ARBUTHNOT BANKING GROUP PLC

Interim Report 2020

The importance of history and Sun Tzu

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

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

“He whose ranks are united in purpose will be victorious.”

“The commander will surely choose those who are most fortunate.”

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

Origins of Arbuthnot Latham

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

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

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

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

Directors

Sir Henry Angest
Chairman and Chief Executive

Nigel Boardman
Independent Non-Executive Director

James Cobb FCA
Group Finance Director

Ian Dewar FCA
Independent Non-Executive Director

Sir Christopher Meyer
Independent Non-Executive Director

Andrew Salmon FCA
Chief Operating Officer

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

Secretary
Nicholas Jennings FCA

Arbuthnot Banking Group PLC

The Seven Principles

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

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

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

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

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

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

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

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

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

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

Sir Henry Angest
Chairman & CEO

13 July 2020

Chairman's Statement

Arbuthnot Banking Group PLC

Given the extraordinary circumstances that the Group has found itself in since the introduction of the UK Government's public health restrictions, I am pleased to say that the Group has remained profitable during the first six months of 2020. This is despite the fact that the Bank of England base rate was reduced by 65 basis points to 0.1%, the lowest level in history, and the decline in economic forecasts that has resulted in a significant increase in provisions arising from the IFRS 9 modelling. Also, the Group has not received in the first half of the year the anticipated dividend income of approximately £1m from its investment in Secure Trust Bank.

The reduction in the base rate has already cost the Group £2.7m in lost revenues and will remain an impediment to the medium term performance of the Group, until the lending portfolios can be fully repriced and lower rates are achieved across our customer deposits. Even then, the Group does not expect to regain all of the lost revenue that was previously earned on the significant surplus of liquidity assets that are held at the Bank of England. To offset this lost revenue the Group has prudently implemented cost control measures, which have included the cancellation of staff bonuses for 2020.

The Group's financial resources have remained strong and as a result of this we have not sought to use any of the emergency support measures that have been made available by the UK Government; no staff have been placed on furlough or made redundant and we have continued to pay all of our tax liabilities by their original due date.

At the end of June, the Group's capital resources stood at £207m with a surplus of £66m. Given our current capital requirement of £141m, this healthy surplus allows room for significant growth once the lending activities return to a more normal environment. In fact, it is our expectation that rates will firm in the markets that we operate in, allowing us to take advantage of our competitive position.

History has taught us that liquidity is the most important of resources when economic shocks or market dislocations arise such as we have seen recently. Thus, the Group took an early decision to focus on increasing the Bank's liquidity position at the start of the lockdown. At the end of March, the surplus liquidity resources that the Bank held above the minimum requirement was £300m; by the end of the second quarter this surplus had increased to in excess of £400m.

I am pleased that the Group has been able to show that the recent investments made in modernising the Bank's infrastructure has paid off. The Bank has been able to maintain an uninterrupted service to all of its clients, with calls answered in a timely manner and in fact in many cases our relationship has been deepened by longer and more in-depth conversations. Our strapline that we are a "service and relationship driven bank powered by modern technology" could never be more true than it is today. Ultimately, this has only been made possible by the dedication and exemplary commitment displayed by all of our employees during this time, whom I would like to thank.

Given the strength of the Group, the Board felt it appropriate to declare a dividend for the year ended 31 December 2019. This was in line with the market expectations at 21p, an increase of 1p on the prior year and therefore a total dividend of 37p, an increase of 2p on 2018. After this dividend was declared, the Prudential Regulation Authority ("PRA") and the Bank of England issued clear guidance that given the economic uncertainty, banks should not pay dividends during 2020. Accordingly, the dividend had to be withdrawn and therefore the Group will also not pay the normal interim dividend for 2020. The Group will have to consult with the regulatory authorities before determining if it will be permitted to resume dividend payments when the final results for 2020 are announced.

Arbuthnot Latham & Co., Limited

Arbuthnot Latham ("AL") has reported a profit before tax for the first half of the year of £5m (H1 2019: £6.7m), with the fall in the profitability due to the decline in revenues as a result of the reduction in the base rate and the additional credit provisions required by IFRS 9 of £1m.

Total assets of the Bank have increased to £2.7bn (H1 2019: £2.33bn), an increase of 16%. Customer loans ended the first half at £1.62bn (H1 2019: £1.28bn), an increase of 27% and 1% higher than the balance reported at the 2019 year-end. This is the result of the purchase of the mortgage portfolio in the second half of 2019 and also the ongoing activity in AL to grow customer loan portfolios.

At the same time, in line with our approach to balanced growth, customer deposits have grown to £2.21bn (H1 2019: £1.83bn), an increase of 21% on the prior year and an increase of 6% from the levels at the 2019 year-end.

Despite the volatility in the markets, the investment management team has performed well and has continued to see net inflows of client balances, which have offset the variances caused by falling valuations. At the end of the first half, Assets Under Management ("AUMs") stood at £1.07bn

(H1 2019: £1.03bn), an increase of 4% and 3% lower than the balance at the 2019 year-end.

During the half year, the Bank originated new loans of £193m (H1 2019: £206m), which is a creditable performance given that the lending markets more or less closed during the lockdown and have been slow to rebound as the economy has gradually begun to re-emerge.

Private Bank

The Private Bank has reported a loss before tax of £2.3m (H1 2019: profit of £0.8m), the reduction in profit being due to the fall in revenues caused by the reduction in the base rate and the incremental credit provisions.

The strategy continues to focus on the Private Bank developing existing relationships as well as acquiring new criteria clients. From March onwards, when the impact of the pandemic became more evident, the Bank's primary objective was to communicate with existing clients to ensure we were providing the banking and relationship support that they required.

A leading indicator of the Private Bank, namely customer balances, has shown good growth in the first six months of 2020. Deposit balances have increased 1% to £1.05bn and loan balances are up 2% to £564m. In due course, we expect a portion of the increase in deposit balances will lead to new investment management and wealth planning opportunities. We are pleased with this performance given the external environment and pricing pressure seen for deposits and lending.

The Wealth Management division experienced significant global market volatility as the pandemic took effect. Investment Management focused on existing clients as well as new to bank clients, a strategy that proved fruitful with positive net flows and £58.3m of gross inflows, 77% ahead of the same period last year and also with increased new client numbers. Of the gross inflows, £28.8m included Wealth Planning advice, with advice fees at the end of June already surpassing the full year 2019 performance. AUMs are now at £1.07bn, £142m up from March lows.

The Investment Committee delivered resilient performance against benchmarks during the first half, supporting positive client retention and prospect conversations. Notwithstanding the challenging external factors affecting global markets, our focus remains on providing excellent service to our clients and we continue to see significant long-term growth potential for our wealth management business.

The Dubai Private Banking business continued its positive story and has seen growth against all key business areas in the first half of the year. New deposit balances increased by 12% on H1 2019 and customer loan balances have increased by 4% at the end of June 2020 compared to the year-end 2019 position. Despite the market volatility, AUMs have increased by 10% during the first half of the year, as we have seen high volumes of new investment inflows into our discretionary management service. Dubai has also seen double digit growth in new client acquisition numbers.

Commercial Bank

The Commercial Bank has reported a profit before tax of £2.5m (H1 2019: £3.2m), the reduction in profit again being due to the fall in revenues caused by the reduction in the base rate.

The commercial bankers also began the lockdown period by developing existing relationships as well as acquiring new criteria clients. This resulted in us providing SMEs with an innovative interest free overdraft if directly impacted, as well as applying to the British Business Bank to be an accredited lender for the Coronavirus Business Interruption Loan Scheme ("CBILs") and Bounce Bank Loan Scheme ("BBLs"). We commenced lending under these schemes on 23 June 2020. In addition, we have proactively been supporting clients with short term payment holidays or deferrals.

We are planning to apply to the RBS Remedies Scheme for the Capabilities and Innovation Fund given two previous awardees have handed back £100m. We believe we have a compelling case given our long history in serving our clients, with high quality products and a tailored relationship-led service. Since the launch of our Commercial Bank in 2016 we have successfully grown deposit balances to £907m and loan balances to £552m in the SME sector. If we were successful it would enable us to bring our differentiated, private banking style relationship offer to a wider range of SME businesses than we are currently able to service, and to offer a more complete banking service to SME clients across the country.

Mortgage Portfolios

The balance of the acquired mortgage portfolios ended the first half of 2020 at £301m and delivered a profit before tax of £2.4m after including interest costs and third party servicing charges. Given the fall in the Bank of England base rate, those mortgages referenced to a Standard Variable Rate ("SVR") have seen their interest rates adjusted in line with the decline.

Chairman's Statement

In accordance with the guidance from the Financial Conduct Authority, all of those mortgage customers that requested a payment holiday were granted the forbearance measure. The largest portfolio that was acquired in 2019 received requests from 26% of its customers although this has subsequently fallen back to 8% as borrowers started to make repayments as the first payment holiday period has begun to expire. Customers are now permitted to request a further payment holiday until 31 October 2020.

The smaller portfolio purchased in 2014 received requests from 14% of its customers and this has now fallen back to 13%. The level of payment holiday requests for both of these portfolios is in line with other mortgage books with similar characteristics.

Renaissance Asset Finance ("RAF")

RAF has reported a profit before tax of £1m (H1 2019: £0.9m). This increase is despite the incremental provisions required by the IFRS 9 model totalling £0.3m, an increase in provisions of 48%.

The business has reacted creditably to working remotely while at the same time receiving a significant number of inbound requests for payment holidays as business sectors such as the London taxi market, to which RAF supplies asset finance, temporarily closed down. At the peak, the portfolio saw 65% of its loan balances in the forbearance measures available. This has now declined to 63% and the business has started to resume lending, which should reverse the decline in customer loan balances that reached up to £0.5m per month, as the natural amortisation of the balances exceeded any new lending. The customer loan balances were £101m at 30 June 2020 compared to £98m at the same time in the prior year. The business was not affected by the fall in the base rate as the lending rate is fixed at the time of origination for the term of the loan. However, this business is the most sensitive to the SME economy and expected to take some time to recover while it waits for its customers in forbearance to resume normal payment behaviours.

Arbuthnot Commercial Asset Based Lending ("ACABL")

ACABL has reported a profit before tax of £0.7m (H1 2019: loss of £0.1m)

The business has seen the drawn balances on its commercial facilities fall from £102m at the start of the lockdown to £67m at the half year end. This is due to the continued repayment of invoices by debtors to our borrowers, while at the same time the issuance of new invoices all but ceased as the economy slowed. However, with the return of the borrowers' business activity, we expect that the balances will start to be drawn again. The ACABL business has selectively written new business during the pandemic taking a cautious approach and the book has grown to 43 clients, with new facilities written in the first half of the year of £32.8m, taking the total available book limits to £162.8m at 30 June 2020. The business has also taken the opportunity to expand the team which now totals 18 people.

A significant number of ACABL customers are introduced via private equity funds who require financing for businesses after completing an acquisition. Given the increasing number of distressed businesses that previously enjoyed sound operating models that may come to the market for new equity funding, ACABL should be in a strong position to take advantage of this potential opportunity.

Following the accreditation of the Bank by the British Business Bank on 12 June to provide CBILs and BBLs, ACABL has underwritten the first CBIL loan for £1.2m.

Arbuthnot Specialist Finance Limited ("ASFL")

ASFL has made a loss before tax of £0.5m (H1 2019: loss of £0.5m) as the division has only recently fully launched its lending capabilities. Customer Loan balances were £9m at the half year end. The ASFL operating platform, "nCino", has now completed all of the user acceptance testing and became fully operational on 1 July.

It is expected that the lack of liquidity within the non-bank lending sector, many of whom are competitors of ASFL, will feed its way into the bridge finance market and will result in less competition and accordingly firmer pricing conditions. To take advantage of this opportunity, the business has developed a new range of products. The number of enquiries has increased in recent weeks, which is a positive sign that the bridge finance market is emerging from the lockdown period.

Operations

During this period the Bank was able to respond well to the move into lockdown, enabling all staff to work remotely, whilst maintaining good levels of client interaction. This is testament to the significant recent investment in underlying IT infrastructure and adoption of cloud services to boost the organisation's operational resilience.

Not unexpectedly, the impact of the lockdown has seen a slowdown in the growth of new accounts opened, while the current environment has also seen changes in client behaviours.

Payment volumes have declined across all channels (cards, ATM and online) over the last three months, whilst the value of transactions has increased. As part of the Bank's continued investment in enhanced digital services and in order to provide clients with more control during these times, a new Arbuthnot Latham card app was launched in early June, giving clients enhanced ability to manage their card accounts.

Despite the move to working remotely, the Bank has not slowed the pace to modernise its technology. Over the last six months, the planned delivery of the new CRM platform has been maintained and will go live in July. The first phase of this multi-year programme will provide relationship teams with a more accessible and efficient means to operate and will deliver a platform for future enhancements to the way in which the Bank serves its clients.

IFRS 9

Given the significant forbearance measures that are in place, the activity around credit has been largely centred on monitoring and indeed the credit stewardship measures across the Bank have improved in the past three months.

However, IFRS 9 requires the credit exposures to be assessed on potential economic scenarios and how these may impact impairments in the future. At the year end, the probability of the severe decline scenario, which would result in a fall in property prices of 40% was estimated as being 1%. This has now been estimated as 2%. The overall weighted average of the scenarios at the year-end suggested that property prices would increase by 0.1%. This has now reversed to a weighted average scenario of a decline in property prices of 8.3%. This appears to be in line with professional valuers who are suggesting property price falls of between 5-10%. When this 8.3% reduction in property collateral values is applied to the stage 1,2 and 3 credit exposures, a resultant increase in credit provisions of £0.7m has been recorded in the first half results, an increase in provisions of 15%. Our conservative risk appetite in terms of underwriting loans with modest LTVs has currently limited this incremental provision requirement.

Additionally, the exposures in the RAF asset finance loan portfolio have been reassessed in light of the value of their collateral levels and this required an additional provision of £0.3m or an increase of 48%.

Support for the UK Economy

As previously mentioned, the Group has not sought to take advantage of any of the measures of support provided by the UK Government and has maintained full employment for all of its staff. Additionally, the Group has attempted to provide support to the UK economy wherever possible. As soon as the CBILs and BBLs schemes were announced we applied to the British Business Bank to be accredited to provide these loans to our clients. The Group was approved on 12 June and thus far we have provided £1.2m of CBILs with a further £6.9m approved awaiting draw down or pending in the pipeline. Also, we have lent £2.8m of BBLs loans with £1.9m in process.

Additionally, in the first phase of payment holidays, the Group immediately provided forbearance on more than £250m of customer loan balances, to help our borrowers cope in the difficult economic environment.

Outlook

It would appear that the downturn was not as severe as many economists had forecast, and there is hope that the recovery will be "V shaped" rather than prolonged. However, what is not certain is how the economy will perform when the support packages provided by the UK Government are withdrawn. It is expected that any resultant impact on credit impairments will therefore not be fully understood until 2021, as the payment holiday schemes are phased out.

While the ultimate economic impact of Covid-19 remains unknown, the Group has been developing a further business strategy for implementation in the new economic environment. The strategy will be led by further growth in lending balances in the subsidiary divisions and a refocus of the core bank to residential property lending. This strategy, if successfully implemented, will see the return on capital optimised in the medium term, but the Group may forego revenues on non-strategic assets in the short term if they decline before new target lending balances are built.
The Group has all the necessary resources to carry out this plan including: capital, liquidity and technological capability.

Sir Henry Angest
Chairman & CEO

13 July 2020

Consolidated Statement of Comprehensive Income

	Note	Six months ended 30 June 2020 £000	Six months ended 30 June 2019 £000
Interest income		39,045	35,251
Interest expense		(9,337)	(6,483)
Net interest income		**29,708**	**28,768**
Fee and commission income		6,993	6,935
Fee and commission expense		(147)	(80)
Net fee and commission income		**6,846**	**6,855**
Operating income		**36,554**	**35,623**
Net impairment loss on financial assets		(1,701)	(1,317)
Other income	6	420	2,384
Operating expenses		(35,072)	(33,801)
Profit before income tax		**201**	**2,889**
Income tax expense		(70)	(413)
Profit after income tax from continuing operations		**131**	**2,476**
Profit for the period		**131**	**2,476**
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Changes in fair value of equity investments at fair value through other comprehensive income		(15,832)	7,370
Tax on other comprehensive income		(20)	(53)
Other comprehensive income for the period, net of tax		**(15,852)**	**7,317**
Total comprehensive income for the period		**(15,721)**	**9,793**
Profit attributable to:			
Equity holders of the Company		131	2,476
		131	**2,476**
Total comprehensive income attributable to:			
Equity holders of the Company		(15,721)	9,793
		(15,721)	**9,793**
Earnings per share for profit attributable to the equity holders of the Company during the period			
(expressed in pence per share):			
– basic	7	0.9	16.6
– diluted	7	0.9	16.6

The notes on pages 10 to 25 are an integral part of these consolidated financial statements

Consolidated Statement of Financial Position

	At 30 June 2020 £000	At 30 June 2019 £000	At 31 December 2019 £000
ASSETS			
Cash and balances at central banks	434,761	431,760	325,908
Loans and advances to banks	109,751	85,775	46,258
Debt securities at amortised cost	359,042	383,459	442,960
Assets classified as held for sale	7,617	8,020	7,617
Derivative financial instruments	1,749	1,354	1,804
Loans and advances to customers	1,620,262	1,275,372	1,599,053
Other assets	90,010	15,286	86,443
Financial investments	15,310	27,467	30,919
Deferred tax asset	1,931	1,438	1,815
Intangible assets	22,776	17,349	20,082
Property, plant and equipment	6,849	5,453	5,813
Right-of-use assets	18,527	20,559	19,944
Investment properties	6,763	69,446	6,763
Total assets	**2,695,348**	**2,342,738**	**2,595,379**
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital	154	154	154
Retained earnings	209,302	207,940	209,171
Other reserves	(16,927)	(4,273)	(990)
Total equity	**192,529**	**203,821**	**208,335**
LIABILITIES			
Deposits from banks	230,638	236,203	230,421
Derivative financial instruments	634	174	319
Deposits from customers	2,206,515	1,829,227	2,084,903
Current tax liability	603	649	633
Other liabilities	7,477	14,124	13,500
Lease liabilities	19,152	20,882	20,431
Debt securities in issue	37,800	37,658	36,837
Total liabilities	**2,502,819**	**2,138,917**	**2,387,044**
Total equity and liabilities	**2,695,348**	**2,342,738**	**2,595,379**

The notes on pages 10 to 25 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	Revaluation reserve £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 1 January 2020	**154**	**–**	**19**	**205**	**(1,214)**	**209,171**	**208,335**
Total comprehensive income for the period							
Profit for the six months ended 30 June 2020	–	–	–	–	–	131	131
Other comprehensive income, net of income tax							
Changes in the fair value of financial assets at FVOCI[1]	–	–	–	(15,872)	–	–	(15,872)
Tax on other comprehensive income	–	–	–	20	–	–	20
Total other comprehensive income	**–**	**–**	**–**	**(15,852)**	**–**	**–**	**(15,852)**
Total comprehensive income for the period	**–**	**–**	**–**	**(15,852)**	**–**	**131**	**(15,721)**
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Purchase of own shares	–	–	–	–	(85)	–	(85)
Total contributions by and distributions to owners	**–**	**–**	**–**	**–**	**(85)**	**–**	**(85)**
Balance at 30 June 2020	**154**	**–**	**19**	**(15,647)**	**(1,299)**	**209,302**	**192,529**

	Attributable to equity holders of the Group						
	Share capital £000	Revaluation reserve £000	Capital redemption reserve £000	Fair value reserve £000	Treasury shares £000	Retained earnings £000	Total £000
Balance at 1 January 2019	**153**	**–**	**20**	**(12,169)**	**(1,131)**	**209,083**	**195,956**
Total comprehensive income for the period							
Profit for the six months ended 30 June 2019	–	–	–	–	–	2,476	2,476
Other comprehensive income, net of income tax							
Changes in the fair value of financial assets at FVOCI	–	–	–	7,370	–	–	7,370
Tax on other comprehensive income	–	–	–	(53)	–	–	(53)
Total other comprehensive income	**–**	**–**	**–**	**7,317**	**–**	**–**	**7,317**
Total comprehensive income for the period	**–**	**–**	**–**	**7,317**	**–**	**2,476**	**9,793**
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Issue of non-voting share capital	1	–	(2)	–	–	(32)	(33)
Unwind Employee Trust	–	–	–	–	–	1,083	1,083
Sale of Secure Trust Bank shares	–	–	–	1,692	–	(1,692)	–
Final dividend relating to 2018	–	–	–	–	–	(2,978)	(2,978)
Total contributions by and distributions to owners	**1**	**–**	**(2)**	**1,692**	**–**	**(3,619)**	**(1,928)**
Balance at 30 June 2019	**154**	**–**	**18**	**(3,160)**	**(1,131)**	**207,940**	**203,821**

[1] The change in fair value of financial investments of £15.9m is due to the movement in the value of the investment in Secure Trust Bank, as the share price reduced from £16.00 at 31 December 2019 to £7.24 at 30 June 2020. This also reduced CET1 capital resources by £5.4m, after the deduction for a non-significant investment in a financial institution was removed.

The notes on pages 10 to 25 are an integral part of these consolidated financial statements

Consolidated Statement of Cash Flows

	Six months ended 30 June 2020 £000	Six months ended 30 June 2019 £000
Cash flows from operating activities		
Interest received	63,829	46,707
Interest paid	(10,892)	(6,796)
Fees and commissions received	6,491	4,798
Net trading and other income	420	2,384
Cash payments to employees and suppliers	(65,108)	(16,938)
Cash flows from operating (losses)/profits before changes in operating assets and liabilities	(5,260)	30,155
Changes in operating assets and liabilities:		
- net decrease in derivative financial instruments	370	478
- net increase in loans and advances to customers	(22,646)	(51,806)
- net increase in other assets	(2,687)	(23,147)
- net increase in deposits from banks	217	3,528
- net increase in amounts due to customers	121,612	114,941
- net (decrease) / increase in other liabilities	(7,302)	16,457
Net cash inflow from operating activities	**84,304**	**90,606**
Cash flows from investing activities		
Purchase of financial investments	(225)	(128)
Disposal of financial investments	–	15,330
Purchase of computer software	(3,973)	(1,723)
Refurbishment cost investment property	–	(2,365)
Purchase of property, plant and equipment	(1,301)	(837)
Purchases of debt securities	(433,775)	(325,055)
Proceeds from redemption of debt securities	527,316	285,187
Net cash inflow/(outflow) from investing activities	**88,042**	**(29,591)**
Cash flows from financing activities		
Dividends paid	–	(2,978)
Net cash used in financing activities	**–**	**(2,978)**
Net increase in cash and cash equivalents	172,346	58,037
Cash and cash equivalents at 1 January	372,166	459,498
Cash and cash equivalents at 30 June	**544,512**	**517,535**

The notes on pages 10 to 25 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 2019 statutory accounts as amended by standards and interpretations effective during 2020 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 13 July 2020 and are unaudited. The interim financial statements will be available on the Group website (www.arbuthnotgroup.com) from 14 July 2020.

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. A detailed description of the risk management framework and associated policies is set out in note 4.

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

Macroeconomic and competitive environment

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

Coronavirus

The COVID-19 pandemic has had and continues to have a significant impact on businesses and the economic environment they operate in both in the UK and around the world. There have been significant restrictions on the movement of the UK population, which has had a severe impact on the economic activity. The UK government and Bank of England have provided unprecedented support through schemes such as the Job Retention Scheme ("JRS"), Coronavirus Business Interruption Loan Scheme ("CBILs") and Bounce Back Loan Scheme ("BBLs").

As the levels of the COVID-19 have receded, the UK government have reduced the severity of the restrictions and started to reopen the economy. The overall impact to the economy and length of the economic downturn remains uncertain, whilst the virus has receded in the UK the risk of further spikes and a potential second wave remains.

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

a) Increased credit risk as borrowers are unable to continue to meet their interest obligations as they fall due. It is also currently unclear precisely how the Government's announced package of measures will interact with this clear risk. The mortgage payment holiday for three months, which was subsequently extended by a further three months for retail mortgage customers, will allow borrowers some grace to return to normal payments. Additionally, the introduction of CBILs and BBLs, which include Government guarantees, provide additional support to customers which may potentially reduce some of this risk to the Group.

b) The uncertainty in the economy could result in a significant fall in the collateral values of our security held against the loans. The Royal Institute of Charter Surveyors ("RICS") has issued a statement suggesting that any valuations they may produce in the current environment would be subject to a warning that the values vary significantly. However, the average loan to value of our property backed lending book is 53.5%, so to have any material impact, this fall in collateral values would have to be severe and prolonged.

c) A prolonged reduction in business activity will affect our ability to generate new business opportunities and it is highly likely that repayments in our current lending portfolios will be greater than new originations, which could lead to an overall fall in the Group's customer lending balances and the associated revenue that this generates.

d) The economic shock could also lead to a fall in valuations in the Groups investment properties and those properties held in inventory.

e) As the revenues earned by the Group's Investment Management business are directly linked to the balances managed on behalf of our customers, any reduction in these values due to market movements will have a corresponding impact on these revenues.

Notes to the Consolidated Financial Statements *continued*

2. Risks and uncertainties (continued)

Brexit

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

Strategic risk

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

Credit risk

Credit risk is the risk that a counterparty (borrower) will be unable to pay amounts in full when due. This risk exists in Arbuthnot Latham, which currently has a loan book of £1,620m (H1 2019: £1,275m). The lending portfolio in AL is extended to clients, the majority of which is secured against cash, property or other quality assets. Credit risk is managed through the Credit Committee of AL.

Market risk

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

The Group is exposed to changes in the market value of properties. The current carrying value of Investment Property is £6.8m (H1 2019: £69.4m; 31 December 2019: £6.8m) and properties classified as inventory are carried at £76.9m (H1 2019: £4.1m; 31 December 2019: £75.2m). Any changes in the market value of the property will be accounted for in the Income Statement for the Investment Property and could also impact the carrying value of inventory, which is at the lower of cost and net realisable value. As a result, it could have a significant impact on the profit or loss of the Group.

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

Liquidity risk

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

Operational risk

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

Cyber risk

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

Notes to the Consolidated Financial Statements *continued*

2. Risks and uncertainties (continued)

Conduct risk

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

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

Regulatory risk

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

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.

3. 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. For a full list of critical accounting estimates and judgements, please refer back to the Annual Report and Accounts for 2019. Assumptions surrounding credit losses are discussed in more detail below, while other critical accounting estimates and judgements have remained unchanged from what was previously reported.

Estimation uncertainty - Expected credit losses ("ECL") on financial assets

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

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

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

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

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

Notes to the Consolidated Financial Statements *continued*

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

If time to collect increased by six months across all client exposures, this would lead to a negative £0.5m (H1 2019: negative £0.4m) impact through the Profit or Loss. A six month reduction in time to collect would lead to a £0.4m favourable (H1 2019: £0.3m favourable) impact on Profit or Loss.

If the collateral valuations increased by 10% across client exposures, this would lead to a positive £1.5m (H1 2019: positive £1.6m) impact through Profit or Loss. If the collateral valuations decreased by 10% across all Stage 3 client exposures, this would lead to a £2.2m adverse (H1 2019: £2m adverse) impact on Profit or Loss.

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

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

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

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

The table below therefore reflects the expected changes in collateral/property prices in each of the macroeconomic scenarios and the probability weighting applied for each scenario:

		Change in property prices		
Economic Scenarios	Probability weighting June 2020	London	Rest of UK	Overseas
Severe decline	2.0%	(40.0%)	(40.0%)	(40.0%)
Moderate decline	20.0%	(20.0%)	(20.0%)	(20.0%)
Decline	70.0%	(5.0%)	(5.0%)	(5.0%)
No Change	4.0%	-	-	-
Growth	4.0%	0.5%	0.5%	0.5%

Due to the COVID-19 outbreak the probability weighting of the economic scenarios have changed from what was reported at year-end. In a Decline scenario the drop in property prices were also increased to 5%. The table below reflects the macroeconomic scenarios as applied at 30 June 2019 and 31 December 2019:

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

The above tables reflect the 5 year average expected change in collateral values/property prices in each economic scenario, which were applied over the full term the Group is exposed to credit risk (also an average of 5 years). The expected change in property prices under each scenario, were weighted according to the probability of each scenario, to arrive at a probability weighted change

Notes to the Consolidated Financial Statements *continued*

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

in property prices. These adjusted property values are then used to assess the future expected cash flows, which are considered along with the loan exposures at default to calculate the expected credit loss. No other long term averages are used in the calculation of ECL, as the above changes are in effect modelled over the full term of the Group's exposure to credit risk.

The table below provides a breakdown of the loan impairment on a pre and post COVID-19 adjusted basis:

Drivers of loan impairment charge	£000
Impairment charge generated using scenarios before COVID-19	5,214
Impact of COVID-19 scenario and weights	1,012
Total loan impairment	**6,226**

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

Impact of economic scenarios at 100% probability weighting	Jun 2020 £000	Jun 2019 £000	Dec 2019 £000
Severe decline	(31,790)	(12,366)	(30,442)
Moderate decline	(3,099)	(4,617)	(7,390)
Decline	658	117	(18)
No change	1,282	356	412
Growth	1,391	918	638

4. Financial risk management

Strategy

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

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

Credit risk

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

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

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

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

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

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

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

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

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

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

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

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

Group Credit risk exposures (all stage 1, unless otherwise stated)	30 June 2020 Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
On–balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	434,587	434,587
Loans and advances to banks	–	–	–	–	–	–	109,751	109,751
Debt securities at amortised cost	–	–	–	–	–	–	359,042	359,042
Derivative financial instruments	–	–	–	–	–	–	1,749	1,749
Loans and advances to customers	591,793	561,759	291,958	100,693	65,528	8,531	–	1,620,262
Stage 1 - Gross amount outstanding	529,247	525,628	279,963	98,475	65,559	8,554	–	1,507,426
Stage 1 - Allowance for impairment	(288)	(236)	–	(285)	(31)	(23)	–	(863)
Stage 2 - Gross amount outstanding	38,094	25,000	6,314	792	–	–	–	70,200
Stage 2 - Allowance for impairment	(24)	–	–	(1)	–	–	–	(25)
Stage 3 - Gross amount outstanding	28,063	12,960	5,681	2,158	–	–	–	48,862
Stage 3 - Allowance for impairment	(3,299)	(1,593)	–	(446)	–	–	–	(5,338)
Other assets	–	–	–	–	–	–	4,837	4,837
Financial investments	–	–	–	–	–	–	15,310	15,310
Off–balance sheet:								
Guarantees	2,610	3,791	–	–	–	–	–	6,401
Loan commitments	54,032	75,926	–	–	97,238	1,136	–	228,332
At 30 June 2020	**648,435**	**641,476**	**291,958**	**100,693**	**162,766**	**9,667**	**925,276**	**2,780,271**

Group Credit risk exposures (all stage 1, unless otherwise stated)	30 June 2019 Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
On–balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	431,619	431,619
Loans and advances to banks	–	–	–	–	–	–	85,775	85,775
Debt securities at amortised cost	–	–	–	–	–	–	383,459	383,459
Derivative financial instruments	–	–	–	–	–	–	1,354	1,354
Loans and advances to customers	579,586	478,902	61,267	97,663	57,655	228	71	1,275,372
Stage 1 - Gross amount outstanding	513,879	465,202	61,267	95,730	57,772	228	71	1,194,149
Stage 1 - Allowance for impairment	(807)	(817)	–	(122)	(117)	–	–	(1,863)
Stage 2 - Gross amount outstanding	40,543	9,931	–	1,055	–	–	–	51,529
Stage 2 - Allowance for impairment	(98)	(7)	–	–	–	–	–	(105)
Stage 3 - Gross amount outstanding	30,801	5,420	–	1,138	–	–	–	37,359
Stage 3 - Allowance for impairment	(4,732)	(827)	–	(138)	–	–	–	(5,697)
Other assets	–	–	–	–	–	–	3,365	3,365
Financial investments	–	–	–	–	–	–	27,467	27,467
Off–balance sheet:								
Guarantees	2,557	3,591	–	–	–	–	–	6,148
Loan commitments	84,700	93,091	–	–	36,778	–	–	214,569
At 30 June 2019	**666,843**	**575,584**	**61,267**	**97,663**	**94,433**	**228**	**933,110**	**2,429,128**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

Group Credit risk exposures (all stage 1, unless otherwise stated)	31 December 2019 Private Banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Total £000
On–balance sheet:								
Cash and balances at central banks	–	–	–	–	–	–	325,800	325,800
Loans and advances to banks	–	–	–	–	–	–	46,258	46,258
Debt securities at amortised cost	–	–	–	–	–	–	442,960	442,960
Derivative financial instruments	–	–	–	–	–	–	1,804	1,804
Loans and advances to customers	579,267	527,620	306,044	102,888	75,871	7,352	11	1,599,053
Stage 1 - Gross amount outstanding	509,865	505,692	306,044	101,144	75,911	7,356	11	1,506,023
Stage 1 - Allowance for impairment	(145)	(174)	–	(163)	(40)	(4)	–	(526)
Stage 2 - Gross amount outstanding	43,525	22,090	–	756	–	–	–	66,371
Stage 2 - Allowance for impairment	(34)	(11)	–	(1)	–	–	–	(46)
Stage 3 - Gross amount outstanding	29,549	375	–	1,523	–	–	–	31,447
Stage 3 - Allowance for impairment	(3,493)	(352)	–	(371)	–	–	–	(4,216)
Other assets	–	–	–	–	–	–	4,625	4,625
Financial investments	–	–	–	–	–	–	30,919	30,919
Off–balance sheet:								
Guarantees	2,610	3,791	–	–	–	–	–	6,401
Loan commitments	88,226	47,372	–	–	53,494	972	–	190,064
At 31 December 2019	**670,103**	**578,783**	**306,044**	**102,888**	**129,365**	**8,324**	**852,377**	**2,647,884**

Market risk

(a) Properties

The COVID-19 situation and changing market conditions are monitored closely. As at 30 June 2020, the Group has not recorded any change in the assumptions and carrying values of the properties held by the Group as Investment Property and Inventory. Refurbishment work on the King Street property was started in H1 2020 with costs capitalised as part of the carrying value.

(b) Financial investments

Financial investments mainly consist out of a 9.85% interest in STB. The carrying value is adjusted to market value at each balance sheet date, according to the share price of STB and any gains or losses that arise are recorded in Other Comprehensive Income. Due to current market conditions, the value of this investment reduced to £13.2m compared to £29.1m as at the end of December 2019.

Liquidity risk

During these uncertain times, the Group has managed to increase customer deposits by £54m since year-end. Liquidity buffers have been maintained in excess of minimum requirements throughout the period, with the actual Liquidity Coverage Ratio (“LCR”) at 222% (31 December 2019: 269%) significantly exceeding the regulatory minimum of 100%.

Capital management

During the period all regulated entities have complied with all of the externally imposed capital requirements to which they are subject. The reduction in regulatory capital resources from the fall in value of financial investments as highlighted above, were largely offset by the previous deduction for non-significant investments. The capital position of the Group therefore remains strong. During the period, the Bank of England also announced the reduction of the Countercyclical Capital Buffer to 0%. The Total Capital Requirement Ratio (“TCR”) is unchanged from 2019 year-end at 9.12%, while the CET1 capital ratio is 13.9% (31 December 2019: 14.4%) and the total capital ratio is 17% (31 December 2019: 17.3%).

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

Valuation of financial instruments

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

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

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

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

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

At 30 June 2020	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	1,749	–	1,749
Financial investments	13,178	–	2,132	15,310
Investment properties	–	–	6,763	6,763
	13,178	**1,749**	**8,895**	**23,822**
LIABILITIES				
Derivative financial instruments	–	634	–	634
Other liabilities (contingent consideration)	–	–	854	854
	–	**634**	**854**	**1,488**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

At 30 June 2019	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Derivative financial instruments	–	1,452	–	1,452
Financial investments	25,928	–	1,539	27,467
Investment properties	–	–	69,446	69,446
	25,928	**1,452**	**70,985**	**98,365**
LIABILITIES				
Derivative financial instruments	–	174	–	174
Other liabilities (contingent consideration)	–	–	1,528	1,528
	–	**174**	**1,528**	**1,702**

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

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

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

Movement in level 3	At 30 June 2020 £000	At 30 June 2019 £000	At 31 December 2019 £000
At 1 January	8,566	68,209	68,209
Acquisitions	225	2,494	3,083
Disposals	–	–	(63,219)
Movements recognised in Other Comprehensive Income	106	281	502
Movements recognised in the Income Statement	(2)	1	(10)
At 30 June / 31 December	**8,895**	**70,985**	**8,565**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

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

At 30 June 2020	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	434,761	–	434,761
Loans and advances to banks	–	109,743	–	109,743
Debt securities at amortised cost	–	359,042	24,267	383,309
Loans and advances to customers	–	1,317,606	302,656	1,620,262
Other assets	–	–	5,225	5,225
	–	**2,221,152**	**332,148**	**2,553,300**
LIABILITIES				
Deposits from banks	–	230,638	–	230,638
Deposits from customers	–	2,206,515	–	2,206,515
Other liabilities	–	–	8,993	8,993
Debt securities in issue	–	–	62,067	62,067
	–	**2,437,153**	**71,060**	**2,508,213**

At 30 June 2019	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
ASSETS				
Cash and balances at central banks	–	431,760	–	431,760
Loans and advances to banks	–	85,767	–	85,767
Debt securities at amortised cost	–	383,459	–	383,459
Loans and advances to customers	–	1,147,685	127,687	1,275,372
Other assets	–	–	3,365	3,365
	–	**2,048,671**	**131,052**	**2,179,723**
LIABILITIES				
Deposits from banks	–	236,204	–	236,204
Deposits from customers	–	1,829,227	–	1,829,227
Other liabilities	–	–	3,341	3,341
Debt securities in issue	–	–	37,651	37,651
	–	**2,065,431**	**40,992**	**2,106,423**

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

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

All above assets and liabilities are carried at amortised cost. Therefore for these assets, the fair value hierarchy noted above relates to the disclosure in this note only.

Cash and balances at central banks
The fair value of cash and balances at central banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

At the end of each year, the fair value of cash and balances at central banks was calculated to be equivalent to their carrying value.

Loans and advances to banks
The fair value of loans and advances to banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

Loans and advances to customers
The fair value of loans and advances to customers was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date, and the same assumptions regarding the risk of default were applied as those used to derive the carrying value.

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends and expected future cash flows.

For the acquired loan book, the discount on acquisition is used to determine the fair value in addition to the expected credit losses and expected future cash flows.

Debt securities
The fair value of debt securities is based on the quoted mid-market share price.

Derivatives
Where derivatives are traded on an exchange, the fair value is based on prices from the exchange.

Deposits from banks
The fair value of amounts due to banks was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date.

Notes to the Consolidated Financial Statements *continued*

4. Financial risk management (continued)

At the end of each year, the fair value of amounts due to banks was calculated to be equivalent to their carrying value due to the short maturity term of the amounts due.

Deposits from customers

The fair value of deposits from customers was calculated based upon the present value of the expected future principal and interest cash flows. The rate used to discount the cash flows was the market rate of interest at the balance sheet date for the notice deposits and deposit bonds. The fair value of instant access deposits is equal to book value as they are repayable on demand.

Financial liabilities

The fair value of other financial liabilities was calculated based upon the present value of the expected future principal cash flows.

At the end of each year, the fair value of other financial liabilities was calculated to be equivalent to their carrying value due to their short maturity. The other financial liabilities include all other liabilities other than non-interest accruals.

Subordinated liabilities

The fair value of subordinated liabilities was calculated based upon the present value of the expected future principal cash flows.

5. Operating segments

The Group is organised into eight operating segments as disclosed below:

1) Private Banking – Provides traditional private banking services as well as offering financial planning and investment management services. This segment includes Dubai.

2) Commercial Banking – Provides bespoke commercial banking services and tailored secured lending against property investments and other assets.

3) Mortgage Portfolios – Acquired mortgage portfolios.

4) RAF – Specialist asset finance lender mainly in high value cars but also business assets.

5) ACABL – Provides finance secured on either invoices, assets or stock of the borrower.

6) ASFL – Provides short term secured lending solutions to professional and entrepreneurial property investors.

7) All Other Divisions – All other smaller divisions and central costs in Arbuthnot Latham & Co., Ltd (Investment property and Central costs).

8) Group Centre – ABG Group management.

During 2019 the Group changed the way indirect costs are allocated to divisions. Treasury income and expenditure and the cost relating to certain support departments are no longer allocated out to divisions. This is in accordance with how the divisions are managed internally. The Mortgage Portfolios were previously included as part of Private Banking. ACABL and ASFL are now also reported separately (previously included in All Other Divisions). The comparative numbers for the divisions have been restated to reflect the new allocation method.

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

Notes to the Consolidated Financial Statements *continued*

5. Operating segments (continued)

Six months ended 30 June 2020	Private banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Group Centre £000	Total £000
Interest revenue	11,245	11,668	5,434	5,058	2,014	393	3,233	27	**39,072**
Inter-segment revenue	–	–	–	–	–	–	–	(27)	**(27)**
Interest revenue from external customers	11,245	11,668	5,434	5,058	2,014	393	3,233	–	**39,045**
Fee and commission income	4,996	613	–	87	1,043	1	253	–	**6,993**
Revenue from external customers	**16,241**	**12,281**	**5,434**	**5,145**	**3,057**	**394**	**3,486**	**–**	**46,038**
Interest expense	(1,077)	(1,319)	(2,213)	(1,410)	(859)	(128)	(1,009)	271	**(7,744)**
Add back inter–segment revenue	–	–	–	–	–	–	–	27	**27**
Subordinated loan note interest	–							(1,620)	**(1,620)**
Fee and commission expense	(62)	(74)	–	(1)	(9)	–	(1)	–	**(147)**
Segment operating income	15,102	10,888	3,221	3,734	2,189	266	2,476	(1,322)	**36,554**
Impairment losses	(1,028)	(59)	–	(603)	9	(20)	–	–	**(1,701)**
Other income	–	–	–	–	–	–	840	(420)	**420**
Operating expenses	(16,330)	(8,374)	(838)	(2,171)	(1,524)	(760)	(2,039)	(3,036)	**(35,072)**
Segment (loss) / profit before tax	(2,256)	2,455	2,383	960	674	(514)	1,277	(4,778)	**201**
Income tax (expense) / income	–	–	–	(206)	–	–	–	136	**(70)**
Segment profit / (loss) after tax	**(2,256)**	**2,455**	**2,383**	**754**	**674**	**(514)**	**1,277**	**(4,642)**	**131**
Loans and advances to customers	563,821	551,998	300,846	101,425	66,504	8,654	38,514	(11,500)	**1,620,262**
Other assets	–	–	–	–	–	–	1,065,434	9,652	**1,075,086**
Segment total assets	**563,821**	**551,998**	**300,846**	**101,425**	**66,504**	**8,654**	**1,103,948**	**(1,848)**	**2,695,348**
Customer deposits	1,049,246	906,907	–	–	–	–	276,826	(26,464)	**2,206,515**
Other liabilities	–	–	–	–	–	–	281,850	14,454	**296,304**
Segment total liabilities	**1,049,246**	**906,907**	**–**	**–**	**–**	**–**	**558,676**	**(12,010)**	**2,502,819**
Other segment items:									
Capital expenditure	–	–	–	–	(363)	–	(4,354)	–	**(4,717)**
Depreciation and amortisation	–	–	–	(5)	(11)	(6)	(880)	(13)	**(915)**

The "Group Centre" segment above includes the parent entity and all intercompany eliminations.

Notes to the Consolidated Financial Statements *continued*

5. Operating segments (continued)

Six months ended 30 June 2019	Private banking £000	Commercial Banking £000	Mortgage Portfolios £000	RAF £000	ACABL £000	ASFL £000	All Other Divisions £000	Group Centre £000	Total £000
Interest revenue	12,818	10,977	1,269	4,562	1,122	4	2,222	33	**33,007**
Inter–segment revenue	–	–	–	–	–	–	–	(138)	**(138)**
Interest revenue from external customers	12,818	10,977	1,269	4,562	1,122	4	2,222	(105)	**32,869**
Fee and commission income	5,385	540	–	106	511	–	393	–	**6,935**
Revenue from external customers	**18,203**	**11,517**	**1,269**	**4,668**	**1,633**	**4**	**2,615**	**(105)**	**39,804**
Interest expense	(1,019)	(1,280)	(500)	(1,312)	(548)	(7)	872	(85)	**(3,879)**
Add back inter-segment revenue	–	–	–	–	–	–	–	138	**138**
Subordinated loan note interest	–	–	–	–	–	–	–	(360)	**(360)**
Fee and commission expense	(28)	(34)	–	(12)	(5)	–	(1)	–	**(80)**
Segment operating income	17,156	10,203	769	3,344	1,080	(3)	3,486	(412)	**35,623**
Impairment losses	(824)	(225)	–	(202)	(66)	–	–	–	**(1,317)**
Other income	–	–	–	–	–	–	1,872	512	**2,384**
Operating expenses	(15,523)	(6,763)	(110)	(2,281)	(1,161)	(521)	(3,545)	(3,897)	**(33,801)**
Segment profit / (loss) before tax	809	3,215	659	861	(147)	(524)	1,813	(3,797)	**2,889**
Income tax expense	–	–	–	(188)	–	–	–	(225)	**(413)**
Segment profit / (loss) after tax	**809**	**3,215**	**659**	**673**	**(147)**	**(524)**	**1,813**	**(4,022)**	**2,476**
Loans and advances to customers	554,874	467,229	65,610	97,923	58,304	231	42,701	(11,500)	**1,275,372**
Other assets	–	–	–	–	–	–	1,046,850	20,516	**1,067,366**
Segment total assets	**554,874**	**467,229**	**65,610**	**97,923**	**58,304**	**231**	**1,089,551**	**9,016**	**2,342,738**
Customer deposits	1,042,634	668,792	–	–	–	–	142,253	(24,452)	**1,829,227**
Other liabilities	–	–	–	–	–	–	300,587	9,103	**309,690**
Segment total liabilities	**1,042,634**	**668,792**	**–**	**–**	**–**	**–**	**442,840**	**(15,349)**	**2,138,917**
Other segment items:									
Capital expenditure	–	–	–	(5)	–	(140)	(4,780)	–	**(4,925)**
Depreciation and amortisation	–	–	–	(6)	(11)	(12)	(1,558)	(13)	**(1,600)**

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

Prior year numbers have been represented according to the 2019 operating segments reported to management. The UK private bank has a branch in Dubai, which generated £2m (H1 2019: £2.1m) of income and had direct operating costs of £1.2m (H1 2019: £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.

Notes to the Consolidated Financial Statements *continued*

6. Other income

Other income mainly includes rental income received from the investment properties of £0.4m (2019: £1.3m) and £nil dividend income received from STB (2019: £1m).

7. 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 14,926,992 (2019: 14,889,048) in issue during the period. On 17 May 2019, the Company issued 152,621 Ordinary Non-Voting shares.

Diluted

Diluted earnings per ordinary share are calculated by dividing the dilutive profit after tax attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the 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 (2019: nil).

Profit attributable	Six months ended 30 June 2020 £000	Six months ended 30 June 2019 £000
Total profit after tax attributable to equity holders of the Company	131	2,476

Basic earnings per share	Six months ended 30 June 2020 p	Six months ended 30 June 2019 p
Total Basic Earnings per share	0.9	16.6

8. Other assets

During the second half of 2019, two properties with a value of £63.2m were reclassified from investment property to inventory (disclosed as part of other assets), while a further property valued at £7.9m was repossessed and classified as inventory. This is disclosed in note 24 of the 2019 Annual Report and Accounts.

9. Events after the balance sheet date

There were no material post balance sheet events to report.

Corporate Contacts and Advisers

Group Address and Registered Office

Arbuthnot Banking Group PLC
Arbuthnot House
7 Wilson Street
London EC2M 2SN
T 020 7012 2400
E info@arbuthnotgroup.co.uk
www.arbuthnotgroup.com

Corporate Contacts

London
Arbuthnot Latham & Co., Limited
Arbuthnot House
7 Wilson Street
London EC2M 2SN
T 020 7012 2500
F 020 7012 2501
E banking@arbuthnot.co.uk
www.arbuthnotlatham.co.uk

Bristol
St Brandon's House
27-29 Great George Street
Bristol BS1 5QT
T 01392 496061

Exeter
The Senate
Ground Floor
Southernhay Gardens
Exeter
Devon EX1 1UG
T 01392 496061
F 01392 413638

Manchester
8th Floor
82 King Street
Manchester M2 4WQ
T 0161 413 0030

International
Dubai branch
PO Box 482007
Gate Precinct 4
Level 3
Office 308
Dubai International Financial Centre
Dubai
T +971 (4) 3770900

Renaissance Asset Finance Limited
RFC House
137 High Street
Brentwood
Essex CM14 4RZ
T 01277 215355
F 01277 203350
E info@renaissanceaf.com
www.renaissanceaf.com

Arbuthnot Commercial Asset Based Lending Limited
The Beehive
City Place
Gatwick RH6 0PA
E ABL@arbuthnot.co.uk

Arbuthnot Specialist Finance Limited
Manchester
8th Floor
82 King Street
Manchester M2 4WQ
T 0161 413 0030
E ASFLenquiries@arbuthnot.co.uk

Advisers

Auditor
Mazars LLP

Principal Bankers
Barclays Bank PLC
Lloyds Bank PLC

Joint Stockbroker
Numis Securities Limited
Shore Capital Stockbrokers Limited

Nominated Adviser and AQSE Corporate Adviser
Grant Thornton UK LLP

Registrars
Link Asset Services
The Registry
34 Beckenham Road
Beckenham, Kent BR3 4TU

Arbuthnot Banking Group PLC
Arbuthnot House
7 Wilson Street
London EC2M 2SN

T 020 7012 2400
E info@arbuthnotgroup.co.uk

www.arbuthnotgroup.com

Registration No. 1954085