
Financial investments	4	-	2,203	2,207
	4	2,551	2,203	4,758
LIABILITIES				
Derivative financial instruments	-	931	-	931
	-	931	-	931

Group and Company At 31 December 2016	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	-	1,516	-	1,516
Financial investments	13	-	2,012	2,025
	13	1,516	2,012	3,541
LIABILITIES				
Derivative financial instruments	-	227	-	227
	-	227	-	227

There were no transfers between level 1 and level 2 during the year for the Group or the Company.

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

Group and Company	2017	2016
Movement in level 3	£000	£000
At 1 January	2,012	2,548
Consideration received	-	494
Disposals	-	(1,309)
Movements recognised in Other Comprehensive Income	136	75
Movements recognised in the Income Statement	55	204
At 31 December	2,203	2,012

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Visa Inc. investment

Arbuthnot Latham currently holds preference shares in Visa Inc., valued at £706k as at 31 December 2017. 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.

A 5% increase in valuation would lead to a £35k increase in the gain through Other Comprehensive Income. A 5% decrease would lead to a £35k decrease in the gain through Other Comprehensive Income.

Investment in overseas property company

For those financial investments measured at fair value, the Group uses proprietary valuation models which are developed from recognised valuation techniques. Some or all of the significant inputs into these models may not be observable in the market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value.

The Group has established a valuation methodology for measuring level 3 financial investments which are categorised as available for sale. Unobservable inputs used include: yield of 4.60% (2016: 4.90%) and occupancy rates of 90.0% (2016: 95.3%). These inputs are taken from online real estate reports available from BNP Paribas. The inputs are stressed to ensure that the fair value is robust. Increases in the yield or decreases in annual rental value or occupancy rate would result in lower fair values - (an increase in yield by 0.5% would lead to a decrease in fair value of £126k). Another indicator of appropriate fair value would be if a reasonable offer were to be made on the value of the property. Management analyse and investigate any significant movements in the unobservable inputs which impact the valuation of level 3 instruments.

Acquisition Accounting

As part of the acquisition of Renaissance Asset Finance Limited, the identifiable assets and liabilities acquired, including intangible assets, were recognised at their fair value in accordance with IFRS 3 'Business combinations'. The determination of the fair values on acquired assets and liabilities is based to a considerable extent, on management's judgement. In particular, the discount rate applied to the economic life of the intangible assets totalling £2.3m was sensitive to management's assessment. A movement of plus or minus 1% on the discount rate equated to movement of £0.06m against the intangible with a corresponding increase or decrease in goodwill.

Notes to the Consolidated Financial Statements

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

Group At 31 December 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	-	313,101	-	313,101
Loans and advances to banks	-	70,665	-	70,665
Debt securities held-to-maturity	-	227,019	-	227,019
Loans and advances to customers	-	-	1,060,769	1,060,769
Other assets	-	-	11,966	11,966
	-	610,785	1,072,735	1,683,520
LIABILITIES				
Deposits from banks	-	195,097	-	195,097
Deposits from customers	-	1,439,804	-	1,439,804
Other liabilities	-	-	957	957
	-	1,634,901	957	1,635,858
Group At 31 December 2016	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	-	195,752	-	195,752
Loans and advances to banks	-	36,937	-	36,937
Debt securities held-to-maturity	-	107,300	-	107,300
Loans and advances to customers	-	-	770,299	770,299
Other assets	-	-	2,336	2,336
	-	339,989	772,635	1,112,624
LIABILITIES				
Deposits from banks	-	3,200	-	3,200
Deposits from customers	-	1,099,744	-	1,099,744
Other liabilities	-	-	1,062	1,062
	-	1,102,944	1,062	1,104,006

Notes to the Consolidated Financial Statements

Company At 31 December 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	-	313,101	-	313,101
Loans and advances to banks	-	69,578	-	69,578
Debt securities held-to-maturity	-	227,019	-	227,019
Loans and advances to customers	-	-	1,058,388	1,058,388
Other assets	-	-	11,910	11,910
	-	609,698	1,070,298	1,679,996
LIABILITIES				
Deposits from banks	-	195,097	-	195,097
Deposits from customers	-	1,440,428	-	1,440,428
Other liabilities	-	-	925	925
	-	1,635,525	925	1,636,450
Company At 31 December 2016	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	-	195,752	-	195,752
Loans and advances to banks	-	36,937	-	36,937
Debt securities held-to-maturity	-	107,300	-	107,300
Loans and advances to customers	-	-	770,299	770,299
Other assets	-	-	2,331	2,331
	-	339,989	772,630	1,112,619
LIABILITIES				
Deposits from banks	-	3,200	-	3,200
Deposits from customers	-	1,099,744	-	1,099,744
Other liabilities	-	-	1,062	1,062
	-	1,102,944	1,062	1,104,006

Notes to the Consolidated Financial Statements

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 2017:

	Due within one year	Due after more than one year	Total
At 31 December 2017	£000	£000	£000
ASSETS			
Cash and balances at central banks	313,101	-	313,101
Loans and advances to banks	70,665	-	70,665
Debt securities held-to-maturity	122,236	104,783	227,019
Current assets held for sale	2,915	-	2,915
Derivative financial instruments	950	1,601	2,551
Loans and advances to customers	236,454	824,315	1,060,769
Other assets	16,153	4,436	20,589
Financial investments	-	2,207	2,207
Deferred tax asset	-	886	886
Intangible assets	-	19,728	19,728
Property, plant and equipment	-	3,806	3,806
Investment property	-	59,439	59,439
	762,474	1,021,201	1,783,675
LIABILITIES			
Deposits from banks	195,097	-	195,097
Derivative financial instruments	931	-	931
Deposits from customers	1,382,446	57,358	1,439,804
Current tax liability	553	-	553
Other liabilities	14,353	-	14,353
	1,593,380	57,358	1,650,738

Notes to the Consolidated Financial Statements

The table below shows the maturity analysis of assets and liabilities of the Group as at 31 December 2016:

	Due within one year	Due after more than one year	Total
At 31 December 2016	£000	£000	£000
ASSETS			
Cash and balances at central banks	195,752	-	195,752
Loans and advances to banks	36,937	-	36,937
Debt securities held-to-maturity	82,782	24,518	107,300
Derivative financial instruments	85	1,431	1,516
Loans and advances to customers	348,876	421,423	770,299
Other assets	9,369	3,603	12,972
Financial investments	-	2,025	2,025
Deferred tax asset	-	1,268	1,268
Interests in associate	900	-	900
Intangible assets	-	12,255	12,255
Property, plant and equipment	-	4,599	4,599
Investment property	-	53,339	53,339
	674,701	524,461	1,199,162
LIABILITIES			
Deposits from banks	3,200	-	3,200
Derivative financial instruments	227	-	227
Deposits from customers	1,061,122	38,622	1,099,744
Current tax liability	147	-	147
Other liabilities	15,146	-	15,146
	1,079,842	38,622	1,118,464

Notes to the Consolidated Financial Statements

The table below shows the maturity analysis of assets and liabilities of the Company as at 31 December 2017:

At 31 December 2017	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Cash and balances at central banks	313,101	-	313,101
Loans and advances to banks	69,578	-	69,578
Debt securities held-to-maturity	122,236	104,783	227,019
Current assets held for sale	2,915	-	2,915
Derivative financial instruments	950	1,601	2,551
Loans and advances to customers	282,787	775,601	1,058,388
Other assets	16,010	4,436	20,446
Financial investments	-	2,207	2,207
Deferred tax asset	-	864	864
Intangible assets	-	21,969	21,969
Property, plant and equipment	-	3,795	3,795
Investment property	-	59,439	59,439
	807,577	974,695	1,782,272
LIABILITIES			
Deposits from banks	195,097	-	195,097
Derivative financial instruments	931	-	931
Deposits from customers	1,383,070	57,358	1,440,428
Current tax liability	38	-	38
Other liabilities	13,991	-	13,991
	1,593,127	57,358	1,650,485

Notes to the Consolidated Financial Statements

The table below shows the maturity analysis of assets and liabilities of the Company as at 31 December 2016:

	Due within one year	Due after more than one year	Total
At 31 December 2016	£000	£000	£000
ASSETS			
Cash and balances at central banks	195,752	-	195,752
Loans and advances to banks	36,937	-	36,937
Debt securities held-to-maturity	82,782	24,518	107,300
Derivative financial instruments	85	1,431	1,516
Loans and advances to customers	348,876	421,423	770,299
Other assets	9,369	3,598	12,967
Financial investments	-	2,025	2,025
Deferred tax asset	-	1,268	1,268
Investment in associate	900	-	900
Intangible assets	-	12,255	12,255
Property, plant and equipment	-	4,599	4,599
Investment property	-	53,339	53,339
	674,701	524,456	1,199,157
LIABILITIES			
Deposits from banks	3,200	-	3,200
Derivative financial instruments	227	-	227
Deposits from customers	1,061,122	38,622	1,099,744
Current tax liability	147	-	147
Other liabilities	15,146	-	15,146
	1,079,842	38,622	1,118,464

Notes to the Consolidated Financial Statements

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 and liquidity risks.

(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. Impairment provisions are provided for losses that have been incurred at the balance sheet date. 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.

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
- Personal guarantees; and

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.

Notes to the Consolidated Financial Statements

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

Group	2017 £000	2016 £000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances at central banks	312,946	195,652
Loans and advances to banks	70,665	36,937
Debt securities held-to-maturity	227,019	107,300
Derivative financial instruments	2,551	1,516
Loans and advances to customers	1,060,769	770,299
Other assets	11,966	2,336
Financial investments	2,207	2,025
Credit risk exposures relating to off-balance sheet assets are as follows:		
Guarantees	2,976	274
Loan commitments and other credit related liabilities	131,963	54,934
At 31 December	1,823,062	1,171,273

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

Company	2017 £000	2016 £000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances at central banks	312,946	195,652
Loans and advances to banks	69,578	36,937
Debt securities held-to-maturity	227,019	107,300
Derivative financial instruments	2,551	1,516
Loans and advances to customers	1,058,388	770,299
Other assets	16,346	2,331
Financial investments	2,207	2,025
Credit risk exposures relating to off-balance sheet assets are as follows:		
Guarantees	2,976	274
Loan commitments and other credit related liabilities	131,963	54,934
At 31 December'	1,823,974	1,171,268

The above tables represent the maximum credit risk exposure (net of impairment) to the Group and Company at 31 December 2017 and 2016 without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures are based on the net carrying amounts as reported in the Statement of Financial Position.

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

	Group				Company			
	31 December 2017		31 December 2016		31 December 2017		31 December 2016	
	Loan Balance	Property Collateral	Loan Balance	Property Collateral	Loan Balance	Property Collateral	Loan Balance	Property Collateral
Loan to value	£000	£000	£000	£000	£000	£000	£000	£000
Less than 60%	455,398	1,108,363	438,076	1,219,532	455,398	1,108,363	438,076	1,219,532
60% - 80%	343,864	524,256	167,765	253,550	343,864	524,256	167,765	253,550
80% - 100%	69,826	80,998	76,289	88,598	69,826	80,998	76,289	88,598
Greater than 100%*	45,242	34,354	32,022	21,387	45,242	34,354	32,022	21,387
Total	914,330	1,747,971	714,152	1,583,067	914,330	1,747,971	714,152	1,583,067

Notes to the Consolidated Financial Statements

*In addition to property, other security is taken, including charges over Arbuthnot Latham Investment Management portfolios, other chattels and personal guarantees.

Property valuations used are those from the loan origination date or updated 3rd party valuations where applicable.

The table below represents an analysis of loan commitments compared to the values of properties for the Group:

	Group				Company			
	31 December 2017		31 December 2016		31 December 2017		31 December 2016	
	Committed	Property Collateral	Committed	Property Collateral	Committed	Property Collateral	Committed	Property Collateral
	£000	£000	£000	£000	£000	£000	£000	£000
Loan commitments								
Less than 60%	62,775	274,643	26,988	73,659	62,775	274,643	26,988	73,659
60% - 80%	26,340	38,796	23,940	42,102	26,340	38,796	23,940	42,102
80% - 100%	29,579	32,737	-	-	29,579	32,737	-	-
Greater than 100%	5,090	4,104	-	-	5,090	4,104	-	-
Total	123,784	350,280	50,928	115,761	123,784	350,280	50,928	115,761

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.

As at 31 December 2017, loans for which forbearance measures were in place totalled 0.12% (2016: 0.49%) of total loans to customers for the Group. These are set out in the following tables:

Group	2017		2016	
	Number	Loan Balance £000	Number	Loan Balance £000
Transfer to interest only	-	-	3	115
Interest temporarily not being charged	-	-	1	3,607
Long term extension	1	84	-	-
Payment holiday	5	1,237	1	78
Total forbearance	6	1,321	5	3,800

Company	2017		2016	
	Number	Loan Balance £000	Number	Loan Balance £000
Transfer to interest only	-	-	3	115
Interest temporarily not being charged	-	-	1	3,607
Long term extension	1	84	-	-
Payment holiday	5	1,237	1	78
Total forbearance	6	1,321	5	3,800

Notes to the Consolidated Financial Statements

Concentration risk

The Group is well diversified in the UK, being exposed to private and commercial banking. Management assesses the potential concentration risk from a number of areas including:

- Product concentration;
- Geographical concentration; and
- High value residential properties.

Due to the well diversified nature of the Group and the significant collateral held against the loan book, the Directors do not consider there to be a potential material exposure arising from concentration risk.

The tables below show the concentration in the loan book based on the most significant type of collateral held for each loan. Where multiple types of collateral are held with no significant majority, the loan is shown within 'mixed collateral'.

Group	Loans and advances to customers		Loan Commitments	
	2017	2016	2017	2016
	£000	£000	£000	£000
Concentration by product				
Asset finance	71,425	-	-	-
Cash collateralised	29,247	16,745	-	-
Commercial lending	202,912	71,674	24,371	18,260
Investment portfolio secured	49,667	34,014	4,222	4,006
Residential mortgages	633,003	642,704	99,413	32,668
Mixed collateral	70,954	2,103	3,957	-
Unsecured	3,561	3,059	-	-
At 31 December	1,060,769	770,299	131,963	54,934

Commercial lending and Mixed collateral reflect the growth in the Commercial bank.

Concentration by location

East Anglia	18,438	2,714	-	-
London	419,305	434,401	56,777	27,161
Midlands	42,484	25,481	800	108
North East	25,741	8,498	-	-
North West	44,630	14,288	825	4,590
Northern Ireland	2,903	-	-	-
Scotland	10,988	13,410	-	-
South East	203,305	117,805	23,462	12,560
South West	116,692	89,018	15,236	3,468
Wales	8,002	7,460	-	-
Overseas	21,556	20,700	-	-
Non-property collateral	146,725	36,524	34,863	7,047
At 31 December	1,060,769	770,299	131,963	54,934

Notes to the Consolidated Financial Statements

Company	Loans and advances to customers		Loan Commitments	
	2017	2016	2017	2016
	£000	£000	£000	£000
Concentration by product				
Asset Finance	69,044	-	-	-
Cash collateralised	29,247	16,745	-	-
Commercial Lending	202,912	71,674	24,371	18,260
Investment portfolio secured	49,667	34,014	4,222	4,006
Mixed Collateral	70,954	2,103	3,957	-
Residential mortgages	633,003	642,704	99,413	32,668
Unsecured	3,561	3,059	-	-
At 31 December	1,058,388	770,299	131,963	54,934

Commercial lending and Mixed collateral reflect the growth in the Commercial bank.

Concentration by location

East Anglia	18,438	2,714	-	-
London	419,305	434,401	56,777	27,161
Midlands	42,484	25,481	800	108
North East	25,741	8,498	-	-
North West	44,630	14,288	825	4,590
Northern Ireland	2,903	-	-	-
Scotland	10,988	13,410	-	-
South East	203,305	117,805	23,462	12,560
South West	116,692	89,018	15,236	3,468
Wales	8,002	7,460	-	-
Overseas	21,556	20,700	-	-
Non-property collateral	144,344	36,524	34,863	7,047
At 31 December	1,058,388	770,299	131,963	54,934

(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. Operational risk arises from all of the Group's operations.

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.

(c) Market risk

Price risk

The Company and Group are exposed to price risk from equity investments and derivatives held by the Group and classified in the Consolidated Statement of Financial Position either as available-for-sale or at fair value through the profit and loss. The Group is not exposed to commodity price risk.

Based upon the financial investment exposure in Note 23, a stress test scenario of a 10% (2016: 10%) decline in market prices, with all other things being equal, would result in a £19k (2016: £11k) decrease in the Company and Group's income and a decrease of £220k (2016: £172k) in the Company and Group's equity. The Group considers a 10% stress test scenario appropriate after taking the current values and historic data into account.

Notes to the Consolidated Financial Statements

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 2017. Included in the table below are the Group's assets and liabilities at carrying amounts, categorised by currency.

At 31 December 2017					
	GBP (£)	USD (\$)	Euro (€)	Other	Total
ASSETS					
Cash and balances at central banks	313,101	-	-	-	313,101
Loans and advances to banks	6,013	40,870	16,944	6,838	70,665
Debt securities held-to-maturity	170,723	56,296	-	-	227,019
Derivative financial instruments	2,525	1	25	-	2,551
Loans and advances to customers	1,021,894	14,912	23,963	-	1,060,769
Other assets	11,966	-	-	-	11,966
Financial investments	-	706	1,501	-	2,207
LIABILITIES					
Deposits from banks	195,067	-	-	30	195,097
Derivative financial instruments	914	1	-	16	931
Deposits from customers	1,277,901	112,731	42,733	6,439	1,439,804
Other liabilities	957	-	-	-	957
Net on-balance sheet position					
	51,383	53	(300)	353	51,489
Credit commitments					
	131,963	-	-	-	131,963

The table below summarises the Group's exposure to foreign currency exchange risk at 31 December 2016:

At 31 December 2016					
	GBP (£)	USD (\$)	Euro (€)	Other	Total
ASSETS					
Cash and balances at central banks	195,669	35	40	8	195,752
Loans and advances to banks	2,183	24,494	5,062	5,198	36,937
Debt securities held-to-maturity	94,299	13,001	-	-	107,300
Derivative financial instruments	1,516	-	-	-	1,516
Loans and advances to customers	725,700	21,927	22,672	-	770,299
Other assets	2,336	-	-	-	2,336
Financial investments	-	569	1,456	-	2,025
LIABILITIES					
Deposits from banks	3,198	-	-	2	3,200
Derivative financial instruments	227	-	-	-	227
Deposits from customers	1,005,782	59,916	28,535	5,511	1,099,744
Other liabilities	1,062	-	-	-	1,062
Net on-balance sheet position					
	11,434	110	695	(307)	11,932
Credit commitments					
	54,934	-	-	-	54,934

Notes to the Consolidated Financial Statements

Derivative financial instruments (see note 19) are in place to mitigate foreign currency risk on net exposures for each currency. A 10% strengthening of the pound against the euro would lead to a £30k decrease (2016: a £6k increase) in the Group's profits, while a 10% weakening of the pound against the euro would lead to the same increase in the Bank's profits. Similarly, a 10% strengthening of the pound against the US dollar would lead to a £5k increase (2016: a £3k increase) in the Group's profits, while a 10% weakening of the pound against the US dollar would lead to the same decrease in the Bank's profits.

The table below summarises the Company's exposure to foreign currency exchange risk at 31 December 2017:

	GBP (£)	USD (\$)	Euro (€)	Other	Total
	£000	£000	£000	£000	£000
At 31 December 2017					
ASSETS					
Cash and balances at central banks	313,101	-	-	-	313,101
Loans and advances to banks	4,926	40,870	16,944	6,838	69,578
Debt securities held-to-maturity	170,723	56,296	-	-	227,019
Derivative financial instruments	2,525	1	25	-	2,551
Loans and advances to customers	1,019,513	14,912	23,963	-	1,058,388
Other assets	16,346	-	-	-	16,346
Financial investments	-	706	1,501	-	2,207
	1,527,134	112,785	42,433	6,838	1,689,190
LIABILITIES					
Deposits from banks	195,067	-	-	30	195,097
Derivative financial instruments	914	1	-	16	931
Deposits from customers	1,278,525	112,731	42,733	6,439	1,440,428
Other liabilities	925	-	-	-	925
	1,475,431	112,732	42,733	6,485	1,637,381
Net on-balance sheet position	51,703	53	(300)	353	51,809
Credit commitments	131,963	-	-	-	131,963

The table below summarises the Company's exposure to foreign currency exchange risk at 31 December 2016:

	GBP (£)	USD (\$)	Euro (€)	Other	Total
	£000	£000	£000	£000	£000
At 31 December 2016					
ASSETS					
Cash and balances at central banks	195,669	35	40	8	195,752
Loans and advances to banks	2,183	24,494	5,062	5,198	36,937
Debt securities held-to-maturity	94,299	13,001	-	-	107,300
Derivative financial instruments	1,516	-	-	-	1,516
Loans and advances to customers	725,700	21,927	22,672	-	770,299
Other assets	2,331	-	-	-	2,331
Financial investments	-	569	1,456	-	2,025
	1,021,698	60,026	29,230	5,206	1,116,160
LIABILITIES					
Deposits from banks	3,198	-	-	2	3,200
Derivative financial instruments	227	-	-	-	227
Deposits from customers	1,005,782	59,916	28,535	5,511	1,099,744
Other liabilities	1,062	-	-	-	1,062
	1,010,269	59,916	28,535	5,513	1,104,233
Net on-balance sheet position	11,429	110	695	(307)	11,927
Credit commitments	54,934	-	-	-	54,934

Notes to the Consolidated Financial Statements

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 and 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 £1m. The current position of the balance sheet is such that it results in a favourable impact on the economic value of equity of £0.9m (2016: £2.2m) for a positive 200bps shift and an adverse impact of £0.2m (2016: £0.3m) for a negative 200bps movement capped at the Bank of England base rate (50bps).

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	Within 3 months	More than 3 months but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non interest bearing	Total
As at 31 December 2017	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	313,101	-	-	-	-	-	313,101
Loans and advances to banks	61,197	579	8,889	-	-	-	70,665
Debt securities held-to-maturity	185,926	35,093	6,000	-	-	-	227,019
Derivative financial instruments	950	-	-	1,601	-	-	2,551
Loans and advances to customers	892,322	6,938	10,774	143,979	-	6,756	1,060,769
Other assets	-	-	-	-	-	107,363	107,363
Financial investments	-	-	-	-	-	2,207	2,207
	1,453,496	42,610	25,663	145,580	-	116,326	1,783,675
LIABILITIES							
Deposits from banks	195,097	-	-	-	-	-	195,097
Derivative financial instruments	931	-	-	-	-	-	931
Deposits from customers	1,110,465	162,503	109,478	57,358	-	-	1,439,804
Other liabilities	-	-	-	-	-	14,906	14,906
Equity	-	-	-	-	-	132,937	132,937
	1,306,493	162,503	109,478	57,358	-	147,843	1,783,675
Interest rate sensitivity gap	147,003	(119,893)	(83,815)	88,222	-	(31,517)	
Cumulative gap	147,003	27,110	(56,705)	31,517	31,517	-	

Notes to the Consolidated Financial Statements

Group	Within 3 months	More than 3 months but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non interest bearing	Total
As at 31 December 2016	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	195,752	-	-	-	-	-	195,752
Loans and advances to banks	36,937	-	-	-	-	-	36,937
Debt securities held-to-maturity	78,994	6,813	21,493	-	-	-	107,300
Derivative financial instruments	85	-	-	1,431	-	-	1,516
Loans and advances to customers	635,968	120,311	8,755	5,265	-	-	770,299
Other assets	-	-	-	-	-	85,333	85,333
Financial investments	-	-	-	-	-	2,025	2,025
	947,736	127,124	30,248	6,696	-	87,358	1,199,162
LIABILITIES							
Deposits from banks	3,200	-	-	-	-	-	3,200
Derivative financial instruments	227	-	-	-	-	-	227
Deposits from customers	915,142	61,519	84,480	38,603	-	-	1,099,744
Other liabilities	-	-	-	-	-	15,293	15,293
Equity	-	-	-	-	-	80,698	80,698
	918,569	61,519	84,480	38,603	-	95,991	1,199,162
Impact of derivative instruments	3,800	(3,800)	-	-	-	-	-
Interest rate sensitivity gap	32,967	61,805	(54,232)	(31,907)	-	(8,633)	-
Cumulative gap	32,967	94,772	40,540	8,633	8,633	-	-
Company	Within 3 months	More than 3 months but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non interest bearing	Total
As at 31 December 2017	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	313,101	-	-	-	-	-	313,101
Loans and advances to banks	60,110	579	8,889	-	-	-	69,578
Debt securities held-to-maturity	185,926	35,093	6,000	-	-	-	227,019
Derivative financial instruments	950	-	-	1,601	-	-	2,551
Loans and advances to customers	955,367	1,000	-	95,265	-	6,756	1,058,388
Other assets	-	-	-	-	-	109,428	109,428
Financial investments	-	-	-	-	-	2,207	2,207
	1,515,454	36,672	14,889	96,866	-	118,391	1,782,272
LIABILITIES							
Deposits from banks	195,097	-	-	-	-	-	195,097
Derivative financial instruments	931	-	-	-	-	-	931
Deposits from customers	1,111,089	162,503	109,478	57,358	-	-	1,440,428
Other liabilities	-	-	-	-	-	14,029	14,029
Equity	-	-	-	-	-	131,787	131,787
	1,307,117	162,503	109,478	57,358	-	145,816	1,782,272
Interest rate sensitivity gap	208,337	(125,831)	(94,589)	39,508	-	(27,425)	-
Cumulative gap	208,337	82,506	(12,083)	27,425	27,425	-	-

Notes to the Consolidated Financial Statements

Company	Within 3 months	More than 3 months but less than 6 months	More than 6 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Non interest bearing	Total
As at 31 December 2016	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	195,752	-	-	-	-	-	195,752
Loans and advances to banks	36,937	-	-	-	-	-	36,937
Debt securities held-to-maturity	78,994	6,813	21,493	-	-	-	107,300
Derivative financial instruments	85	-	-	1,431	-	-	1,516
Loans and advances to customers	635,968	120,311	8,755	5,265	-	-	770,299
Other assets	-	-	-	-	-	85,333	85,333
Financial investments	-	-	-	-	-	2,025	2,025
	947,736	127,124	30,248	6,696	-	87,358	1,199,162
LIABILITIES							
Deposits from banks	3,200	-	-	-	-	-	3,200
Derivative financial instruments	227	-	-	-	-	-	227
Deposits from customers	915,142	61,519	84,480	38,603	-	-	1,099,744
Other liabilities	-	-	-	-	-	15,293	15,293
Equity	-	-	-	-	-	80,698	80,698
	918,569	61,519	84,480	38,603	-	95,991	1,199,162
Impact of derivative instruments	3,800	(3,800)	-	-	-	-	-
Interest rate sensitivity gap	32,967	61,805	(54,232)	(31,907)	-	(8,633)	-
Cumulative gap	32,967	94,772	40,540	8,633	8,633	-	-

Notes to the Consolidated Financial Statements

(d) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

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 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 and Finance Director 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 Individual 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 that 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.

The Group 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 has significantly exceeded the regulatory minimum 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.

Notes to the Consolidated Financial Statements

The tables below show the undiscounted contractual cash flows of the Group's financial liabilities and assets as at 31 December 2017:

	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
At 31 December 2017	£000	£000	£000	£000	£000	£000
Financial liability by type						
Non-derivative liabilities						
Deposits from banks	195,097	(195,097)	(195,097)	-	-	-
Deposits from customers	1,439,804	(1,444,793)	(1,089,916)	(293,425)	(61,452)	-
Other liabilities	957	(957)	(957)	-	-	-
Issued financial guarantee contracts	-	(2,976)	(2,976)	-	-	-
Unrecognised loan commitments	-	(131,963)	(131,963)	-	-	-
	1,635,858	(1,775,786)	(1,420,909)	(293,425)	(61,452)	-
Derivative liabilities						
Risk management:	931					
- Outflows		(931)	(931)	-	-	-
	931	(931)	(931)	-	-	-
	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
At 31 December 2017	£000	£000	£000	£000	£000	£000
Financial asset by type						
Non-derivative assets						
Cash and balances at central banks	313,101	313,101	313,101	-	-	-
Loans and advances to banks	70,665	70,665	61,197	579	8,889	-
Debt securities held-to-maturity	227,019	227,166	22,886	101,277	103,003	-
Loans and advances to customers	1,060,769	1,199,165	138,189	121,493	800,091	139,392
Other assets	11,966	11,966	11,966	-	-	-
Financial investments	2,207	2,207	2,207	-	-	-
	1,685,727	1,824,270	549,546	223,349	911,983	139,392
Derivative assets						
Risk management:	2,551					
- Inflows		2,551	-	-	-	2,551
	2,551	2,551	-	-	-	2,551

Notes to the Consolidated Financial Statements

The tables below show the undiscounted contractual cash flows of the Group's financial liabilities and assets as at 31 December 2016:

	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
At 31 December 2016	£000	£000	£000	£000	£000	£000
Financial liability by type						
Non-derivative liabilities						
Deposits from banks	3,200	(3,200)	(3,200)	-	-	-
Deposits from customers	1,099,744	(1,102,479)	(818,380)	(243,247)	(40,852)	-
Other liabilities	1,062	(1,062)	(1,062)	-	-	-
Issued financial guarantee contracts	-	(274)	(274)	-	-	-
Unrecognised loan commitments	-	(54,934)	(54,934)	-	-	-
	1,104,006	(1,161,949)	(877,850)	(243,247)	(40,852)	-
Derivative liabilities						
Risk management:	227					
- Outflows		(227)	(227)	-	-	-
	227	(227)	(227)	-	-	-
	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
At 31 December 2016	£000	£000	£000	£000	£000	£000
Financial asset by type						
Non-derivative assets						
Cash and balances at central banks	195,752	195,752	195,752	-	-	-
Loans and advances to banks	36,937	36,937	36,937	-	-	-
Debt securities held-to-maturity	107,300	130,360	70,082	41,334	18,944	-
Loans and advances to customers	770,299	852,783	229,927	130,870	447,253	44,733
Other assets	2,336	2,336	2,336	-	-	-
Financial investments	2,025	2,025	2,025	-	-	-
	1,114,649	1,220,193	537,059	172,204	466,197	44,733
Derivative assets						
Risk management:	1,517					
- Inflows		1,517	86	-	-	1,431
	1,517	1,517	86	-	-	1,431

Notes to the Consolidated Financial Statements

The tables below show the undiscounted contractual cash flows of the Company's financial liabilities and assets as at 31 December 2017:

	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
At 31 December 2017	£000	£000	£000	£000	£000	£000
Financial liability by type						
Non-derivative liabilities						
Deposits from banks	195,097	(195,097)	(195,097)	-	-	-
Deposits from customers	1,440,428	(1,445,417)	(1,090,540)	(293,425)	(61,452)	-
Other liabilities	925	(925)	(925)	-	-	-
Issued financial guarantee contracts	-	(2,976)	(2,976)	-	-	-
Unrecognised loan commitments	-	(131,963)	(131,963)	-	-	-
	1,636,450	(1,776,378)	(1,421,501)	(293,425)	(61,452)	-
Derivative liabilities						
Risk management:	931					
- Outflows		(931)	(931)	-	-	-
	931	(931)	(931)	-	-	-
	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
At 31 December 2017	£000	£000	£000	£000	£000	£000
Financial asset by type						
Non-derivative assets						
Cash and balances at central banks	313,101	313,101	313,101	-	-	-
Loans and advances to banks	69,578	69,578	60,110	579	8,889	-
Debt securities held-to-maturity	227,019	227,166	22,886	101,277	103,003	-
Loans and advances to customers	1,058,388	1,196,784	201,234	115,555	789,317	90,678
Other assets	11,910	11,910	11,910	-	-	-
Financial investments	2,207	2,207	2,207	-	-	-
	1,682,203	1,820,746	611,448	217,411	901,209	90,678
Derivative assets						
Risk management:	2,551					
- Inflows		2,551	-	-	-	2,551
	2,551	2,551	-	-	-	2,551

Notes to the Consolidated Financial Statements

The tables below show the undiscounted contractual cash flows of the Company's financial liabilities and assets as at 31 December 2016:

	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
	£000	£000	£000	£000	£000	£000
At 31 December 2016						
Financial liability by type						
Non-derivative liabilities						
Deposits from banks	3,200	(3,200)	(3,200)	-	-	-
Deposits from customers	1,099,744	(1,102,479)	(818,380)	(243,247)	(40,852)	-
Other liabilities	1,062	(1,062)	(1,062)	-	-	-
Issued financial guarantee contracts	-	(274)	(274)	-	-	-
Unrecognised loan commitments	-	(54,934)	(54,934)	-	-	-
	1,104,006	(1,161,949)	(877,850)	(243,247)	(40,852)	-
Derivative liabilities						
Risk management:	227					
- Outflows		(227)	(227)	-	-	-
	227	(227)	(227)	-	-	-
	Carrying amount	Gross nominal inflow/ (outflow)	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years
	£000	£000	£000	£000	£000	£000
At 31 December 2016						
Financial asset by type						
Non-derivative assets						
Cash and balances at central banks	195,752	195,752	195,752	-	-	-
Loans and advances to banks	36,937	36,937	36,937	-	-	-
Debt securities held-to-maturity	107,300	130,360	70,082	41,334	18,944	-
Loans and advances to customers	770,299	852,783	229,927	130,870	447,253	44,733
Other assets	2,331	2,331	2,331	-	-	-
Financial investments	2,025	2,025	2,025	-	-	-
	1,114,644	1,220,188	537,054	172,204	466,197	44,733
Derivative assets						
Risk management:	1,517					
- Inflows		1,517	86	-	-	1,431
	1,517	1,517	86	-	-	1,431

Notes to the Consolidated Financial Statements

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

	31 December 2017		31 December 2016	
	Amount	Fair value	Amount	Fair value
	£000	£000	£000	£000
Liquidity reserves				
Cash and balances at central banks	313,101	313,101	195,752	195,752
Loans and advances to banks	70,665	70,665	36,937	36,937
Debt securities held-to-maturity	227,019	227,951	107,300	107,349
	610,785	611,717	339,989	340,038

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

	31 December 2017		31 December 2016	
	Amount	Fair value	Amount	Fair value
	£000	£000	£000	£000
Liquidity reserves				
Cash and balances at central banks	313,101	313,101	195,752	195,752
Loans and advances to banks	69,578	69,578	36,937	36,937
Debt securities held-to-maturity	227,019	227,951	107,300	107,349
	609,698	610,630	339,989	340,038

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 2017 were £148.0m (2016: £112.0m).

Financial assets are pledged as collateral as part of sales and repurchases, securities borrowing and securitisation transactions under terms that are usual and customary for such activities. In addition, as part of these transactions, the Group has received collateral that it is permitted to sell or repledge in the absence of default.

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 £1,044m (2016: £920m). Additionally, the Group provides investment advisory services.

Notes to the Consolidated Financial Statements

(e) Financial assets and liabilities

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

	Fair value through profit or loss	Held-to- maturity	Loans and receivables	Available- for-sale	Liabilities at amortised cost	Total carrying amount	Fair value
At 31 December 2017	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	-	-	313,101	-	-	313,101	313,101
Loans and advances to banks	-	-	70,665	-	-	70,665	70,665
Debt securities held-to-maturity	-	227,019	-	-	-	227,019	227,951
Derivative financial instruments	2,551	-	-	-	-	2,551	2,551
Loans and advances to customers	-	-	1,060,769	-	-	1,060,769	1,034,316
Other assets	-	-	11,966	-	-	11,966	11,966
Financial investments	-	-	-	2,207	-	2,207	2,207
	2,551	227,019	1,456,501	2,207	-	1,688,278	1,662,757
LIABILITIES							
Deposits from banks	-	-	-	-	195,097	195,097	195,097
Derivative financial instruments	931	-	-	-	-	931	931
Deposits from customers	-	-	-	-	1,439,804	1,439,804	1,439,804
Other liabilities	-	-	957	-	-	957	957
	931	-	957	-	1,634,901	1,636,789	1,636,789

	Fair value through profit or loss	Held-to- maturity	Loans and receivables	Available- for-sale	Liabilities at amortised cost	Total carrying amount	Fair value
At 31 December 2016	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	-	-	195,752	-	-	195,752	195,752
Loans and advances to banks	-	-	36,937	-	-	36,937	36,937
Debt securities held-to-maturity	-	107,300	-	-	-	107,300	107,349
Derivative financial instruments	1,516	-	-	-	-	1,516	1,516
Loans and advances to customers	-	-	770,299	-	-	770,299	750,772
Other assets	-	-	2,336	-	-	2,336	2,336
Financial investments	-	-	-	2,025	-	2,025	2,025
	1,516	107,300	1,005,324	2,025	-	1,116,165	1,096,687
LIABILITIES							
Deposits from banks	-	-	-	-	3,200	3,200	3,200
Derivative financial instruments	227	-	-	-	-	227	227
Deposits from customers	-	-	-	-	1,099,744	1,099,744	1,099,744
Other liabilities	-	-	1,062	-	-	1,062	1,062
	227	-	1,062	-	1,102,944	1,104,233	1,104,233

Notes to the Consolidated Financial Statements

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

	Fair value through profit or loss	Held-to- maturity	Loans and receivables	Available- for-sale	Liabilities at amortised cost	Total carrying amount	Fair value
At 31 December 2017	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	-	-	313,101	-	-	313,101	313,101
Loans and advances to banks	-	-	69,578	-	-	69,578	69,578
Debt securities held-to-maturity	-	227,019	-	-	-	227,019	227,951
Derivative financial instruments	2,551	-	-	-	-	2,551	2,551
Loans and advances to customers	-	-	1,058,388	-	-	1,058,388	1,031,935
Other assets	-	-	16,346	-	-	16,346	11,910
Financial investments	-	-	-	2,207	-	2,207	2,207
	2,551	227,019	1,457,413	2,207	-	1,689,190	1,659,233
LIABILITIES							
Deposits from banks	-	-	-	-	195,097	195,097	195,097
Derivative financial instruments	931	-	-	-	-	931	931
Deposits from customers	-	-	-	-	1,440,428	1,440,428	1,440,428
Other liabilities	-	-	925	-	-	925	925
	931	-	925	-	1,635,525	1,637,381	1,637,381

	Fair value through profit or loss	Held-to- maturity	Loans and receivables	Available- for-sale	Liabilities at amortised cost	Total carrying amount	Fair value
At 31 December 2016	£000	£000	£000	£000	£000	£000	£000
ASSETS							
Cash and balances at central banks	-	-	195,752	-	-	195,752	195,752
Loans and advances to banks	-	-	36,937	-	-	36,937	36,937
Debt securities held-to-maturity	-	107,300	-	-	-	107,300	107,349
Derivative financial instruments	1,516	-	-	-	-	1,516	1,516
Loans and advances to customers	-	-	770,299	-	-	770,299	750,772
Other assets	-	-	2,331	-	-	2,331	2,331
Financial investments	-	-	-	2,025	-	2,025	2,025
	1,516	107,300	1,005,319	2,025	-	1,116,160	1,096,682
LIABILITIES							
Deposits from banks	-	-	-	-	3,200	3,200	3,200
Derivative financial instruments	227	-	-	-	-	227	227
Deposits from customers	-	-	-	-	1,099,744	1,099,744	1,099,744
Other liabilities	-	-	1,062	-	-	1,062	1,062
	227	-	1,062	-	1,102,944	1,104,233	1,104,233

Notes to the Consolidated Financial Statements

7. Capital management

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's lead regulator, the Prudential Regulatory Authority ("PRA"), sets and monitors capital requirements for the Bank. In accordance with the EU's Capital Requirements Directive ("CRD"), the Individual Capital Adequacy Assessment Process ("ICAAP") is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. However, at a minimum, the ICAAP is updated annually as part of the business planning process. The ICAAP is a process that 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.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar I plus" approach to determine the level of capital the Group needs to hold. This method takes the Pillar 1 capital formula calculations (standardised approach for credit, market and operational risk) as a starting point, and then considers whether each of the calculations delivers a sufficient capital sum adequately to cover management's anticipated risks. Where the Board considered that the Pillar 1 calculations did not reflect the risk, an additional capital add-on in Pillar II is applied.

The Group's regulatory capital is currently made up of only Tier 1 capital, which comprises mainly shareholders' funds and revaluation reserves, after deducting goodwill and other intangible assets.

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

	2017	2016
	£000	£000
Tier 1		
Share capital	15,000	15,000
Retained earnings	33,575	24,638
AFS reserve	162	60
Capital contribution reserve	84,200	41,000
Deduction for goodwill	(8,935)	(5,415)
Deduction for other intangibles	(10,793)	(6,840)
Deduction for deferred tax asset	(886)	(1,268)
Total tier 1 capital resources	112,323	67,175
Tier 2		
Total tier 2 capital resources	-	-
Total tier 1 & tier 2 capital resources	112,323	67,175

The ICAAP includes a summary of the capital required to mitigate the identified risks in its regulated entities and the amount of capital that the Group has available. The ICAAP is a key input into the PRA's Individual Capital Guidance ("ICG") setting process, which addresses the requirements of Pillar II of the Basel III framework. The PRA's approach is to issue an Individual Capital Guidance ("ICG") and then monitor the available capital resources in relation to it. The Group maintains an extra internal buffer and capital ratios are reviewed on a monthly basis to ensure that external requirements are adhered to. During the period no breaches of externally imposed capital requirements have been reported.

Notes to the Consolidated Financial Statements

8. Net interest income

	2017	2016
	£000	£000
Cash and balances at central banks	801	873
Loans and advances to banks	258	124
Debt securities held-to-maturity	1,353	844
Loans and advances to customers	45,189	36,404
Total interest income	47,601	38,245
Deposits from banks	(35)	(297)
Deposits from customers	(6,164)	(7,177)
Total interest expense	(6,199)	(7,474)
Net interest income	41,402	30,771

In 2017, the Group recognised £64k (2016: £325k) of additional interest income to reflect actual cash flows received on the acquired mortgage books being in excess of forecast cash flows.

9. Fee and commission income

	2017	2016
	£000	£000
Banking commissions	2,263	1,947
Investment management fees and commissions	7,887	7,122
Wealth planning fees and commissions	2,593	2,156
Other fee income	1,062	205
Total	13,805	11,430

10. Net impairment loss on financial assets

	2017	2016
	£000	£000
Net Impairment losses on loans and advances to customers	394	427
Impairment losses on financial investments	-	47
Total	394	474

During the year, the Bank recovered £116k (2016: £nil) of loans which had previously been written off.

11. Other income

Other income mainly consists of rental income from the investment property (see note 29) of £2.1m (2016: £1.1m), and re-charges to the Arbuthnot Banking Group for the shared use of premises and information technology infrastructure of £1.7m (2016: £1.7m). In 2016, other income also included £1.6m realised on the investment in Visa Europe Ltd (see note 23).

Notes to the Consolidated Financial Statements

12. Operating expenses

	2017	2016
	£000	£000
Operating expenses comprise:		
Staff costs, including Directors:		
Wages, salaries and bonuses	26,189	19,768
Social security costs	2,922	2,206
Pension costs	1,444	1,053
Amortisation of intangibles (note 26)	1,036	521
Depreciation (note 28)	1,482	1,120
Operating lease rentals	3,087	2,610
Operating expenses for investment property	230	115
Parent company management charge	1,483	1,483
Other administrative expenses	11,051	9,236
Total operating expenses from continuing operations	48,924	38,112
	2017	2016
	£000	£000
Remuneration of the auditor and its associates, excluding VAT, was as follows:		
Fees payable to the Group's auditor for the audit of the Group's annual accounts	183	125
Fees payable to the Group's auditor and its associates for other services:		
Audit of the accounts of subsidiaries	38	-
Audit related assurance services	85	109
Taxation compliance services	-	15
Other assurance services	17	15
Total fees payable	323	264

Other assurance services include regulatory assessments.

Notes to the Consolidated Financial Statements

13. Income tax expense

	2017	2016
	£000	£000
United Kingdom corporation tax at 19.25% (2016: 20%)		
Current taxation		
Corporation tax charge - current year	320	179
Corporation tax charge - adjustments in respect of prior years	(141)	(32)
	179	147
Deferred taxation		
Origination and reversal of temporary differences	109	(6)
Adjustments in respect of prior years	252	70
	361	64
Income tax expense	540	211
Tax reconciliation		
Profit before tax	9,477	7,543
Tax at 19.25% (2016: 20%)	1,824	1,509
Tax transfer pricing and Group relief	(1,526)	(1,447)
Permanent differences	133	44
Tax rate change	(2)	67
Adjustments in respect of prior years	111	38
Corporation tax charge for the year	540	211

On 26 October 2015 the Government substantively enacted a reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017). An additional reduction to 17% (effective from 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Bank's future current tax charge accordingly. The deferred tax asset at 31 December 2017 has been calculated based on the rate of 19%.

14. Average number of employees

	2017	2016
Central support services	99	81
Private banking	136	117
Commercial banking	38	14
Operations	62	56
Renaissance Asset Finance	13	-
	348	268

The breakdown of the prior year comparative has been restated to provide better insight.

15. Cash and balances at central banks

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Cash and balances at central banks	313,101	195,752	313,101	195,752

Surplus funds are mainly held in the Bank of England reserve account, with the remainder held in certificates of deposit, fixed rate notes and money market deposits in highly rated banks (the majority held in UK clearing banks).

Notes to the Consolidated Financial Statements

16. Loans and advances to banks

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Placements with banks included in cash and cash equivalents (note 37)	70,665	36,937	69,578	36,937

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

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Aa3	39,871	-	39,871	-
A1	20,547	36,272	20,547	36,272
A2	10,012	280	8,925	280
A3	-	110	-	110
Baa1	235	275	235	275
	70,665	36,937	69,578	36,937

None of the loans and advances to banks are either past due or impaired (2016: £nil)

17. Debt securities held-to-maturity

Debt securities represent certificates of deposit. The Group's intention is to hold them to maturity and, therefore, they are presented in the Statement of Financial Position at amortised cost.

The movement in debt securities held to maturity for the Group may be summarised as follows:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
At 1 January	107,300	83,931	107,300	83,931
Exchange difference	(951)	2,087	(951)	2,087
Additions	211,080	89,384	211,080	89,384
Redemptions	(90,410)	(68,102)	(90,410)	(68,102)
At 31 December	227,019	107,300	227,019	107,300

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

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Aaa	100,106	40,337	100,106	40,337
Aa1	51,389	23	51,389	23
Aa2	5,946	26,089	5,946	26,089
Aa3	18,384	6,000	18,384	6,000
A1	18,187	31,953	18,187	31,953
A3	33,007	2,898	33,007	2,898
	227,019	107,300	227,019	107,300

None of the debt securities held-to-maturity are either past due or impaired.

Notes to the Consolidated Financial Statements

18. Current assets held for sale

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Seed capital investments held for sale	-	-	-	-
Reposessed property held for sale	2,915	-	2,915	-
	2,915	-	2,915	-

Seed capital investments held for sale

The Group considers itself a sponsor of an investment fund when it facilitates the establishment of a fund in which the Group is the investment manager. The Group ordinarily provides seed capital in order to provide initial scale and facilitate marketing of the funds to third-party investors. The fund is then financed through the issue of units to investors. Aggregate interests held by the Group include seed capital, management fees and performance fees. The Group generates management and performance fee income from managing the assets on behalf of third-party investors.

The Group has an investment of £1 in the share capital of the SPV created to administer the fund. At 31 December 2017, the Group has a receivable of £6.8m from the SPV, which is reflected in note 22.

Reposessed property held for sale

During the year, a property held as collateral on a loan was reposessed. The property is expected to be sold within 12 months and is therefore classified in the accounts as held for sale.

19. Derivative financial instruments

Group	2017			2016		
	Contract/ notional amount	Fair value assets	Fair value liabilities	Contract/ notional amount	Fair value assets	Fair value liabilities
	£000	£000	£000	£000	£000	£000
Currency swaps	9,614	950	931	6,566	85	218
Interest rate swaps	17,824	-	-	3,800	-	9
Structured notes	1,607	1,601	-	1,607	1,431	-
	29,045	2,551	931	11,973	1,516	227

Company	2017			2016		
	Contract/ notional amount	Fair value assets	Fair value liabilities	Contract/ notional amount	Fair value assets	Fair value liabilities
	£000	£000	£000	£000	£000	£000
Currency swaps	9,614	950	931	6,566	85	218
Interest rate swaps	17,824	-	-	3,800	-	9
Structured notes	1,607	1,601	-	1,607	1,431	-
	29,045	2,551	931	11,973	1,516	227

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.

Notes to the Consolidated Financial Statements

Also included in derivative financial instruments are structured notes. These notes contain embedded derivatives (embedded options to buy and sell indices) and non-derivative host contracts (discounted bonds). Both the host and embedded derivatives are presented net within derivative financial instruments. 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. None of the contracts are collateralised.

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		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
A1	26,521	10,366	26,521	10,366
A2	2,524	-	2,524	-
Baa1	-	1,607	-	1,607
	29,045	11,973	29,045	11,973

20. Loans and advances to customers

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Gross loans and advances	1,062,131	771,272	1,059,589	771,272
Less: allowances for impairment on loans and advances (note 21)	(1,362)	(973)	(1,201)	(973)
	1,060,769	770,299	1,058,388	770,299

For a maturity profile of loans and advances to customers, refer to note 5.

Loans and advances to customers include finance lease receivables as follows:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Gross investment in finance lease receivables:				
- No later than 1 year	28,911	-	-	-
- Later than 1 year and no later than 5 years	53,766	-	-	-
	82,677	-	-	-
Unearned future finance income on finance leases	(11,412)	-	-	-
Net investment in finance leases	71,265	-	-	-
The net investment in finance leases may be analysed as follows:				
- No later than 1 year	23,170	-	-	-
- Later than 1 year and no later than 5 years	48,095	-	-	-
	71,265	-	-	-

Notes to the Consolidated Financial Statements

Loans and advances to customers can be further summarised as follows:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Neither past due nor impaired	899,832	731,015	899,204	731,015
Past due but not impaired	131,247	23,379	129,365	23,379
Impaired	31,052	16,878	31,020	16,878
Gross	1,062,131	771,272	1,059,589	771,272
Less: allowance for impairment	(1,362)	(973)	(1,201)	(973)
Net	1,060,769	770,299	1,058,388	770,299

(a) Loans and advances past due but not impaired

Gross amounts of loans and advances to customers that were past due but not impaired were as follows:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Past due up to 30 days	115,126	961	113,864	961
Past due 30 - 60 days	11,043	5,689	10,901	5,689
Past due 60 - 90 days	5,078	638	4,600	638
Over 90 days	-	16,091	-	16,091
Total	131,247	23,379	129,365	23,379

The newly implemented banking system has enabled the Group to establish a more sophisticated tracking of early stage arrears. The majority of loans and advances up to 30 days past due were subsequently up to date post year end.

Loans and advances typically fall into this category when there is a delay in either the sale of the underlying collateral or the completion of formalities to extend the credit facilities for a further period. Management have no material concerns regarding the quality of the collateral that secures the lending.

Additionally, the Group updated its impairment policy in the year to include all loans and advances over 90 days past due within impaired loans.

Interest income from impaired assets in the year was £338k (2016: £126k).

(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 (2016: £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 past due but not impaired or impaired balances is £302.9m (2016: £103.7m) against loans of £162.3m (2016: £40.3m), giving an average loan-to-value of 54% (2016: 39%). The weighted average loan-to-value is 46% (2016: 61%). The net amount of individually impaired loans and advances to customers after impairment but before taking into account the cash flows from collateral held is £29.7m (2016: £15.9m).

Notes to the Consolidated Financial Statements

21. Allowances for impairment of loans and advances

Reconciliation of specific allowance for impairments:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
At 1 January	973	1,411	973	1,411
Impairment losses	329	474	308	474
On acquisition	51	-	-	-
Loans written off during the year as uncollectible	(15)	(962)	36	(962)
Amounts recovered during the year	(116)	50	(116)	50
At 31 December	1,222	973	1,201	973

Reconciliation of collective allowance for impairments:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Impairment losses	65	-	-	-
On acquisition	75	-	-	-
At 31 December	140	-	-	-

22. Other assets

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Trade receivables	5,200	564	5,149	564
Receivable from Pinnacle Universal	-	-	4,436	5,213
Receivable from investment fund held for sale	6,756	-	6,756	-
Repossessed collateral - held as inventory	4,436	5,213	-	-
Prepayments and accrued income	4,187	5,423	4,100	5,423
Amount due from group companies	10	1,772	5	1,767
	20,589	12,972	20,446	12,967

Pinnacle Universal is a special purpose vehicle, 100% owned by the Bank, which owns land that is currently in the process of being redeveloped with a view to selling off as individual residential plots. The proceeds from the sale of these plots will be used to repay the outstanding loans.

23. Financial investments

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Available-for-sale				
- Listed securities	4	13	4	13
- Debt securities	1,497	1,443	1,497	1,443
- Unlisted securities	706	569	706	569
Total financial investments	2,207	2,025	2,207	2,025

Listed securities

The Group holds investments in listed securities which are valued based on quoted prices.

Notes to the Consolidated Financial Statements

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. This investment is of a medium term nature. There is no open market for the investment and therefore the Group has valued it using appropriate valuation methodologies (see note 4.2), which include net asset valuations and discounted future cash flows. The Directors intend to dispose of the underlying asset when a suitable buyer has been identified and when the Directors believe that the underlying asset has reached its optimal value.

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 £706k (2016: £569k). This valuation includes a 31% haircut, as referred to in Note 4.2.

24. Deferred taxation

The deferred tax asset comprises:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Accelerated capital allowances and other short-term timing differences	26	546	4	546
Movement in fair value of available-for-sale securities	(40)	(14)	(40)	(14)
Unutilised tax losses	900	736	900	736
Deferred tax asset	886	1,268	864	1,268
At 1 January	1,268	1,085	1,268	1,085
On acquisition of RAF	5	-	-	-
Other Comprehensive Income - available-for-sale securities	(26)	247	(26)	247
Profit and loss account - accelerated capital allowances and other short-term timing differences	(525)	-	(542)	-
Profit and loss account - tax losses	164	(64)	164	(64)
Deferred tax asset at 31 December	886	1,268	864	1,268

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.

25. Interests in associates

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Tarn Crag	-	900	-	900
Interests in associates	-	900	-	900

Tarn Crag

On 11 October 2013, the Bank, together with Praxis (Holding) Limited, formed a special purpose vehicle in the form of a separate legal entity (Tarn Crag Limited). The purpose of this legal entity was to refurbish and re-let a property in Glasgow, with the intention to exit via a sale to an institutional investor in circa 5 years time. The investment was accounted for using the equity method.

On 28 March 2017, the Bank sold its investment in Tarn Crag to Praxis (Holding) Ltd at book value of £900k.

During the year the associate recorded a loss of £nil (2016: loss of £197k). Legal costs of £nil (2016: 43k), previously capitalised against the carrying value of the associate, were written off in the year.

Notes to the Consolidated Financial Statements

The summarised balance sheet for Tarn Crag at the previous year end is set out below:

	2016
At 31 December	£000
ASSETS	
Cash and balances at central banks	3,468
Other assets	656
Property, plant and equipment	9,201
	13,325
EQUITY AND LIABILITIES	
Deposits from banks	12,474
Other liabilities	1,484
Debt securities in issue	1,400
Revaluation reserve	(1,418)
Retained Earnings	(615)
	13,325

26. Intangible assets

Group	Goodwill £000	Computer software £000	Other intangibles £000	Total £000
Cost				
At 1 January 2016	5,415	3,310	213	8,938
Additions	-	5,155	-	5,155
At 31 December 2016	5,415	8,465	213	14,093
Additions	-	2,641	-	2,641
On acquisition of RAF (see note 27)	3,520	-	2,348	5,868
At 31 December 2017	8,935	11,106	2,561	22,602
Accumulated amortisation				
At 1 January 2016	-	(1,211)	(106)	(1,317)
Amortisation charge	-	(478)	(43)	(521)
At 31 December 2016	-	(1,689)	(149)	(1,838)
Amortisation charge	-	(830)	(206)	(1,036)
At 31 December 2017	-	(2,519)	(355)	(2,874)
Net book amount				
At 31 December 2016	5,415	6,776	64	12,255
At 31 December 2017	8,935	8,587	2,206	19,728

The accounting policy for goodwill is described in note 3.13 (a). The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. 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.

Notes to the Consolidated Financial Statements

- 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 (2016: one) with goodwill attached; the core Arbuthnot Latham CGU (£5.4m) and RAF CGU (£3.5m).

Management considers the value in use for the core Arbuthnot Latham CGU to be the discounted cash flows over 3 years with a terminal value (2016: 3 years with a terminal value). The 3 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 2020 as per the approved 3 year plan. A growth rate of 12.5% (2016: 11%) was used for income and 18% (2016: 13%) for expenditure from 2018 to 2020 (these rates were the best estimate of future forecasted performance), while a 3% (2016: 3%) growth rate for income and expenditure (a more conservative approach was taken for later 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.

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 5% was used (this rate was the best estimate of future forecasted performance).

The growth rates used are above the forecast UK growth rate of 1.8% 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% (2016: 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	Goodwill £000	Computer software £000	Other intangibles £000	Total £000
Cost				
At 1 January 2016	5,415	3,310	213	8,938
Additions	-	5,155	-	5,155
At 31 December 2016	5,415	8,465	213	14,093
Additions	-	2,641	-	2,641
At 31 December 2017	5,415	11,106	213	16,734
Accumulated amortisation				
At 1 January 2016	-	(1,211)	(106)	(1,317)
Amortisation charge	-	(478)	(43)	(521)
At 31 December 2016	-	(1,689)	(149)	(1,838)
Amortisation charge	-	(830)	(42)	(872)
At 31 December 2017	-	(2,519)	(191)	(2,710)
Net book amount				
At 31 December 2016	5,415	6,776	64	12,255
At 31 December 2017	5,415	8,587	22	14,024

Notes to the Consolidated Financial Statements

27. Acquisition of Renaissance Asset Finance Ltd

On 28 April 2017, Arbuthnot Latham & Co. Ltd completed the acquisition of 100% of the share capital of Renaissance Asset Finance Limited ("RAF") from its founders following receipt of regulatory approval.

RAF is a provider of finance for a range of specialist assets which includes vintage and expensive cars and SME business assets. The acquisition supported the Bank's strategy to diversify its proposition within the specialist financial services sector.

The consideration will be paid in four staged amounts, all of which will be in cash. The first payment was equal to the net assets at completion of £2.1m. The remaining three payments are performance related and will be based on the profits of RAF in each of the three calendar years 2018 to 2020. The maximum amount payable for the performance based payments is limited to £6.5m. The Bank has also provided an intercompany loan to RAF at completion of £57m to re-finance RAF's existing finance liabilities. The consideration and the refinancing of RAF's funding liabilities have been satisfied from the Group's current cash resources.

The assets acquired and resulting goodwill on acquisition are set out in the table below. The fair value of intangibles acquired includes £0.4m relating to customer relationships, £1.5m relating to broker relationships and £0.4m for the brand. The resultant goodwill represented the assembled specialist workforce, established process and control environment, cross selling opportunities between the two companies and the opportunity cost of a fully operational company within the sector.

The acquisition contributed £4.2m to interest income and £1.6m to profit before tax.

	Acquired assets / liabilities £000	Fair value adjustments £000	Recognised values on acquisition £000
Loans and advances to banks	2,815	-	2,815
Loans and advances to customers	57,684	-	57,684
Other asset	1,341	-	1,341
Deferred tax assets	5	-	5
Intangible assets	-	2,348	2,348
Property, plant and equipment	23	-	23
Total assets	61,868	2,348	64,216
Deposits from banks	58,969	-	58,969
Current tax liability	195	-	195
Other liabilities	632	-	632
Total liabilities	59,796	-	59,796
Net identifiable assets	2,072	2,348	4,420
Consideration			7,940
Goodwill			3,520

Notes to the Consolidated Financial Statements

28. Property, plant and equipment

Group	Leasehold improvements £000	Computer and other equipment £000	Total £000
Cost or valuation			
At 1 January 2016	4,460	2,306	6,766
Additions	127	222	349
At 31 December 2016	4,587	2,528	7,115
Additions	408	258	666
On acquisition of RAF (note 27)	20	52	72
Disposals	-	(10)	(10)
At 31 December 2017	5,015	2,828	7,843
At 1 January 2016	(520)	(876)	(1,396)
Depreciation charge	(697)	(423)	(1,120)
At 31 December 2016	(1,217)	(1,299)	(2,516)
Depreciation charge	(944)	(538)	(1,482)
On acquisition of RAF (note 27)	(16)	(33)	(49)
Disposals	-	10	10
At 31 December 2017	(2,177)	(1,860)	(4,037)
Net book amount			
At 31 December 2016	3,370	1,229	4,599
At 31 December 2017	2,838	968	3,806

Included within the depreciation charge for the year is £78k (2016: £nil) of additional depreciation in relation to the early termination of a property lease.

Notes to the Consolidated Financial Statements

Company	Leasehold improvements £000	Computer and other equipment £000	Total £000
Cost or valuation			
At 1 January 2016	4,460	2,306	6,766
Additions	127	222	349
At 31 December 2016	4,587	2,528	7,115
Additions	408	256	664
Disposals	-	(10)	(10)
At 31 December 2017	4,995	2,774	7,769
Depreciation			
At 1 January 2016	(520)	(876)	(1,396)
Depreciation charge	(697)	(423)	(1,120)
At 31 December 2016	(1,217)	(1,299)	(2,516)
Depreciation charge	(940)	(528)	(1,468)
Disposals	-	10	10
At 31 December 2017	(2,157)	(1,817)	(3,974)
Net book amount			
At 31 December 2016	3,370	1,229	4,599
At 31 December 2017	2,838	957	3,795

29. Investment property

Group & Company	2017 £000	2016 £000
Opening balance	53,339	-
Purchase price	6,100	50,200
Acquisition costs	321	3,139
Fair value adjustment	(321)	-
At 31 December	59,439	53,339

King Street London

The Group acquired premises in the West End of London (namely 20 King Street/10 St James's Street) on 23 June 2016. The property comprises 22,450 square feet of office space and approximately 7,000 square feet of retail space. The property is held by way of leasehold from The Crown Estate Commissioners with 119 years unexpired and with a rent review every five years.

The property is currently fully tenanted, with the main lease ending in 2019. It is accounted for as investment property and the Group has elected to apply the fair value model. It is therefore initially recognised at cost and then subsequently at fair value. The fair value is determined using the rental income on the property and the associated effective yield of similar properties in the surrounding area (see note 4.1(c)). At 31 December 2017 there was no material difference between the cost of the property and the fair value. No property interests are held under operating leases and accounted for as investment property. No independent valuation was undertaken at year end.

The Group received £2.1m rental income during the year and incurred £0.2m of direct operating expenses.

St Philips Place Birmingham

On 24 November 2017, the Bank acquired freehold premises in Birmingham (St Philips House, 4 St Philips Place). The property comprises 24,286 square feet of office space.

Notes to the Consolidated Financial Statements

The property is unoccupied and will be refurbished at an estimated cost of £3.4m. After refurbishment the property will be let out. It is accounted for as investment property and the Group has elected to apply the fair value model. It is therefore initially recognised at cost and then subsequently at fair value. As the property was bought shortly before the year end, the capitalised acquisition costs of £0.3m were written off and the cost at acquisition was deemed to be the fair value. No independent valuation was undertaken at year end.

30. Deposits from banks

	2017	2016
Group & Company	£000	£000
Deposits from other banks	195,097	3,200

Deposits from banks include £188m obtained through the Bank of England Term Funding Scheme ("TFS"). For a maturity profile of deposits from banks, refer to Note 5.

31. Deposits from customers

Group	2017 £000	2016 £000
Current/demand accounts	917,878	712,607
Notice accounts	101,909	141,728
Term deposits	420,017	245,409
	1,439,804	1,099,744

Company	2017 £000	2016 £000
Current/demand accounts	918,502	712,607
Notice accounts	101,909	141,728
Term deposits	420,017	245,409
	1,440,428	1,099,744

Included in customer accounts are deposits of £29.2m (2016: £4.2m) 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 5.

32. Other liabilities

	Group		Company	
	2017 £000	2016 £000	2017 £000	2016 £000
Trade payables	938	1,062	906	1,062
Amount due to Group companies	19	-	19	-
Accruals and deferred income	13,396	14,084	13,066	14,084
	14,353	15,146	13,991	15,146

Financial Services Compensation Scheme Levy

In common with all regulated UK deposit takers, AL pays levies to the Financial Services Compensation Scheme ("FSCS") to enable the FSCS to meet claims against the Scheme. The FSCS levy consists of two parts: a management expenses levy and a more significant compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation and associated interest the Scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

Notes to the Consolidated Financial Statements

The Group's FSCS provision reflects market participation up to the reporting date and the accrual of £0.2m (2016: £0.1m) relates to the interest levy for the Scheme year 2017/18 which is payable in September 2017. This amount was calculated on the basis of the Group's share of protected deposits and the FSCS's estimate of total interest levies payable for each Scheme year.

33. Contingent liabilities and commitments

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 of compliance and other 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 2017, the Group had capital commitments of £nil (2016: £nil) in respect of equipment purchases.

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		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Guarantees and other contingent liabilities	2,976	274	2,976	274
Commitments to extend credit:				
- Original term to maturity of one year or less	131,963	54,934	131,963	54,934
	134,939	55,208	134,939	55,208

Operating lease commitments

Where a Group company is the lessee, the future aggregate lease payments under non-cancellable operating leases are as follows:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Expiring:				
Within 1 year	2,330	2,635	2,330	2,635
Later than 1 year and no later than 5 years	10,943	8,422	10,943	8,422
Later than 5 years	5,384	5,745	5,384	5,745
	18,657	16,802	18,657	16,802

In 2013, the Bank entered into a 16 year lease on 7 Wilson Street, London (the principal location for the Bank), with a break at 11 years and rent reviews after 5, 10 and 15 years. The initial rent is £1.75m per annum. This lease forms the most significant part of the operating leases disclosed in the table above.

In 2015, the Bank entered into a 10 year lease to occupy part of the ground floor of The Senate, Southernhay Gardens, Exeter, with a break clause and rent review after 5 years. The initial rent is £0.1m per annum.

In 2017, the Bank entered into a 10 year lease to occupy part of the eighth floor of 82 King Street, Manchester, with a break clause and rent review after 5 years. The initial rent is £0.1m per annum.

On 3 January 2018, Arbuthnot Latham entered into a 12 year lease (up to 16 October 2029) to occupy the first, second and third floor of 10 Dominion Street, London, with a break clause on 16 October 2024. The initial rent is £0.7m per annum. This is reflected in the table above as an adjusting post balance sheet event.

Notes to the Consolidated Financial Statements

In addition to the above commitments, ground rent of £230k per annum is payable for the remaining term of 119 years of the King Street investment property.

Prior to the year end, the Bank reached agreement on the early termination of a property lease, which gave rise to an onerous lease provision of £282k (2016: £nil).

34. Share capital

Group and Company	Number of shares	Ordinary share capital £000
At 1 January 2016	15,000,000	15,000
At 31 December 2016 & December 2017	15,000,000	15,000

The Ordinary shares have a par value of £1 per share (2016: £1 per share).

35. Reserves and retained earnings

	Group		Company	
	2017 £000	2016 £000	2017 £000	2016 £000
Retained earnings	33,575	24,638	32,425	24,638
Capital contribution reserve	84,200	41,000	84,200	41,000
Available-for-sale reserve	162	60	162	60
Total reserves at 31 December	117,937	65,698	116,787	65,698

36. Share-based payment options

Company - equity settled

On 1 April 2014, Mr Fleming was granted an option to subscribe for 50,000 ordinary 1p shares in Arbuthnot Banking Group PLC (the Parent Company) between April 2017 and April 2022 at 1185p. The fair value of these shares at grant date was £53,000.

On 11 April 2017, Mr Fleming exercised all his options granted on 1 April 2014 and sold the shares on the same day at a price of 1457p. No equity settled share options were granted, forfeited, or expired during the year.

There were no other vesting conditions for these awards. The cost of the share options was carried by Arbuthnot Banking Group.

Measurement inputs and assumptions used in the Black-Scholes model are as follows:

Group and Company	2017
Expected Stock Price Volatility	17%
Expected Dividend Yield	2.7%
Risk Free Interest Rate	1.2%
Average Expected Life (in years)	0.25

Company - cash settled

On 14 June 2016, Mr. Henderson was granted phantom options pursuant to the Phantom Option Scheme to acquire 100,000 ordinary 1p shares in Arbuthnot Banking Group PLC ("ABG") 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. The fair value of the options at grant date was £327k. At 31 December 2017, the fair value of the options was £200k.

Notes to the Consolidated Financial Statements

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 ABG 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 ABG 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 ABG 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 ABG 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 9% attrition rate for the share options vesting in June 2019 and 15% attrition rate for the share options vesting in June 2021. The attrition rate will increase by 3% per year until the vesting date. The Bank incurred an expense in relation to share based payments of £0.1m during 2017 (2016: £0.2m).

Measurement inputs and assumptions used in the Black-Scholes model are as follows:

Group and Company	2017	2016
Expected Stock Price Volatility	27.0%	33.0%
Expected Dividend Yield	2.5%	2.3%
Risk Free Interest Rate	0.5%	0.4%
Average Expected Life (in years)	2.46	3.46

37. Cash and cash equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents are comprised of the following balances with less than three months maturity from the date of acquisition.

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Cash and balances at central banks (Note 15)	313,101	195,752	313,101	195,752
Loans and advances to banks (Note 16)	70,665	36,937	69,578	36,937
	383,766	232,689	382,679	232,689

Notes to the Consolidated Financial Statements

38. Related party transactions

Related parties of the Group include Arbuthnot Banking Group PLC and its subsidiaries, 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.

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. The volumes of related party transactions, outstanding balances at year end, and related expense and income for the year are as follows:

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Loans				
Loans outstanding at 1 January	11,499	11,499	11,499	11,499
Loans advanced during the year	-	23,000	102,303	23,000
Loan repayments during the year	-	(23,000)	(33,420)	(23,000)
Loans outstanding at 31 December	11,499	11,499	80,382	11,499
Interest income earned	164	191	1,169	191
	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Deposits				
Deposits at 1 January	107,002	30,264	107,002	30,264
Deposits placed during the year	150,717	166,898	150,717	166,898
Deposits repaid during the year	(203,674)	(90,160)	(203,674)	(90,160)
Deposits at 31 December	54,045	107,002	54,045	107,002
Interest expense on deposits	192	242	192	242
	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Amounts recharged				
Amounts recharged to the parent company	997	997	997	997
Amounts recharged to fellow subsidiaries and associates	670	676	670	676
Amounts recharged from the parent company	1,493	1,483	1,483	1,483
	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Intergroup balances				
Balances due from the parent company	-	1,767	-	1,767
Balances due from fellow subsidiaries and associates	11	5,308	11	5,308
	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Intergroup balances				
Balances due to the parent company	19	-	19	-

Notes to the Consolidated Financial Statements

The Bank paid dividends of £nil (2016: £nil) during the year to Arbuthnot Banking Group PLC.

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Directors and Key Management				
Loans				
Loans outstanding at 1 January	1,958	3,975	1,958	3,975
Loans advanced during the year	2,261	6,266	2,261	6,266
Loan repayments during the year	(494)	(8,283)	(494)	(8,283)
Loans outstanding at 31 December	3,725	1,958	3,725	1,958
Interest income earned	20	155	20	155

	Group		Company	
	2017	2016	2017	2016
	£000	£000	£000	£000
Directors and Key Management				
Deposits				
Deposits at 1 January	6,829	5,327	6,829	5,327
Deposits placed during the year	2,248	17,048	2,248	17,048
Deposits repaid during the year	(2,247)	(15,546)	(2,247)	(15,546)
Deposits at 31 December	6,830	6,829	6,830	6,829
Interest expense on deposits	48	41	48	41

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 (2016: £nil).

Emoluments for Directors (including pension contributions and benefits in kind) for the year were as follows:

	Group & Company	
	2017	2016
	£000	£000
Salary payments	1,615	1,668
Payments in lieu of notice	226	-
Pension contributions	78	86
Share options	61	58
	1,980	1,812

Emoluments for Key Management Personnel (including pension contributions and benefits in kind) for the year were as follows:

	Group & Company	
	2017	2016
	£000	£000
Salary payments	2,678	2,012
Pension contributions	171	120
	2,849	2,132

Pension contributions are being accrued under money purchase schemes for 3 directors (2016: 3 directors) in respect of qualifying service. The emoluments of Sir Henry Angest, JR Cobb, and AA Salmon were paid by the Parent Company. Their total emoluments are disclosed in the financial statements of the Parent Company.

Notes to the Consolidated Financial Statements

Remuneration paid to Directors and Key Management includes amounts paid to the highest paid person in respect of:

	Group & Company	
	2017	2016
	£000	£000
Salary payments	804	726
Pension contributions	35	32
Share options	61	58
	900	816

Other related party transactions

Sir Michael CG Peat is an independent non-executive board member of Deloitte LLP. During 2017 the Bank was invoiced £349k by Deloitte LLP in relation to professional fees. As at 31 December 2017, there were no payments outstanding.

39. Interests in subsidiaries

Company	Investment at cost £000	Impairment provisions £000	Net £000
At 1 January 2016	5	-	5
At 31 December 2016	5	-	5
Purchase of Renaissance Asset Finance Limited	7,940	-	7,940
At 31 December 2017	7,945	-	7,945

(a) List of subsidiaries

The table below provides details of the subsidiaries of Arbuthnot Latham & Co., Ltd at 31 December:

	% shareholding	Country of incorporation	Principal activity
Direct shareholding			
Arbuthnot Latham (Nominees) Limited	100.0%	UK	Dormant
Arbuthnot Securities Limited	100.0%	UK	Dormant
Artillery Nominees Limited (Dissolved 16 January 2018)	100.0%	UK	Dormant
John K Gilliat & Co., Limited	100.0%	UK	Dormant
Pinnacle Universal	100.0%	BVI	Property development
Renaissance Asset Finance Limited	100.0%	UK	Asset finance
Arbuthnot Commercial Asset Based Lending Ltd	100.0%	UK	Property investment
Arbuthnot Latham Real Estate Holdings Ltd	100.0%	UK	Property investment
Arbuthnot Latham Real Estate Capital Ltd (Jersey)	100.0%	Jersey	Property investment
Arbuthnot Latham Real Estate Capital GPI Ltd (Jersey)	100.0%	Jersey	Property investment
Arbuthnot Latham Real Estate Capital Fund 1 LP (Jersey)	100.0%	Jersey	Property investment
Arbuthnot Latham Real Estate Holdco Ltd (Jersey)	100.0%	Jersey	Property investment
Arbuthnot Latham Real Estate PropCo 1 Ltd (Jersey)	100.0%	Jersey	Property investment

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 the above interests relate wholly to ordinary shares. No investments in subsidiary undertakings are impaired.

Notes to the Consolidated Financial Statements

All Jersey entities have their registered office as 26 New Street, St Helier, Jersey, JE2 3RA. Pinnacle Universal Limited's 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 are no subsidiaries with non-controlling interests.

40. 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 2017

Name	Nature of activity	Location	Turnover (£m)	Number FTE employees	Profit/(loss) before tax (£m)	Tax paid (£m)
Arbuthnot Latham & Co., Ltd	Banking Services	UK	51.7	319	9.6	-
Arbuthnot Latham & Co., Ltd	Banking Services	Dubai	-	16	(2.7)	-
Renaissance Asset Finance Ltd	Asset Finance	UK	9.7	19	2.6	-

31 December 2016

Name	Nature of activity	Location	Turnover (£m)	Number FTE employees	Profit/(loss) before tax (£m)	Tax paid (£m)
Arbuthnot Latham & Co., Ltd	Banking Services	UK	49.7	253	9.8	0.2
Arbuthnot Latham & Co., Ltd	Banking Services	Dubai	-	15	(2.2)	-

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 £1.8m profit (2016: £0.9m). No public subsidies were received during 2017 or 2016.

41. Ultimate controlling party

The Directors regard Arbuthnot Banking Group PLC, a company registered in England and Wales, as the ultimate parent company. Sir Henry Angest, the Group Chairman and CEO has a beneficial interest in 53.7% of the issued share capital of Arbuthnot Banking Group PLC and is regarded by the Directors as the controlling entity. A copy of the consolidated financial statements of Arbuthnot Banking Group PLC may be obtained from 7 Wilson Street, London, EC2M 2SN.

42. Events after the balance sheet date

On 3 January 2018, Arbuthnot Latham entered into a 12 year lease (up to 16 October 2029) to occupy the first, second and third floor of 10 Dominion Street London, with a break clause on 16 October 2024. The initial rent is £0.7m per annum. This is reflected in contingent liabilities (note 33) as an adjusting post balance sheet event.