ARBUTHNOT BANKING GROUP PLC

Interim Report 2018

Directors

Sir Henry Angest
Chairman and Chief Executive

James Cobb FCA
Group Finance Director

Ian Dewar FCA
Independent Non-Executive Director

Ian Henderson
Director

Paul Lynam
Non-Executive Director

Sir Christopher Meyer
Non-Executive Director

Andrew Salmon ACA
Chief Operating Officer

Sir Alan Yarrow FCSI (Hons)
Independent Non-Executive Director

Secretary
Nicholas Jennings FCA

The importance of history and Sun Tzu

The importance of previous experience cannot be overstated. "Those who are not willing to learn from history are doomed to repeat the mistakes of previous generations". A good place to start, therefore, is with the famous Chinese General, Sun Tzu and his writings in "The Art of War" ca. 2500 years ago. He established some basic truths such as:

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

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

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

Arbuthnot Banking Group PLC

Arbuthnot has a 185 year history

...of serving its customers, as well as a long track record of profitability against the background of a continually changing environment.

The ability of Arbuthnot to adapt and grow has come from managing the business through seven key principles developed over time. These principles, always applied with pragmatism and common sense, govern the activities of the Group, ranging from major strategic issues to smaller day-to-day operational matters.

Corporate philosophy

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

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

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

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

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

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

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

The continued application of these principles will allow the business to pursue growth in a controlled manner, providing a high quality service to its customers whilst delivering good returns to shareholders and securing the well-being of its employees.

Sir Henry Angest
Chairman & CEO

16 July 2018

Chairman's Statement

Arbuthnot Banking Group PLC

I am pleased to report that Arbuthnot Banking Group ("ABG") has delivered a profit before tax of £3.5m for the first six months of 2018. This compares to a profit of £2.5m for the same period of 2017, an increase of 39%. This includes an estimated profit from our associate, Secure Trust Bank PLC ("STB"), which will publish its interim results on 8 August.

As highlighted in the Annual Report and Accounts for 2017, the Group believes in diversification of its income streams and has accordingly been developing new businesses. I am encouraged with the progress being made by our new Asset Based Lending team. The team joined us on 2 January and from a standing start have set up their business in an efficient manner. The policies, processes and operating systems were all in place ahead of plan so they were able to fund their first deal on 4 May. At the end of June they had drawn balances of £8.9m from four clients and a pipeline of new business totalling £76.5m. The core team is now nearly complete and will consist of 10 employees by the end of the year. With sales executives covering the North, Midlands, London, South and soon to be added South West, the business has a national sales coverage.

In line with our diversification strategy we have also reached an agreement with an incoming management team to establish a new lending division that will be named "Arbuthnot Specialist Lending". This business will focus on providing short-term secured lending solutions to professional property businesses and entrepreneurs. The team will join us on 1 August with a core team of 6 employees. We expect that it will open for business in the fourth quarter of 2018. Its costs will be an organic investment in the current year, and the business should reach monthly break even and become fully profitable during 2020.

Given that the long-term prospects for the Group are encouraging and in line with previous years, the Board has decided to increase the interim dividend by 1p to 15p, which will be paid on 28 September 2018 to shareholders on the register on 31 August 2018.

Arbuthnot Latham & Co., Limited

Arbuthnot Latham ("AL") has reported a profit before tax for the first half of the year of £5.4m (H1 2017: £4.9m), which represents an increase of 10%.

Total assets of the bank have increased to £1.96bn (H1 2017: £1.43bn), an increase of 37%. This increase is the result of continued growth in both the customer loans and deposit balances.

Customer loans ended the first half at £1.10bn, an increase of 24% from the prior year and £47m higher than the year ended December 2017. The bank has originated £207m of loans during the first half, but has continued to experience a number of repayments as the lending markets remain competitive. During the period we have followed our principles of pricing appropriately for risk and return on capital employed and not relaxing our credit criteria such as loan to value limits. The resulting output from these input criteria is the volume of loans originated. We believe this is the prudent way to grow the business as compared to setting volume and balance sheet targets that require reductions in returns or higher credit risks to be taken.

Customer deposits have increased to £1.55bn (H1 2017: £1.24bn), an increase of 25% and £156m higher than the end of 2017. The increase in customer deposits reflects the diversity of sources of deposit funding. The Private Bank continues to attract deposits but the Commercial Bank has also been successful in developing new business and has now raised £471m of deposits.

Assets under management have grown to £1.07bn (H1 2017: £1bn).

Renaissance Asset Finance ("RAF") has continued to grow its loan balances, which stood at £78m (H1 2017: £60m), an increase of 30%. This is £7m higher than at the year end and represents good growth in increasingly competitive markets. The business has invested in developing its sales force and is seeing the benefit of the recruitment of four new Sales Executives and a new Sales Director at the end of 2017.

Overall, impairments continue to show an improvement with only £0.2m of losses incurred even after the introduction of IFRS 9.

Secure Trust Bank PLC

We have recorded £2.3m of income related to STB (H1 2017: £2.1m). This represents an estimate of our 18.6% share of the after tax earnings of the investment in our associate undertaking. In calculating this estimate, the Group has used the full year market consensus of the equity research on STB, with an assumed straight-line growth in profits over the first half, noting the trading statement made by STB on 16 May 2018 in relation to STB's first quarter trading being in line with STB's management expectations. This method is consistent with that used for the Group's 2017 Interim Report.

Capital Efficiency

The Board continually reviews the Group's capital structure and options to optimise the capital base in order to support the Group's strategy most effectively. The Board has noted recent announcements by a number of the smaller UK banks that have raised capital in the debt markets. To that extent, the Board is considering opportunities to raise Sterling denominated Additional Tier 1 or Tier 2 Capital, subject to market conditions and the Board determining that it is advantageous to do so.

Outlook

The Group has successfully been deploying the surplus capital generated from the sale of STB shares in 2016. New opportunities to deploy this capital have been created with the establishment of our Asset Based Lending and Specialist Lending businesses. Therefore the Group remains confident in its long-term prospects, despite the continuing uncertainty in the geopolitical and macroeconomic environment.

Sir Henry Angest
Chairman & CEO

16 July 2018

Consolidated Statement of Comprehensive Income

	Note	Six months ended 30 June 2018 £000	Six months ended 30 June 2017 £000
Interest income		28,628	22,106
Interest expense		(3,651)	(2,839)
Net interest income		**24,977**	**19,267**
Fee and commission income		6,513	6,183
Fee and commission expense		(112)	(322)
Net fee and commission income		**6,401**	**5,861**
Operating income		**31,378**	**25,128**
Net impairment loss on financial assets		(208)	(343)
Other income	6	1,649	1,104
Profit from associate	5	2,329	2,145
Operating expenses		(31,636)	(25,499)
Profit before income tax		**3,512**	**2,535**
Income tax expense		(275)	(90)
Profit for the period		**3,237**	**2,445**
Other comprehensive income			
Items that may be reclassified to profit or loss			
Available-for-sale reserve - Associate		–	389
Tax on other comprehensive income		–	(78)
Items that will not be reclassified to profit or loss			
Changes in fair value of equity investments at fair value through other comprehensive income		135	–
Tax on other comprehensive income		(26)	–
Other comprehensive income for the period, net of tax		**109**	**311**
Total comprehensive income for the period		**3,346**	**2,756**
Profit attributable to:			
Equity holders of the Company		3,237	2,445
		3,237	**2,445**
Total comprehensive income attributable to:			
Equity holders of the Company		3,346	2,756
		3,346	**2,756**
Earnings per share for profit attributable to the equity holders of the Company during the period			
(expressed in pence per share):			
– basic	8	21.7	16.5
– diluted	8	21.7	16.5

The notes on pages 8 to 19 are an integral part of these consolidated financial statements

Consolidated Statement of Financial Position

	At 30 June 2018 £000	At 30 June 2017 £000	At 31 December 2017 £000
ASSETS			
Cash and balances at central banks	361,892	253,309	313,101
Loans and advances to banks	76,840	35,898	70,679
Debt securities at amortised cost / held-to-maturity	307,560	158,515	227,019
Assets classified as held for sale	8,017	–	2,915
Derivative financial instruments	1,906	1,816	2,551
Loans and advances to customers	1,096,739	879,348	1,049,269
Other assets	23,036	20,102	20,624
Financial investments	2,459	2,173	2,347
Deferred tax asset	2,032	1,689	1,527
Investment in associate	84,032	82,132	83,804
Intangible assets	15,941	16,953	15,995
Property, plant and equipment	5,311	7,629	3,962
Investment properties	59,439	50,200	59,439
Total assets	**2,045,204**	**1,509,764**	**1,853,232**
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	153	153	153
Retained earnings	236,007	235,178	237,171
Other reserves	(840)	(1,051)	(949)
Total equity	**235,320**	**234,280**	**236,375**
LIABILITIES			
Deposits from banks	232,152	6,579	195,097
Derivative financial instruments	1,383	–	931
Deposits from customers	1,546,607	1,234,445	1,390,781
Current tax liability	550	450	705
Other liabilities	16,103	21,042	16,239
Debt securities in issue	13,089	12,968	13,104
Total liabilities	**1,809,884**	**1,275,484**	**1,616,857**
Total equity and liabilities	**2,045,204**	**1,509,764**	**1,853,232**

The notes on pages 8 to 19 are an integral part of these consolidated financial statements

Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Group					
	Share capital £000	Capital redemption reserve £000	Fair value reserve* £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 31 December 2017	**153**	**20**	**162**	**(1,131)**	**237,171**	**236,375**
IFRS 9 adjustment	–	–	–	–	(2,257)	(2,257)
Balance at 1 January 2018	**153**	**20**	**162**	**(1,131)**	**234,914**	**234,118**
Total comprehensive income for the period						
Profit for the six months ended 30 June 2018	–	–	–	–	3,237	3,237
Other comprehensive income, net of income tax						
Changes in the fair value of financial assets at FVOCI	–	–	109	–	–	109
Total other comprehensive income	**–**	**–**	**109**	**–**	**–**	**109**
Total comprehensive income for the period	**–**	**–**	**109**	**–**	**3,237**	**3,346**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Equity settled share based payment transactions	–	–	–	–	685	685
Final dividend relating to 2017	–	–	–	–	(2,829)	(2,829)
Total contributions by and distributions to owners	**–**	**–**	**–**	**–**	**(2,144)**	**(2,144)**
Balance at 30 June 2018	**153**	**20**	**271**	**(1,131)**	**236,007**	**235,320**

* The Available-for-sale reserve was reclassified as the Fair value reserve as from 1 January 2018.

	Attributable to equity holders of the Group					
	Share capital £000	Capital redemption reserve £000	Available-for-sale reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 1 January 2017	**153**	**20**	**(251)**	**(1,131)**	**235,567**	**234,358**
Total comprehensive income for the period						
Profit for the six months ended 30 June 2017	–	–	–	–	2,445	2,445
Other comprehensive income, net of income tax						
Available-for-sale reserve	–	–	389	–	–	389
Available-for-sale reserve – Associate	–	–	(78)	–	–	(78)
Total other comprehensive income	**–**	**–**	**311**	**–**	**–**	**311**
Total comprehensive income for the period	**–**	**–**	**311**	**–**	**2,445**	**2,756**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Equity settled share based payment transactions	–	–	–	–	(154)	(154)
Final dividend relating to 2016	–	–	–	–	(2,680)	(2,680)
Total contributions by and distributions to owners	**–**	**–**	**–**	**–**	**(2,834)**	**(2,834)**
Balance at 30 June 2017	**153**	**20**	**60**	**(1,131)**	**235,178**	**234,280**

The notes on pages 8 to 19 are an integral part of these consolidated financial statements

Consolidated Statement of Cash Flows

	Six months ended 30 June 2018 £000	Six months ended 30 June 2017 £000
Cash flows from operating activities		
Interest received	39,584	20,004
Interest paid	(3,889)	(3,347)
Fees and commissions received	6,740	4,966
Net trading and other income	1,649	1,104
Cash payments to employees and suppliers	(40,947)	(16,392)
Cash flows from operating profits before changes in operating assets and liabilities	3,137	6,335
Changes in operating assets and liabilities:		
- net decrease / (increase) in derivative financial instruments	1,097	(527)
- net increase in loans and advances to customers	(50,442)	(121,290)
- net increase in other assets	(7,742)	(7,720)
- net increase in deposits from banks	37,055	3,379
- net increase in amounts due to customers	155,826	236,796
- net (decrease) / increase in other liabilities	(136)	3,960
Net cash inflow from operating activities	**138,795**	**120,933**
Cash flows from investing activities		
Purchase of financial investments	(107)	–
Disposal of financial investments	136	–
Purchase of computer software	(748)	(8,797)
Purchase of property, plant and equipment	(1,799)	(361)
Proceeds from sale of property, plant and equipment	39	–
Purchases of debt securities	(153,823)	(108,363)
Proceeds from redemption of debt securities	75,288	55,772
Net cash outflow from investing activities	**(81,014)**	**(61,749)**
Cash flows from financing activities		
Dividends paid	(2,829)	(2,680)
Net cash used in financing activities	**(2,829)**	**(2,680)**
Net increase in cash and cash equivalents	54,952	56,504
Cash and cash equivalents at 1 January	383,780	232,703
Cash and cash equivalents at 30 June	**438,732**	**289,207**

The notes on pages 8 to 19 are an integral part of these consolidated financial statements

Notes to the Consolidated Financial Statements

1. Basis of preparation

The interim financial statements have been prepared on the basis of accounting policies set out in the Group's 2017 statutory accounts as amended by standards and interpretations effective during 2018 as set out below and in accordance with IAS 34 "Interim Financial Reporting". The directors do not consider the fair value of the assets and liabilities presented in these financial statements to be materially different from their carrying value.

The statements were approved by the Board of Directors on 16 July 2018 and are unaudited. The interim financial statements will be posted to shareholders and copies may be obtained from The Company Secretary, Arbuthnot Banking Group PLC, Arbuthnot House, 7 Wilson Street, London EC2M 2SN.

2. 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.

The principal risks inherent in the Group's business are strategic, credit, market, liquidity, operational, cyber, conduct 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. Also, the Board of Directors meets once a year to hold a two day board meeting to ensure that the Group's strategy is appropriate for the market and economy.

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. This risk exists in Arbuthnot Latham, which currently has a loan book of £1,097m. The lending portfolio in AL is extended to clients, the majority of which is secured against cash, property or other assets. Credit risk is managed through the Credit Committee of AL.

Market risk

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

The Group is exposed to changes in the market value of properties. The current carrying value of Investment Properties is £59m. Any changes in the market value of the properties will be accounted for in the Income Statement and as a result could have a significant impact on the profit or loss of the Group.

The Group has an 18.6% interest in STB. This is currently recorded in the Group's balance sheet as an interest in associate and at 30 June 2018 was carried at £84.0m or the equivalent of £24.40 per share (31 December 2017: carried at £83.8m or the equivalent of £24.33 per share). At 30 June 2018 the market price of STB was £18.20 per share (31 December 2017: £17.97 per share). The Board has determined that the current carrying value remains appropriate after having carried out extensive analysis to be satisfied that the long term value in use does not suggest that this carrying value is impaired. These valuations included the Gordon's Growth model and Dividend Discount model. The resultant output from the models indicated valuations in a range that was in excess of £24 but this will be ultimately dependent on the surplus capital within STB being deployed in the business over the long term. There is a risk that the output of the value in use models could require an impairment charge to be recognised in the future.

If the Group was considered to no longer have significant influence over STB it would lead to the investment being accounted for as a financial asset at fair value. The value would then be marked to market with changes in the share price giving rise to gains or losses being recorded in Other Comprehensive Income.

Notes to the Consolidated Financial Statements *continued*

2. Risks and uncertainties (continued)

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 Arbuthnot Latham 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.

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. The Group's overall approach to managing internal control and financial reporting is described in the Corporate Governance section of the Annual Report.

Cyber risk

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

Conduct risk

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

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

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 Banking Group. 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.

Notes to the Consolidated Financial Statements *continued*

3. Changes in significant accounting policies

IFRS 9, 'Financial instruments'

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 Group applied IFRS 9 from 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 Group's financial assets' classification and measurement. The Group has taken 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, has been incorporated through an adjustment to the opening reserves and retained earnings position as at 1 January 2018.

The following table summarises the impact, net of tax, of transition to IFRS 9 on the opening balance of retained earnings:

Retained Earnings	£000
Recognition of expected credit losses under IFRS 9	2,787
Related tax	(530)
Impact at 1 January 2018	**2,257**

i) Classification and Measurement of Financial Assets and Liabilities

There are three measurement classifications under IFRS 9: amortised cost, fair value through profit or loss ("FVPL") 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 FVPL.

The Group 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 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 FVPL 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 FVPL attributable to changes in liability credit risk (under IFRS 9 these changes are presented within other comprehensive income). There has been no change in the way the Group classifies and measures its financial liabilities.

Notes to the Consolidated Financial Statements *continued*

3. Changes in significant accounting policies (continued)

As mentioned above, IFRS 9 was adopted without restating comparative information. The reclassifications and the adjustments arising from the new impairment rules are therefore not reflected in a restated statement of financial position as at 31 December 2017, but are recognised in the opening balances on 1 January 2018. The following tables show the adjustments and reclassifications recognised for each individual line item in the statement of financial position. All financial assets and liabilities are disclosed below.

At 1 January 2018 (under IFRS 9)	FVPL £000	FVOCI £000	Amortised cost £000	Total carrying amount £000	Fair value £000
ASSETS					
Cash and balances at central banks	–	–	313,101	313,101	313,101
Loans and advances to banks	–	–	70,679	70,679	70,679
Debt securities at amortised cost	–	–	227,019	227,019	227,951
Derivative financial instruments	2,551	–	–	2,551	2,551
Loans and advances to customers	–	–	1,046,482	1,046,482	1,022,816
Other assets	11,964	–	–	11,964	11,964
Financial investments	128	2,219	–	2,347	2,347
	14,643	**2,219**	**1,657,281**	**1,674,143**	**1,651,409**
LIABILITIES					
Deposits from banks	–	–	195,097	195,097	195,097
Derivative financial instruments	931	–	–	931	931
Deposits from customers	–	–	1,390,781	1,390,781	1,390,781
Other liabilities	1,207	–	–	1,207	1,207
Debt securities in issue	–	–	13,104	13,104	13,104
	2,138	**–**	**1,598,982**	**1,601,120**	**1,601,120**

At 31 December 2017 (under IAS 39)	FVPL £000	Held-to-maturity £000	Loans and receivables £000	Available-for-sale £000	Liabilities at amortised cost £000	Total carrying amount £000	Fair value £000
ASSETS							
Cash and balances at central banks	–	–	313,101	–	–	313,101	313,101
Loans and advances to banks	–	–	70,679	–	–	70,679	70,679
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	–	–	1,049,269	–	–	1,049,269	1,022,816
Other assets	–	–	11,964	–	–	11,964	11,964
Financial investments	–	–	–	2,347	–	2,347	2,347
	2,551	**227,019**	**1,445,013**	**2,347**	**–**	**1,676,930**	**1,651,409**
LIABILITIES							
Deposits from banks	–	–	–	–	195,097	195,097	195,097
Derivative financial instruments	931	–	–	–	–	931	931
Deposits from customers	–	–	–	–	1,390,781	1,390,781	1,390,781
Other liabilities	–	–	1,207	–	–	1,207	1,207
Debt securities in issue	–	–	–	–	13,104	13,104	13,104
	931	**–**	**1,207**	**–**	**1,598,982**	**1,601,120**	**1,601,120**

Notes to the Consolidated Financial Statements *continued*

3. Changes in significant accounting policies (continued)

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

IFRS 9 introduced a new forward-looking expected credit loss ("ECL") impairment framework for all financial assets not measured at FVPL and certain off-balance sheet loan commitments and guarantees. It replaced the "incurred loss model" from IAS 39. The new ECL framework resulted in an allowance for ECL recorded on financial assets regardless of whether there has been an actual loss event. This differs from the previous approach where the allowance recorded on performing loans was 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 previous approach, which estimated 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, but is not limited to, 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 Group consider a financial asset to be in default when:

- The borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group 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 Group.

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

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 Group 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 Group's historical experience, expert credit assessment and forward-looking information.

Notes to the Consolidated Financial Statements *continued*

3. Changes in significant accounting policies (continued)

The Group 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 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 Group 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 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) Impact of new impairment model, including impact on capital

The Group has recorded 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 has not restated comparative periods. The application of IFRS 9 resulted in additional impairment allowance as at 1 January 2018 of £2.8m, as disclosed below:

Impairment allowance	£000
Loss allowance at 31 December 2017 under IAS 39	1,362
Additional impairment recognised at 1 January 2018 on loans and advances to customers	2,787
Loss allowance at 1 January 2018 under IFRS 9	**4,149**

CET 1 ratio at 30 June 2018:

- 15.22% before transitional relief;
- 15.43% 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 Group adopted 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 years. The proportion phased in for the balance at each reporting period is 2018: 10%; 2019 20%; 2020 40%; 2021 60%; 2022 80%. From 2023 onwards, there is no transitional relief.

Notes to the Consolidated Financial Statements *continued*

3. Changes in significant accounting policies (continued)

v) Impact on Governance and Controls

The Group applied its existing governance framework to ensure that appropriate controls and validations were in place over key processes and judgments to determine the ECL. As part of the implementation, the Group refined internal controls and implemented new controls where required in areas that were 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'

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. The Group applied IFRS 15 from 1 January 2018.

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. Revenue recognition for current revenue streams were unchanged after the implementation of IFRS 15.

4. 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.

Notes to the Consolidated Financial Statements *continued*

4. Valuation of financial instruments (continued)

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

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

At 30 June 2018	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	1,906	–	1,906
Financial investments	17	–	2,442	2,459
	17	**1,906**	**2,442**	**4,365**
LIABILITIES				
Derivative financial instruments	–	1,383	–	1,383
	–	**1,383**	**–**	**1,383**

At 30 June 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	1,816	–	1,816
Financial investments	112	–	2,061	2,173
	112	**1,816**	**2,061**	**3,989**

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	144	–	2,203	2,347
	144	**2,551**	**2,203**	**4,898**
LIABILITIES				
Derivative financial instruments	–	931	–	931
	–	**931**	**–**	**931**

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

Notes to the Consolidated Financial Statements *continued*

4. Valuation of financial instruments (continued)

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

Movement in level 3	At 30 June 2018 £000	At 30 June 2017 £000	At 31 December 2017 £000
At 1 January	2,203	2,012	2,012
Consideration received	104	–	–
Movements recognised in Other Comprehensive Income	135	–	136
Movements recognised in the Income Statement	–	49	55
At 30 June / 31 December	**2,442**	**2,061**	**2,203**

5. Operating segments

The Group is organised into three main operating segments as disclosed below:

1) Retail banking (associate) – incorporating household cash management, personal lending and banking services.

2) UK Private banking – incorporating private banking, wealth management and commercial banking.

3) Group Centre – ABG Group Centre management.

Transactions between the operating segments are on normal commercial terms. Centrally incurred expenses are charged to operating segments on an appropriate pro-rata basis. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet.

In calculating the Income from associate, the Company has used an estimate based on the full year market consensus of the equity research performed on STB with an assumed straight-line growth in profits over the first half, noting the trading statement made by STB on 16 May 2018 in relation to STB's first 4 months trading being in-line with STB's management's expectations. The Group's profit before tax, profit after tax and earnings per share therefore include this estimated income from STB.

Notes to the Consolidated Financial Statements *continued*

5. Operating segments (continued)

Six months ended 30 June 2018	Retail Bank Associate Income £000	UK Private banking £000	Group Centre £000	Total £000
Interest revenue	–	28,720	54	**28,774**
Inter-segment revenue	–	(92)	(54)	**(146)**
Interest revenue from external customers	**–**	**28,628**	**–**	**28,628**
Fee and commission income	–	6,513	–	**6,513**
Revenue from external customers	**–**	**35,141**	**–**	**35,141**
Interest expense	–	(3,525)	54	**(3,471)**
Add back inter-segment revenue	–	92	(92)	**–**
Subordinated loan note interest	–	–	(180)	**(180)**
Fee and commission expense	–	(112)	–	**(112)**
Segment operating income	**–**	**31,596**	**(218)**	**31,378**
Impairment losses	–	(208)	–	**(208)**
Other income	–	1,980	(331)	**1,649**
Income from associate	2,329	–	–	**2,329**
Operating expenses	–	(27,986)	(3,650)	**(31,636)**
Segment profit/(loss) before tax	**2,329**	**5,382**	**(4,199)**	**3,512**
Income tax expense	–	(237)	(38)	**(275)**
Segment profit/(loss) after tax	**2,329**	**5,145**	**(4,237)**	**3,237**
Loans and advances to customers	–	1,096,739	–	**1,096,739**
Other assets	–	867,281	81,184	**948,465**
Segment total assets	**–**	**1,964,020**	**81,184**	**2,045,204**
Customer deposits	–	1,546,607	–	**1,546,607**
Other liabilities	–	284,108	(20,831)	**263,277**
Segment total liabilities	**–**	**1,830,715**	**(20,831)**	**1,809,884**
Other segment items:				
Capital expenditure	–	(2,456)	(95)	**(2,551)**
Depreciation and amortisation	–	(1,459)	(13)	**(1,472)**

Notes to the Consolidated Financial Statements *continued*

5. Operating segments (continued)

Six months ended 30 June 2017	Retail Bank Associate Income £000	UK Private banking £000	Group Centre £000	Total £000
Interest revenue	–	22,184	117	**22,301**
Inter-segment revenue	–	(78)	(117)	**(195)**
Interest revenue from external customers	**–**	**22,106**	**–**	**22,106**
Fee and commission income	–	6,183	–	**6,183**
Revenue from external customers	**–**	**28,289**	**–**	**28,289**
Interest expense	–	(2,782)	117	**(2,665)**
Add back inter-segment revenue	–	78	(78)	**–**
Subordinated loan note interest	–	–	(174)	**(174)**
Fee and commission expense	–	(322)	–	**(322)**
Segment operating income	**–**	**25,263**	**(135)**	**25,128**
Impairment losses	–	(343)	–	**(343)**
Other income	–	1,588	(484)	**1,104**
Income from associate	2,145	–	–	**2,145**
Operating expenses	–	(21,632)	(3,867)	**(25,499)**
Segment profit/(loss) before tax	**2,145**	**4,876**	**(4,486)**	**2,535**
Income tax expense	–	(90)	–	**(90)**
Segment profit/(loss) after tax	**2,145**	**4,786**	**(4,486)**	**2,445**
Loans and advances to customers	–	879,348	–	**879,348**
Other assets	–	551,239	79,177	**630,416**
Segment total assets	**–**	**1,430,587**	**79,177**	**1,509,764**
Customer deposits	–	1,234,445	–	**1,234,445**
Other liabilities	–	111,199	(70,160)	**41,039**
Segment total liabilities	**–**	**1,345,644**	**(70,160)**	**1,275,484**
Other segment items:				
Capital expenditure	–	(2,658)	–	**(2,658)**
Depreciation and amortisation	–	(1,046)	(1)	**(1,047)**

Segment profit is shown prior to any intra-group eliminations.

The UK private bank has a branch in Dubai, which generated £2.2m (2017: £2.1m) income and had operating costs of £1.5m (2017: £1.4m). All Dubai branch income is booked in the UK. Other than the Dubai branch, all operations of the Group are conducted wholly within the United Kingdom and geographical information is therefore not presented.

6. Other income

Other income mainly consists out of rental income received from the investment properties and from STB for office space occupied.

Notes to the Consolidated Financial Statements *continued*

7. Underlying profit reconciliation

The profit before tax as reported in the operating segments can be reconciled to the underlying profit as disclosed in the tables below.

Underlying profit reconciliation Six months ended 30 June 2018	Arbuthnot Latham & Co. £000	Arbuthnot Banking Group £000
Profit before tax	5,382	3,512
Investment in new ventures	670	670
Underlying profit	**6,052**	**4,182**

Underlying profit reconciliation Six months ended 30 June 2017	Arbuthnot Latham & Co. £000	Arbuthnot Banking Group £000
Profit before tax	4,876	2,535
Investment in operating systems	97	97
Acquisition costs	67	67
RAF - full year equivalent income*	466	466
Underlying profit	**5,506**	**3,165**

* RAF profit contribution adjustment as if received from 1 January 2017 and not as included from 28 April 2017 (pro rata basis).

8. Earnings per ordinary share

Basic

Basic earnings per ordinary share are calculated by dividing the profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares 14,889,048 (2017: 14,815,045) in issue during the period. On 30 March 2017, Sir Henry Angest bought 150,500 shares previously held in an ESOP trust.

Diluted

Diluted earnings per ordinary share are calculated by dividing the diluted profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the period, as well as the number of dilutive share options in issue during the period. There were no dilutive share options in issue at the end of June (2017: nil).

Profit and diluted profit attributable	Six months ended 30 June 2018 £000	Six months ended 30 June 2017 £000
Profit and diluted profit after tax attributable to equity holders of the Company	3,237	2,445

Basic and diluted earnings per share	Six months ended 30 June 2018 p	Six months ended 30 June 2017 p
Basic and diluted earnings per share	21.7	16.5

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