ARBUTHNOT LATHAM
Private Bankers
Since 1833

Arbuthnot Latham & Co., Limited

Report and financial statements
for the year ended 31 December 2016

Registered Number 00819519

Contents

Company Information

Directors

Sir Henry Angest (Chairman)

Ian A Henderson (Chief Executive)

James R Cobb (Non-executive Director)

James W Fleming (Vice Chairman)

Stephen P Kelly (Finance Director)

Angela A Knight (Independent Non-executive Director)

Paul Marrow (Independent Non-executive Director)

Sir Michael C G Peat (Independent Non-executive Director)

Andrew A Salmon (Non-executive Director)

Secretary

Nicole Smith

Registered office

Arbuthnot House
7 Wilson Street
London
EC2M 2SN

Registered Number

00819519

Auditor

KPMG LLP
15 Canada Square
London
E14 5GL

Incorporated in the United Kingdom

Arbuthnot Latham & Co., Limited

Strategic Review

Business review

Arbuthnot Latham & Co., Limited's principal business is private and commercial banking. The Bank's strategy is to continue to build the existing business, and also to diversify into other areas of financial services. During 2016 the Bank took significant steps to develop its commercial banking proposition, and has further accelerated its diversification and growth with finalising terms of three transactions. These include an agreement to acquire Renaissance Asset Finance Limited which should complete in the first half of 2017 subject to regulatory approvals; the purchase of an investment property for £53m in the heart of the West End of London; and the purchase of a private banking loan portfolio from Duncan Lawrie Limited.

To facilitate the Bank's growth, further support totalling £22m has been received during the year from the parent company, Arbuthnot Banking Group PLC, such that the net assets of the Bank have increased by 55% to close the year at £81m (2015: £52m).

The Executive Team was strengthened during the year, including the appointment of Ian Henderson as the new Chief Executive from April 2016. Experienced staff have been recruited into senior positions across the Bank to supplement the expertise of existing staff. High quality staff continue to be the Bank's biggest asset, and are essential to the continued growth and diversification of the business within the Board's risk appetite.

The Bank's reported profit before tax increased by 66% to £7.5m (2015: £4.5m) and total client balances, comprising loans, deposits and assets under management (AUMs), have grown by 19% to £2.7bn. The underlying profit for the year of £8.8m compares favourably to 2015 (£7.5m), with the combined cost (£1.4m) of the commercial bank start up and the acquisition transactions being covered by the £1.6m gain that the Bank enjoyed following the acquisition of Visa Europe by Visa Inc.

Underlying profits grew to £8.8m (see reconciliation on page 6) (2015: £7.5m) predominately driven by the private banking business. The UK strategy remains focused on key sectors of the wealth market in the UK, with the Bank continuing to recruit experienced bankers and wealth advisers into its London, South West and North West offices. Growth is expected to be maintained into 2017, with the Bank benefiting from the investment in the commercial bank. The client focused approach, underpinning both the private and commercial banking propositions, has enabled a flow of client referrals between the business units and raised the Bank's profile across a wider range of professional introducers.

The private banking Dubai business enjoyed strong growth in 2016 and made a positive contribution of £0.9m in its third full year of operation (2015: £33k). This was slightly ahead of expectations, despite the impact that the prolonged reduction in the value of oil has had on the region. It has introduced £64m of deposits, £74m of loans and £60m of AUMS to the Bank to date.

From a standing start in September 2015 the commercial bank has now recruited 29 staff with plans to expand this to 50 by the end of 2017. The majority of the recruits are experienced bankers, attracted from larger, more well-known, commercial banks. Initially the coverage was aimed at London and the South East but this has now extended to the South West and North West. The commercial bankers are co-located with the private bankers to enable synergies to be captured across the business units. The team in Manchester, together with the private banking team, will move into our new premises in the old Bank of England building at 82 King Street in the first quarter of 2017.

The teams seek to provide a "high touch relationship service" to commercial clients, with sector coverage of media, real estate financing and trading businesses including healthcare, professional practices and other specialist areas. The division has seen its lending balances grow to £76m by the year end with corresponding deposits reaching £51m. The division has a healthy pipeline of approved lending, supporting the view that the proposition is resonating well in its target markets.

The Tay Mortgage portfolio performed better than expected, generating pre-tax profits of £2.0m in the full year (2015: £1.8m), with £85m of loans at the end of 2016. This portfolio of residential mortgage loans was originally acquired from the Administrators of the Dunfermline Building Society in December 2014 at a discounted price of £106m.

In June 2016, the Bank purchased the long leasehold of 20 King Street, a prominent and well known office building in the heart of the West End of London, at a cost of £53m including all of the associated transaction costs. This building is currently fully occupied, but in time it is planned that the Bank will develop a small suite of offices to serve as the Bank's West End office.

In the second half of the year, the Bank was approached by Duncan Lawrie Limited to help it in its plans to close and return its banking licence. They had identified Arbuthnot Latham as a suitable home for its clients on the basis of our high quality service. As part of this process we were able to reach an agreement to purchase the existing loan portfolio for £43m, with certain deferred items to be factored in. This represented a discount of 5% on the par value of the loans, which have now been fully transferred to Arbuthnot Latham. It is also anticipated that further Duncan Lawrie Limited clients will be attracted to the Bank as they wind down their deposit portfolio.

In December 2016, Arbuthnot Latham reached agreement with the shareholders of Renaissance Asset Finance ("RAF") to acquire the company. RAF currently offers financing solutions mainly to high net worth individuals and SMEs seeking to purchase high value motor vehicles and other equipment. This transaction remains subject to certain conditions, the principal one being the regulatory approvals required, and is expected to complete in the first half of 2017. This business will open up new distribution channels to Arbuthnot Latham and could form the base from which the Bank develops further lending products for the asset backed financing markets.

Investment has continued in the Bank's infrastructure in 2016 reflecting the strategic importance of maintaining high levels of client service as the Bank grows and diversifies. The most significant investment was in the Oracle "Flexcube" product which has been purchased to replace the current banking system. This is scheduled to go-live in the first half of 2017 and will offer a robust and scalable platform to support the growth of the Bank for many years to come. Further investment has also been made in the investment management system, central IT operating platforms and finance systems.

The Bank paid a management charge of £1.5m (2015: £1.2m) to its parent company, Arbuthnot Banking Group PLC, for management costs and centrally shared services.

The Bank continues to be run from a strong capital and liquidity base, and the Directors believe it to be well placed to take advantage of future opportunities.

The private and commercial banking loan book grew by 29% to £674m (2015: £524m), as the Bank supported its clients in pursuing their value enhancing and wealth preservation strategies through the use of well-structured lending. The average loan-to-value on property backed lending improved to 45% (2015: 46%). Credit losses continued at less than 0.25% of combined private and commercial loans.

Client deposits grew by 11% to £998m (2015: £896m), reflecting the increase in private and commercial banking clients. The Bank continued to participate in the Bank of England's Funding for Lending Scheme (FLS), with drawings at £52m (2015: £77m). The FLS funding has a duration of four years, and is supported by property backed loan collateral and debt securities. Client loans at 72.3% of the bank's funding base (client deposits and

FLS) were higher than 2015 (63.6%), with the 2015 position reflecting the decision to raise extra deposits ahead of future lending growth.

KEY METRICS	2016 £m	2015 £m	Mvmt £m
Underlying profit	8.8	7.5	1.3
VISA gain	1.6	-	1.6
Commercial banking investment	(1.0)	(0.3)	(0.7)
Acquisition costs	(0.4)	(0.4)	-
Investment in operating systems	-	(1.1)	1.1
AL profit before group charge	9.0	5.7	3.3
ABG group charge	(1.5)	(1.2)	(0.3)
Pre-tax profit for the year	7.5	4.5	3.0
Private & commercial loans	674.0	524.0	150.0
Tay mortgage Portfolio	85.0	95.0	(10.0)
Client loans	759.0	619.0	140.0
Client deposits	998.0	896.0	102.0
FLS funding	52.0	77.0	(25.0)
Intra-group deposits	102.0	30.3	71.7
Treasury assets	339.9	344.7	(4.8)
Total assets	1,199.2	1,004.4	195.0
Assets under management	920.0	739.0	181.0
Tier 1 capital	67.2	43.6	23.6
Total capital	67.2	43.6	23.6
Key Performance Indicators			
Client loans to client deposits and FLS ratio	72.3%	63.6%	8.7%
Losses in year % of year end private & commercial loans	0.1%	0.2%	(0.1)%
Total losses % of year end private & commercial loans	0.1%	0.3%	(0.2)%
Average LTV on property backed loans	45.1%	45.8%	(0.7)%
Tier 1 capital ratio	12.3%	12.2%	0.1%
Total capital ratio	12.3%	12.2%	0.1%

The investment management business grew AUMs by 24% to close the year at £920m (2015: £739m), despite the volatility in all the main investment markets caused by both the Brexit vote and the mining and natural resources sectors reaching their floors. Income from investment management rose by 20% to £6.6m (2015: £5.5m), with wealth planning service income growing to £2.2m (2015: £1.9m). The Bank continued to benefit from its whole-of-market investment management approach and its Chartered Wealth Planning status.

Arbuthnot Latham & Co., Limited

Strategic Review

Overall income grew by 25% to £46.1m in the year (2015: £37.0m), whilst operating expenses increased by 22% to £38.1m (2015: £31.2m). Costs rose year-on-year principally due to the cost of new staff hired over the last two years to support the continued expansion of the private bank and the commercial bank start-up. Premises costs also rose in 2016, reflecting the full year cost of new premises in Exeter and the City of London that were leased from the fourth quarter of 2015.

The Bank continues to apply a prudent approach to liquidity management, underpinning its on-going stability. This however results in the Bank incurring incremental costs to the business as the low rates on surplus funds invested into treasury assets are below the cost of raising new deposits.

The Bank continues to be well capitalised with the Tier 1 and total capital ratios at 12.3% (2015: 12.2%). The parent company, Arbuthnot Banking Group PLC, made tier 1 capital contributions of £22.0m (2015: £6.5m) in the year to support growth.

Principal Risks and Uncertainties

The Bank 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 business are credit, market, liquidity, conduct, operational, cyber and regulatory.

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

Market risk arises in relation to movement in interest rates, currencies and equity markets. The treasury function operates mainly to provide a service to clients and does not take significant unmatched positions in any market for its own account. As a result, the Bank'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.

Liquidity risk is the risk that the Bank cannot meet its obligations as they fall due. The Bank takes a conservative approach to managing its liquidity profile. Arbuthnot Latham is predominantly funded by retail customer deposits and drawings from the Bank of England Funding for Lending Scheme. The loan to deposit ratio is maintained at a prudent level, and as a result the Bank maintains a high level of liquidity.

The Board annually approves the Individual Liquidity Adequacy Assessment Process (ILAAP). The Directors model various stress scenarios and assess the resultant cash flows in order to evaluate the Bank's potential liquidity requirements. The Directors firmly believe that sufficient liquid assets are held to enable the Bank to meet its liabilities in a stressed environment.

Conduct risk for a financial services provider includes 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 Bank adopts a zero tolerance policy regarding 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 maintained. The Bank also has insurance policies in place to cover any claims that may arise.

Operational risk is the risk that the Bank may be exposed to financial losses from conducting its business. The Bank 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 Bank from these risks.

The Bank is exposed to changes in the market value of properties to the extent that it holds Investment Property carried at fair value. The current carrying value of Investment Property is £53.3m. Any changes in the market value of the property will be accounted for in the Income Statement and as such could have a significant impact on the profit of the Bank.

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

Regulatory risk is the risk that the Bank will have insufficient capital resources to support the business or does not comply with regulatory requirements. The Bank 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. The parent company, Arbuthnot Banking Group PLC, also completes an annual consolidated ICAAP incorporating all group companies.

Regulatory change also exists as a risk to the Bank's business. Notwithstanding the assessments carried out by the Bank 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 Bank's competitive situation and lower its profitability.

The Bank 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.

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

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

IA Henderson, Chief Executive
22 March 2017

Arbuthnot Latham & Co., Limited

Directors' Report

The Directors present the annual report and audited financial statements of Arbuthnot Latham & Co., Limited for the year ended 31 December 2016.

Principal Activities

Arbuthnot Latham & Co., Limited is a banking institution which is authorised by the Prudential Regulation Authority (PRA) and authorised and regulated by the Financial Conduct Authority (FCA) and Prudential Regulation Authority. It provides full banking, investment management and wealth planning services. A strategic review in accordance with section 414c of the Companies Act 2006 forming part of this report has been set out on pages 4 to 8.

Financial Results and Dividends

The profits for the year after tax were £7.3m (2015: £4.6m).

Dividends of £nil were paid during the year (2015: £nil).

Going Concern

After making appropriate enquiries which assessed strategy, profitability, funding and capital resources, the Directors are satisfied that the Bank has adequate resources to continue in operation for the foreseeable future. The financial statements are therefore prepared on the going concern basis.

Financial Risk Management

Details of how the Bank manages risk are set out in the Strategic Report and note 4

Directors

The Directors of the Bank during the year were as follows:
Sir Henry Angest
IA Henderson (appointed 14 April 2016)
JR Cobb
IA Dewar (retired 7 November 2016)
JW Fleming
SP Kelly
AA Knight (appointed 6 October 2016)
P Marrow
Sir Michael CG Peat
AA Salmon

Mr JR Cobb retires by rotation and being eligible offers himself for re-election.

Mr IA Henderson and Mrs AA Knight, who were appointed during the year, retire under the Articles of Association and offer themselves for election.

Nicole Smith was appointed as company secretary on 1 January 2017.

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

Branches outside of the UK
During the year the Bank operated a branch in Dubai which is regulated by the Dubai Financial Services Authority.

Political Donations
The Bank made no political donations during the year (2015: £nil).

Events after the balance sheet date
There were no post balance sheet events to report.

Insurance of Directors
The Bank maintains insurance to provide liability cover for directors and officers of the Company.

Auditor
A resolution to re-appoint KPMG LLP as auditor to the Bank will be proposed at the Annual General Meeting, in accordance with section 487 of the Companies Act 2006.

Statement of disclosure of information to auditor
The Directors confirm that;

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

By order of the Board

N. Smith

N Smith
Secretary
22 March 2017
Company Registered Number: 00819519
Registered Office: Arbuthnot House, 7 Wilson Street, London, EC2M 2SN

Statement of Directors' responsibilities in respect of the Strategic report, Directors' report and the financial statements

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU and applicable law.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent Auditor's Report to the Members of Arbuthnot Latham & Co., Limited

We have audited the financial statements of Arbuthnot Latham & Co Ltd for the year ended 31 December 2016 set out on pages 14 to 67. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 11, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and Directors' report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

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

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

Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London E14 5GL
22 March 2017

Arbuthnot Latham & Co., Limited

Statement of comprehensive income

		Year ended 31 December	
		2016	**2015**
	Note	**£000**	**£000**
Interest and similar income		38,245	32,974
Interest expense and similar charges		(7,474)	(7,691)
Net interest income	**6**	**30,771**	**25,283**
Fee and commission income	7	11,430	9,999
Fee and commission expense		(425)	(206)
Net fee and commission income		**11,005**	**9,793**
Operating income		**41,776**	**35,076**
Net impairment losses on financial assets	8	(474)	(1,250)
Profit on disposal of available-for-sale assets		1,665	-
Rental income	22	1,056	-
Other income	9	1,632	1,894
Operating expenses	10	(38,112)	(31,242)
Profit before tax		**7,543**	**4,478**
Income tax (expense)/credit	12	(211)	109
Profit after tax		**7,332**	**4,587**
Profit for the year		**7,332**	**4,587**
Other Comprehensive Income			
Movement in available-for-sale financial assets net of tax		(987)	1,297
Total comprehensive income net of tax for the year		**6,345**	**5,884**

All amounts relate to continuing operations.

The notes on pages 18 to 67 are an integral part of these financial statements

Arbuthnot Latham & Co., Limited

Statement of financial position

	Note	At 31 December 2016 £000	2015 £000
ASSETS			
Cash on hand		100	130
Cash and balances at central banks		195,652	236,684
Loans and advances to banks	13	36,937	24,110
Loans and advances to customers	14	770,299	630,402
Debt securities held-to-maturity	15	107,300	83,931
Financial investments available for sale	16	2,025	2,561
Derivative financial instruments	17	1,516	1,490
Investments in subsidiary undertakings	18	5	-
Investments in associates	19	900	943
Intangible assets	20	12,255	7,621
Property, plant and equipment	21	4,599	5,370
Investment property	22	53,339	-
Other assets	23	12,967	10,122
Deferred tax asset	24	1,268	1,085
Total assets		**1,199,162**	**1,004,449**
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the Bank			
Share capital	29	15,000	15,000
Other reserves	30	41,060	20,047
Retained earnings	30	24,638	17,306
Total equity		**80,698**	**52,353**
LIABILITIES			
Deposits from banks	25	3,200	25,649
Derivative financial instruments	17	227	135
Deposits from customers	26	1,099,744	921,685
Other liabilities	27	15,146	4,556
Current tax liability		147	71
Total liabilities		**1,118,464**	**952,096**
Total equity and liabilities		**1,199,162**	**1,004,449**

The notes on pages 18 to 67 are an integral part of these financial statements

Company Registered Number 00819519

The financial statements on pages 14 to 67 were approved by the Board of directors on 22 March 2017 and were signed on their behalf by:

Ian Henderson

IA Henderson, Director

Stephen Kelly

SP Kelly, Director

Arbuthnot Latham & Co., Limited

Statement of changes in equity

	Note	Share capital £000	Retained earnings £000	Capital Contribution £000	Available for sale reserve £000	Total £000
At 1 January 2016		15,000	17,306	19,000	1,047	**52,353**
Net profit for the year		-	7,332	-	-	**7,332**
Net movement on available-for-sale financial assets		-	-	-	(987)	**(987)**
Total comprehensive income for year		-	7,332	-	(987)	**6,345**
Capital contribution	30	-	-	22,000	-	**22,000**
Total contributions by & distributions to owners	**30**	**-**	**-**	**22,000**	**-**	**22,000**
At 31 December 2016		**15,000**	**24,638**	**41,000**	**60**	**80,698**
At 1 January 2015		15,000	12,719	12,500	(250)	**39,969**
Net profit for the year		-	4,587	-	-	**4,587**
Net movement on available-for-sale financial assets		-	-	-	1,297	**1,297**
Total comprehensive income for year		-	4,587	-	1,297	**5,884**
Capital contribution	30	-	-	6,500	-	**6,500**
Total contributions by & distributions to owners	**30**	**-**	**-**	**6,500**	**-**	**6,500**
At 31 December 2015		**15,000**	**17,306**	**19,000**	**1,047**	**52,353**

The notes on pages 18 to 67 are an integral part of these financial statements

Arbuthnot Latham & Co., Limited

Statement of cash flows

	Note	Year ended 31 December 2016 £000	2015 £000
Cash flows from operating activities			
Interest and similar income received		34,446	27,551
Interest and similar charges paid		(7,188)	(7,139)
Fees and commissions received		13,156	12,341
Disposal of available-for-sale asset		1,078	-
Other income		5,384	2,929
Cash payments to employees and suppliers		(37,597)	(31,275)
Taxation paid		(71)	-
Cash flows from operating profits before changes in operating assets and liabilities		9,208	4,407
Changes in operating assets and liabilities:			
- net increase in loans and advances to customers		(141,381)	(80,078)
- net (increase) / decrease in other assets		(3,362)	568
- net (decrease) in deposits from other banks		(22,107)	(6,413)
- net increase in amounts due to customers		177,381	302,847
- net increase in other liabilities		12,238	1,659
Net cash inflow from operating activities		31,977	222,990
Cash flows from investing activities			
Purchase of investment property		(53,339)	-
Purchase of computer software		(5,155)	(1,171)
Purchase of property, plant and equipment		(349)	(1,969)
Purchase of debt securities held to maturity		(89,384)	(119,359)
Proceeds from sale of debt securities held to maturity		66,015	111,635
Net cash from investing activities		(82,212)	(10,864)
Cash flows from financing activities			
Repayment of debt securities in issue		-	(4,500)
Capital contribution		22,000	6,500
Net cash used in financing activities		22,000	2,000
Net (decrease) / increase in cash and cash equivalents		**(28,235)**	**214,126**
Cash and cash equivalents at beginning of year		260,924	46,798
Cash and cash equivalents at end of year	**32**	**232,689**	**260,924**

The notes on pages 18 to 67 are an integral part of these financial statements

Arbuthnot Latham & Co., Limited

Notes to the financial statements

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements were authorised for issue by the Board of directors on 22 March 2017.

1.1 Reporting entity

Arbuthnot Latham & Co., Limited (the Bank) is a company domiciled in the United Kingdom. The registered address of Arbuthnot Latham & Co., Limited is Arbuthnot House, 7 Wilson Street, London, EC2M 2SN. The Bank is primarily involved in banking and financial services.

1.2 Basis of presentation

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs as adopted and endorsed by the EU) and the Companies Act 2006 applicable to companies reporting under IFRS. They have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, and financial assets and financial liabilities at fair value through profit or loss.

The financial statements are presented in pounds sterling, which is the Bank's functional and presentational currency.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Notes 2 and 4.

The financial statements have been prepared on a going concern basis.

Accounting developments

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

1.3 Foreign currency transactions

Foreign currency transactions are translated into the functional currency using the spot exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Income Statement. Foreign exchange differences arising from translation of available-for-sale equity instruments are recognised in the Statement of Other Comprehensive Income.

1.4 Interest income and expense

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

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank takes into account all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

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

1.5 Fee and commission income

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

Asset and other management, advisory and service fees are recognised on an accruals basis as the related services are performed.

1.6 Rental income

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

1.7 Financial assets and financial liabilities

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

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

Financial assets and liabilities valued at fair value through profit or loss are financial derivatives. These are recognised on the date on which the Bank becomes a party to the contractual provisions of the instrument.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the receivable. Loans are recognised when cash is advanced to the borrowers. Loans and receivables are carried at amortised cost less impairment using the effective interest rate method.

(c) Held-to-maturity

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

(d) Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. All available-for-sale investments are carried at fair value. Changes in fair value are recognised in Other Comprehensive Income (available-for-sale reserve) until the investment is sold or impaired. Once sold or impaired the cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss.

Other financial liabilities

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

Measurement

a) Amortised cost measurement

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

b) Fair value measurement

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

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

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

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

Derecognition

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

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expired.

1.8 Derivative financial instruments

All derivatives, including embedded derivatives, are recognised at their fair value. Derivatives are shown in the Statement of Financial Position as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are recognised immediately in the Statement of Comprehensive Income. Transaction costs are recognised in the income statement as they occur.

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

1.9 Impairment of financial assets

(a) Assets carried at amortised cost

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

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

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

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Statement of Comprehensive Income. When a loan is assessed to be uncollectible, it is written off against the related provision for loan impairment. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the Statement of Comprehensive Income.

(b) Assets classified as available for sale

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as objective evidence of impairment. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the Statement of Comprehensive Income.

1.10 Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Impairment for goodwill is discussed in more detail under note 1.13(a).

1.11 Funding for Lending Scheme

Under the applicable International Accounting Standard, IAS 39, if a security is lent under an agreement to return it to the transferor, as is the case for eligible securities lent by institutions to the Bank of England under the FLS, then the security is not derecognised because the transferor retains all the risks and rewards of ownership. The UK Treasury Bills borrowed from the Bank of England under the FLS are not recognised on the Statement of Financial Position of the institution until such time as they are subject to a repurchase agreement with a third party, as they will not meet the criteria for derecognition by the Bank of England. When the UK Treasury Bills are pledged as part of a sale and repurchase agreement with a third party, amounts borrowed from the third party are recognised on the Statement of Financial Position.

1.12 Associates

Associates are those entities in which the Bank has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for on the basis of the Bank's direct equity interest and are recognised at cost less impairment.

1.13 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Bank's share of the net identifiable assets of the acquired business. Goodwill on acquisitions of businesses is included in 'intangible assets'. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

The Bank reviews the goodwill for impairment at least annually or more frequently when events or changes in economic circumstances indicate that impairment may have taken place, and carry goodwill at cost less accumulated impairment losses. Assets are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). For impairment testing purposes goodwill cannot be allocated to a CGU that is greater than a reported operating segment. CGUs to which goodwill has been allocated are aggregated so that the level at which impairment is tested reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination. The test for impairment involves comparing the carrying value of goodwill with the present value of pre-tax cash flows, discounted at a rate of interest that reflects the inherent risks of the CGU to which the goodwill relates, or the CGU's fair value if this is higher.

Impairment losses are recognised in profit or loss if the carrying amounts exceed the recoverable amounts.

(b) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives (three to ten years).

Costs associated with maintaining computer software programs are recognised as an expense as incurred.

Costs associated with developing computer software which are not available for use are classified as assets in the course of construction. These are not amortised.

(c) Banking licence fees

Expenditure directly attributable to acquiring licences is recognised as an asset when the Bank can demonstrate that the future economic benefits attributable to the licences will flow to the entity, and the cost of the asset can be measured reliably. These costs are amortised over ten years.

1.14 Property, plant and equipment

Plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, applying the following annual rates, which are subject to regular review:

Leasehold improvements	6 to 20 years
Computer and other equipment	3 to 5 years

Leasehold improvements are depreciated over the term of the lease (until the first break clause). Gains and losses on disposals are determined by deducting proceeds from carrying amount. These are included in the Statement of Comprehensive Income.

1.15 Investment property

Investment property is initially measured at cost and subsequently at fair value, with any change therein recognised in the income statement within other income.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

1.16 Leases

a) As a lessor

Assets leased to customers under agreements which transfer substantially all the risks and rewards of ownership, with or without ultimate legal title, are classified as finance leases. When assets are held subject to finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

Assets leased to customers under agreements which do not transfer substantially all the risks and rewards of ownership are classified as operating leases. When assets are held subject to operating leases, the underlying assets are held at cost less accumulated depreciation, the assets are depreciated down to their estimated residual values on a straight line basis over the lease term. Lease rental income is recognised on a straight line basis over the lease term.

b) As a lessee

Rentals made under operating leases are recognised in the Statement of Comprehensive Income on a straight line basis over the term of the lease.

Leases in which the Bank assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets by way of finance leases are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

1.17 Cash and cash equivalents

For the purposes of the Statement of Cash Flows, cash comprises of cash on hand and demand deposits, and cash equivalents comprise of highly liquid investments that are convertible into cash with an insignificant risk of changes in value with a maturity of three months or less at the date of acquisition, including loans and advances to banks and building societies and short-term highly liquid debt securities.

1.18 Employee benefits

(a) Post-retirement obligations

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

The Bank has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available. There are no post-retirement benefits other than pensions.

(b) Share-based compensation

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

1.19 Taxation

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

Deferred tax is provided in full on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from the initial recognition of goodwill, the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the Statement of Financial Position date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, when they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

1.20 Investments in subsidiaries

Investments in subsidiaries are held at cost less impairment.

1.21 Guarantees and loan commitments

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

1.22 *Forbearance*

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

1.23 Standards, amendments and interpretations to existing standards (applicable to the Bank) that are not yet effective and have not been early adopted by the Bank

The following standards and amendments to existing standards have been published and are mandatory for the Bank's accounting periods beginning on or after 1 January 2017 or later periods, but the Bank has not early adopted them:

- IFRS 15, 'Revenue from contracts with customers' (effective 1 January 2017). This standard establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. This standard is unlikely to have a material impact on the Bank. (This standard has not yet been endorsed by the EU).

- IFRS 9, 'Financial instruments' (effective from 1 January 2018). This standard deals with the classification and measurement of financial assets and will replace IAS 39. The requirements of this standard represent a significant change from the existing requirements in IAS 39. The impairment requirements apply to financial assets measured at amortised cost and FVOCI, loan receivables, certain loan commitments and financial guarantee contracts. At initial recognition, an allowance (or provision in the case of commitments and guarantees) is required for expected credit losses (ECL) resulting from default events that are possible within the next 12 months (12 month ECL). In the event of a significant increase in the credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument (lifetime ECL). Financial assets where 12-month ECL is recognised are considered to be Stage 1; financial assets, which are considered to have experienced a significant increase in credit risk are in Stage 2; and financial assets, which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in Stage 3. Further development phases for IFRS 9 are scheduled to cover key areas such as impairment and hedge accounting. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering the increase in ECL. The potential effect of this standard together with the further development phases are currently being fully evaluated by the Bank. The Bank expects its impairment charge to materially increase.

- IFRS 16, 'Leases' (effective from 1 January 2019). The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract i.e. the customer ('lessee') and the supplier ('lessor'). IFRS 16 replaces the previous leases Standards, IAS 17 Leases, and related Interpretations. IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee. Instead all leases are treated in a similar way to finance leases applying IAS 17. Leases are 'capitalised' by recognising the present value of the lease payments and showing them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, a company also recognises a financial liability representing its obligation to make future lease payments. The most significant effect of the new requirements in IFRS 16 will be an increase in lease assets and financial liabilities. Accordingly, for companies with material off balance sheet leases, there will be a change to key financial metrics derived from the company's assets and liabilities (for example, leverage ratios). At the point in time when this Standard becomes effective, it is expected that assets and liabilities will materially increase.

2. Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. 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.

2.1 Estimation uncertainty

Credit losses

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. The basis for evaluating impairment losses is described in accounting policy 1.9. Financial assets are individually evaluated for impairment with management using their best estimate in calculating the net present value of future cash flows. Management makes judgements on the financial position of the counterparty and the net realisable value of collateral in determining the expected future cash flows.

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

- The property valuation, which is typically updated every 12 months,
- The time taken to realise the sale proceeds (UK property is assumed to take 12 months and Non-UK property 18 months),
- The property marketing costs (UK property is assumed to be at 3% of property value and Non-UK at 7%),
- The legal costs of sale (UK legal sales costs are assumed to be £5k, whilst Non-UK are assumed to be €10k).

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

Taxation

Deferred tax assets on carried forward losses are recognised where it is probable that future taxable profits will be available to utilise it. Where the final tax determination is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax expense in the year in which the determination is made.

Effective interest rate

Acquired loan books are initially recognised at fair value. Subsequently they are measured under the effective interest rate method, based on cash flow models which require significant judgement in assumptions on the interest rates, prepayment rates, the probability and timing of defaults and the amount of incurred losses. Management review the expected cash flows against actual cash flows to ensure future assumptions on customer behaviour and future cash flows remain valid. If the estimates of future cash flows are revised the adjustment to the carrying value of the loan book is recognised in the Statement of Comprehensive Income.

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

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

Investment property

The valuation that the Bank places on its investment property is subject to a degree of uncertainty and is made on the basis of assumptions in relation to prevailing market rents and yields. These assumptions may not prove to be accurate, particularly in periods of market volatility. The main lease on the property expires in 2019; the offices will then be refurbished and re-let at prevailing market rents.

The valuation model considers the net present value of the net cash flows to be generated from the property, taking into account expected rental growth rate, void periods, occupancy rate, lease incentive costs such as rent-free periods and other costs not paid by tenants. The expected net cash flows are discounted using risk-adjusted discount rates. Amongst other factors, the discount rate estimation considers the quality of the building and its location, tenant quality and lease terms. Due to the current sub-market rental achieved and the fact that the future refurbishment works will improve the quality of the building (in a desirable location), it is expected that the risk-adjusted discount rate will decrease. Management estimates are required for significant unobservable inputs used in the discounted cash flow model, which have been assessed as follows:

- Refurbishment period: 6 months
- Void period after refurbishment: 6 months
- Rent free period: 6 months
- Estimated refurbishment costs: £2.4m
- Risk adjusted discount rate 3.75%
- Expected rental uplift following re-let: 22%
- Occupancy rate: 95%

Fair value measurement for investment property is categorised as a Level 3 measurement.

2.2 Judgements

Valuation of financial instruments

The Bank measures the fair value of an instrument using quoted prices in an active market. A market is regarded as active if quoted prices are readily and regularly available, representing actual and regularly occurring market transactions. If a market for a financial instrument is not active, the Bank 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 instance that fair values of assets and liabilities cannot be reliably measured, they are carried at cost.

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements:

- Level 1: Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable 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 tables below analyse financial instruments measured at fair value by the level in the fair value hierarchy into which the measurement is categorised:

At 31 December 2016	Note	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Assets					
Derivative financial instruments	17	-	1,516	-	1,516
Financial investments available for sale	16	13	-	2,012	2,025
		13	**1,516**	**2,012**	**3,541**
Liabilities					
Derivative financial instruments	17	-	227	-	227
		-	**227**	**-**	**227**

At 31 December 2015	Note	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Assets					
Derivative financial instruments	17	-	1,490	-	1,490
Financial investments available for sale	16	13	-	2,548	2,561
		13	**1,490**	**2,548**	**4,051**
Liabilities					
Derivative financial instruments	17	-	135	-	**135**
		-	**135**	**-**	**135**

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

	2016 £000	2015 £000
Movement in level 3		
At January	2,548	1,106
Consideration received	494	-
Disposals	(1,309)	(44)
Gains recognised in other comprehensive income	75	1,559
Foreign exchange movement recognised in the income statement	204	(73)
At December	**2,012**	**2,548**

Visa Inc. investment

On 21 June 2016, Visa Inc. announced that it had completed the acquisition of Visa Europe Limited. This resulted in the gain which the Bank had previously recognised in Other Comprehensive Income being recycled to the Income Statement. As part of the transaction the Bank received preference shares in Visa Inc. These shares have been valued at their future conversion value into Visa Inc. common stock. The valuation includes a 31 % haircut. This comprises a 25% haircut due to a contingent liability disclosed in Visa Europe's accounts in relation to litigation, and a 6% haircut based on a liquidity discount.

Investment in overseas property company

Investment is measured at fair value. The Bank uses a proprietary valuation model which is developed from recognised valuation techniques. Some or all of the significant inputs into these models may not be observable in the market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value.

The Bank has established a valuation methodology for measuring the investment which is categorised as available for sale. Unobservable inputs used include: yield (4.90%) and occupancy rate (95.3%). These inputs are taken from online real estate reports available from BNP Paribas. The inputs are stressed to ensure that the fair value is robust. Significant increases in yield or decreases in annual rental value or occupancy rate would result in lower fair values.

Management analyse and investigate any significant movements to the unobservable inputs which impact the valuation of level 3 instruments.

The tables below analyse financial instruments not measured at fair value by the level in the fair value hierarchy into which the measurement is categorised:

At 31 December 2016	Note	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Assets					
Cash and cash equivalents		-	195,752	-	195,752
Loans and advances to banks	13	-	36,937	-	36,937
Loans and advances to customers	14	-	-	770,299	770,299
Debt securities held-to-maturity	15	-	107,300	-	107,300
		-	**339,989**	**770,299**	**1,110,288**
Liabilities					
Deposits from banks	25	-	3,200	-	3,200
Deposits from customers	26	-	-	1,099,744	1,099,744
		-	**3,200**	**1,099,744**	**1,102,944**

At 31 December 2015	Note	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Assets					
Cash and cash equivalents		-	236,814	-	236,814
Loans and advances to banks	13	-	24,110	-	24,110
Loans and advances to customers	14	-	-	630,402	630,402
Debt securities held-to-maturity	15	-	83,931	-	83,931
		-	**344,855**	**630,402**	**975,257**
Liabilities					
Deposits from banks	25	-	25,649	-	**25,649**
Deposits from customers	26	-	-	921,685	**921,685**
		-	**25,649**	**921,685**	**947,334**

3. Maturity analysis of assets and liabilities

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

At 31 December 2016	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Cash	100	-	100
Cash and balances at central banks	195,652	-	195,652
Loans and advances to banks	36,937	-	36,937
Loans and advances to customers	348,876	421,423	770,299
Debt securities held-to-maturity	82,782	24,518	107,300
Financial investments available for sale	-	2,025	2,025
Derivative financial instruments	85	1,431	1,516
Shares in subsidiary undertakings	-	-	-
Investments in associates	900	-	900
Intangible assets	-	12,255	12,255
Property, plant and equipment	-	4,599	4,599
Investment property	-	53,339	53,339
Other assets	9,369	3,598	12,967
Deferred tax asset	-	1,268	1,268
Total assets	**674,701**	**524,456**	**1,199,157**
LIABILITIES			
Deposits from banks	3,200	-	3,200
Derivative financial instruments	227	-	227
Deposits from customers	1,061,122	38,622	1,099,744
Other liabilities	15,146	-	15,146
Current tax liability	147	-	147
Total liabilities	**1,079,842**	**38,622**	**1,118,464**

3. Maturity analysis of assets and liabilities (continued)

The table below shows the maturity analysis of assets and liabilities as at 31 December 2015

At 31 December 2015	Due within one year £000	Due after more than one year £000	Total £000
ASSETS			
Cash	130	-	130
Cash and balances at central banks	236,684	-	236,684
Loans and advances to banks	24,110	-	24,110
Loans and advances to customers	263,085	367,317	630,402
Debt securities held-to-maturity	52,348	31,583	83,931
Financial investments available for sale	-	2,561	2,561
Derivative financial instruments	59	1,431	1,490
Investment in associate	-	943	943
Intangible assets	-	7,621	7,621
Property, plant and equipment	-	5,370	5,370
Other assets	10,122	-	10,122
Deferred tax asset	-	1,085	1,085
Total assets	**586,538**	**417,911**	**1,004,449**
LIABILITIES			
Deposits from banks	25,649	-	25,649
Derivative financial instruments	135	-	135
Deposits from customers	834,935	86,750	921,685
Other liabilities	4,556	-	4,556
Current tax liability	71	-	71
Total liabilities	**865,346**	**86,750**	**952,096**

4. Financial risk management

Strategy

By their nature, the Bank's activities are principally related to the use of financial instruments. The Directors and senior management of the Bank have formally adopted policies which set 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 Risk Committee and the Board. In addition, the key business risks are identified and evaluated through the Bank's risk register and managed on an ongoing basis by means of procedures such as physical controls, credit and other authorisation limits and segregation of duties. The Bank's risk register is formally reviewed quarterly. The Board 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 also subject to consideration by the Board.

There are well-established budgeting procedures in place and reports are presented regularly to the Board detailing the results of each principal business unit, variances against budget and prior year, and other performance data.

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

4.a.) Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the Statement of Financial Position date. Significant changes in the economy could result in losses that are different from those provided for at the Statement of Financial Position date. Credit risk is managed by the Credit Committee through an annually reviewed policy sanctioned by the Board of Directors.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to 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, corporate and personal guarantees.

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional and commonly used of these is the taking of collateral against residential property for fund advances. Other collateral types for loans and advances include, but are not limited to charges over: commercial properties, financial instruments such as debt securities and equities, personal guarantees, and charges over other chattels.

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 Bank will seek additional capital 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. 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 Bank 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 Bank's maximum exposure to credit risk before collateral held or other credit enhancements is as follows:

		At 31 December
	2016	**2015**
	£000	**£000**
Credit risk exposures relating to on-balance sheet assets as follows:		
Cash and balances at central banks	195,652	236,684
Loans and advances to banks	36,937	24,110
Loans and advances to customers	770,299	630,402
Debt securities held-to-maturity	107,300	83,931
Financial investments available for sale	2,025	2,561
Derivative financial instruments	1,516	1,490
Other assets	2,236	418
Credit Risk exposures relating to off-balance sheet assets are as follows:		
Guarantees	274	56
Loan Commitments	54,934	40,230
At 31 December	**1,171,173**	**1,019,882**

The preceding table represents the maximum credit risk exposure (net of impairment) to the Bank at 31 December 2016 and 2015 without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures are based on the net carrying amounts as reported in the balance sheet.

Management is confident of its ability to continue to control the credit exposure to the Bank resulting from both its loan and advances portfolio and debt securities based on the following:

- All exposures to banks, including debt securities, have at least a Baa1 credit rating or are deemed systemic to the UK or Dubai;
- 95% of the loans and advances to customers are neither past due nor impaired (2015: 93%);
- 3% of the loans and advances to customers are past due but not impaired (2015: 4%);
- Only 2% of the loans and advances to customers are considered individually impaired (2015: 3%).

The Bank has provided credit facilities to companies in which it has investments (Investment in Associate and Unlisted Available-For-Sale Investment). These counterparties are unrated, however the Bank has assessed the facilities to be recoverable in full.

All other assets aside from loans and advances to customers detailed above are deemed to be performing.

Loans and advances to clients where the principal security taken as collateral is residential and/or commercial property are detailed below:

	At December 2016		At December 2015	
	Loans	Residential and Commercial Property Collateral	Loans	Residential and Commercial Property Collateral
	£000	£000	£000	£000
Loan to Value				
Less than 60%	438,076	1,219,532	297,453	870,165
60%-80%	167,765	253,550	167,946	251,610
80%-100%	76,289	88,598	74,401	91,042
Greater than 100%*	32,022	21,387	36,486	25,738
Total	**714,152**	**1,583,067**	**576,286**	**1,238,555**

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

Loan commitments to clients where the principal security taken as collateral that is residential and/or commercial property are detailed below.

	At December 2016		At December 2015	
	Loans	Residential and Commercial Property Collateral	Loans	Residential and Commercial Property Collateral
	£000	£000	£'000	£000
Loan to Value				
Less than 60%	26,988	73,659	7,682	12,963
60%-80%	23,940	42,102	18,570	28,780
80%-100%	-	-	-	-
Greater than 100%	-	-	-	-
Total	**50,928**	**115,761**	**26,252**	**41,743**

The Directors monitor concentrations of sector and geography, but do not consider them to have a significant influence on the credit risk of the Bank's loans and advances.

	Loans and advances to customers		Loan commitments	
	2016	2015	2016	2015
	£000	£000	£000	£000
Concentration by product				
Cash collateralised	16,745	15,987	-	-
Commercial	71,674	22,927	18,260	-
Residential mortgages	626,751	538,537	32,668	40,230
Investment portfolio	34,014	30,284	4,006	-
Non-performing	15,953	9,839	-	-
Other	2,103	7,482	-	-
Unsecured	3,059	5,346	-	-
At 31 December	**770,299**	**630,402**	**54,934**	**40,230**

	Loans and advances to customers		Loan commitments	
	2016	2015	2016	2015
	£000	£000	£000	£000
Concentration by location of collateral				
East Anglia	2,714	9,990	-	-
East Midlands	7,245	7,846	-	-
London	434,401	311,110	27,161	24,457
West Midlands	18,236	7,811	108	-
North East	2,100	4,740	-	-
North West	14,288	17,065	4,590	-
Scotland	13,410	11,918	-	-
South East	117,805	120,120	12,560	12,303
South West	89,018	43,190	3,468	1,800
Wales	7,460	7,366	-	-
Yorkshire & Humber	6,398	6,810	-	792
Overseas	20,700	30,553	-	-
Non-property collateral	36,524	51,883	7,047	878
At 31 December	**770,299**	**630,402**	**54,934**	**40,230**

Forbearance

Details of forbearance measures undertaken by the Bank are set out in the following table:

	Number	Loan Balances
At 31 December 2016		**£000**
Transfer to interest only	3	115
Interest temporarily not being charged	1	3,607
Payment holiday	1	78
Total forbearance	**5**	**3,800**

		Loan Balances
At 31 December 2015	**Number**	**£000**
Transfer to interest only	6	764
Move historic arrears to capital	1	147
Total	**7**	**911**

As at 31 December 2016, loans for which forbearance measures were undertaken totalled 0.49% (2015: 0.14%) of total loans to customers.

4.b.) Market risk

Currency risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure for both overnight and intra-day positions, which are monitored daily. The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2016.

	GBP (£)	USD ($)	Euro (€)	Other	Total
At 31 December 2016	**£000**	**£000**	**£000**	**£000**	**£000**
ASSETS					
Cash	17	35	40	8	100
Cash and balances at central banks	195,652	-	-	-	195,652
Loans and advances to banks	2,183	24,494	5,062	5,198	36,937
Loans and advances to customers	725,700	21,927	22,672	-	770,299
Debt securities held-to-maturity	94,299	13,001	-	-	107,300
Financial investments available for sale	-	569	1,456	-	2,025
Derivative financial instruments	1,516	-	-	-	1,516
Total assets	**1,019,367**	**60,026**	**29,230**	**5,206**	**1,113,829**
LIABILITIES					
Deposits from banks	3,198	-	-	2	3,200
Derivative financial instruments	227	-	-	-	227
Deposits from customers	1,005,782	59,916	28,535	5,511	1,099,744
Total liabilities	**1,009,207**	**59,916**	**28,535**	**5,513**	**1,103,171**
Net on-balance sheet position	**10,160**	**110**	**695**	**(307)**	**10,658**
Credit commitments	**55,208**	**-**	**-**	**-**	**55,208**

At 31 December 2015	GBP (£) £000	USD ($) £000	Euro (€) £000	Other £000	Total £000
ASSETS					
Cash	56	33	35	6	130
Cash and balances at central banks	233,312	3,372	-	-	236,684
Loans and advances to banks	6,310	14,362	1,357	2,081	24,110
Loans and advances to customers	586,515	16,681	27,162	44	630,402
Debt securities held-to-maturity	77,155	6,776	-	-	83,931
Financial investments available for sale	48	-	2,513	-	2,561
Derivative financial instruments	1,490	-	-	-	1,490
Total assets	**904,886**	**41,224**	**31,067**	**2,131**	**979,308**
LIABILITIES					
Deposits from banks	25,307	-	342	-	25,649
Derivative financial instruments	135	-	-	-	135
Deposits from customers	856,925	39,220	23,255	2,285	921,685
Debt securities in issue	71	-	-	-	71
Total liabilities	**882,438**	**39,220**	**23,597**	**2,285**	**947,540**
Net on-balance sheet position	**22,448**	**2,004**	**7,470**	**(154)**	**31,768**
Credit commitments	**40,286**	**-**	**-**	**-**	**40,286**

Derivative financial instruments (see note 17) are in place to mitigate against foreign currency risk on net exposures for each currency. A 10% strengthening of the pound against the euro would lead to a £6k increase (2015: no change) in the Bank's profits, while a 10% weakening of the pound against the euro would lead to the same reduction in the Bank's profits. Similarly a 10% strengthening of the pound against the US dollar would lead to a £3k increase (2015: no change) in the Bank's profits, while a 10% weakening of the pound against the US dollar would lead to the same decrease in the Bank's profits.

4.c.) Interest rate risk

Interest rate risk is the potential adverse impact on the Bank's future cash flows from changes in interest rates, and arises from the differing interest rate risk characteristics of the Bank's assets and liabilities. In particular, fixed rate savings and borrowing products expose the Bank to the risk that a change in interest rates could cause either a reduction in interest income or an increase in interest expense relative to variable rate interest flows. The Bank seeks to "match" interest rate risk on the balance sheet within strictly defined limits. Interest rate risk is present on money market placements of a fixed rate nature, fixed rate loans and fixed rate savings accounts and floating rate products dependent on when they re-price at a future date.

Interest rate risk is measured throughout the maturity bandings of the book on a parallel shift scenario for a 200 basis points movement. Interest rate risk is managed to limit value at risk to be less than £1m. The current position of the balance sheet is such that it results in a favourable impact to the economic value of equity of £2.2m (2015: £2.6m) for a positive 200bps shift and an adverse impact of £0.3m (2015: £0.7m) for a negative 200bps movement capped at the Bank of England base rate (25bps).

The following tables summarise the re-pricing periods for the assets and liabilities in the Bank. Items are allocated to time bands by reference to the earlier of the next contractual interest rate re-price and maturity date.

At 31 December 2016	Within 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000	Non interest bearing £000	Carrying amount £000
ASSETS							
Cash	100	-	-	-	-		100
Cash and balances at central banks	195,652	-	-	-	-	-	195,652
Derivative financial instruments	85	-	-	1,431	-	-	1,516
Loans and advances to banks	36,937	-	-	-	-	-	36,937
Loans and advances to customers	635,968	120,311	8,755	5,265	-	-	770,299
Debt securities held-to-maturity	78,994	6,813	21,493	-	-	-	107,300
Other assets	-	-	-	-	-	34,014	34,014
Total assets	**947,736**	**127,124**	**30,248**	**6,696**	**-**	**34,014**	**1,145,818**
LIABILITIES							
Deposits from banks	3,200	-	-	-	-	-	3,200
Deposits from customers	915,142	61,519	84,480	38,603	-	-	1,099,744
Derivative financial instruments	227	-	-	-	-	-	227
Other liabilities	-	-	-	-	-	15,293	15,293
Total Liabilities	**918,569**	**61,519**	**84,480**	**38,603**	**-**	**15,293**	**1,118,464**
Impact of derivative financial instruments	3,800	(3,800)	-	1,431	-	-	1,431
Interest rate sensitivity gap	**32,967**	**61,805**	**(54,232)**	**(30,476)**	**-**	**18,271**	**28,785**
Cumulative gap	**32,967**	**94,772**	**40,540**	**10,064**	**10,064**	**28,785**	

At 31 December 2015	Within 3 months £000	More than 3 months but less than 6 months £000	More than 6 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000	Non Interest bearing £000	Carrying value £000
ASSETS							
Cash	130	-	-	-			130
Cash and balances at central banks	236,684	-	-	-	-	-	236,684
Derivative financial instruments	-	-	-	-	1,490	-	1,490
Loans and advances to banks	24,110	-	-	-	-	-	24,110
Loans and advances to customers	483,934	129,091	4,041	13,336	-	-	630,402
Debt securities held-to-maturity	50,675	14,481	18,775	-	-	-	83,931
Other assets	-	-	-	-	-	27,702	27,702
Total assets	**795,533**	**143,572**	**22,816**	**13,336**	**1,490**	**27,702**	**1,004,449**
LIABILITIES							
Deposits from banks	5,731	-	19,918	-	-	-	25,649
Deposits from customers	602,352	163,551	90,382	65,400	-	-	921,685
Derivative financial instruments	135	-	-	-	-	-	135
Other liabilities	-	-	-	-	-	4,627	4,627
Total Liabilities	**608,218**	**163,551**	**110,300**	**65,400**	**-**	**4,627**	**952,096**
Impact of derivative financial instruments	3,800	-	-	(3,800)	-	-	
Interest rate sensitivity gap	**191,115**	**(19,979)**	**(87,484)**	**(55,864)**	**1,490**	**23,075**	**52,353**
Cumulative gap	**191,115**	**171,136**	**83,652**	**27,788**	**29,278**	**52,353**	

4.d.) Liquidity risk

Liquidity risk is the risk that a company is not able to meet obligations as they come due. This risk arises as the Bank's liquidity is managed on a mismatch basis, with the mismatch being the difference between the levels of assets and liabilities in the same maturity bands. This maturity transformation is fundamental to the role of a bank in the wider economy.

The Bank has a conservative business model, the key features of which are:

- Client lending is funded by client deposits, with a conservative loan to deposit ratio,
- Excess client deposits are generally placed at the Bank of England or institutions rated Baa1 or above at the time of placing funds,
- Intra-group deposits and loans are segregated and managed separately from client balances.

The Board approved its Individual Liquidity Adequacy Assessment Process ("ILAAP") on 27 January 2016. This document sets out the Bank's approach to liquidity and funding, including how it identifies, measures, manages and monitors liquidity and funding risks across different time horizons and stress scenarios, consistent with its risk appetite.

The Directors considered the impact on liquidity in idiosyncratic, market and combined stress scenarios. In all stress scenarios the Bank's survival horizon is beyond its liquidity risk appetite, which is to ensure that adequate liquidity resources are held to withstand all known reasonable combinations of idiosyncratic and market risks for up to 90 days.

The European Commission Delegated Regulation (EU) 2015/61 became binding and directly applicable in the UK from 1 October 2015, and brought into force the liquidity coverage requirements from Regulation (EU) No 575/2013 (commonly known as "Capital Requirement Regulation" or "CRR"). The Bank is required to maintain a Liquidity Coverage Ratio in excess of 80%, rising to 90% on 1 January 2017 and 100% on 1 January 2018. The Bank's conservative approach to liquidity risk results in it being significantly in excess of this limit.

As at 31 December 2016, the Bank had £209.8m (2015: £330.0m) of High Quality Liquid Assets, with the majority placed in the Bank of England reserve account. The table below sets out the components of the Bank's total liquidity reserves:

	At December 2016		At December 2015	
	Amount £000	Fair value £000	Amount £000	Fair value £000
Cash	100	100	130	130
Cash and balances at central banks	195,652	195,652	236,684	236,684
Loans and advances to banks	36,937	36,937	24,110	24,110
Debt securities held-to-maturity	107,300	107,349	83,931	83,778
Undrawn credit lines	-	-	-	-
Total liquidity reserves	**339,989**	**340,038**	**344,855**	**344,702**

Investment limits for each counterparty are reviewed regularly, and approved in accordance with the Arbuthnot Latham Treasury Policy.

Assets pledged as collateral or encumbered

The total financial assets recognised in the Statement of Financial Position that had been pledged as collateral at 31 December 2016 was £112.0m (2015: £170.0m).

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

The tables below analyse the contractual undiscounted cash flows for the Bank into relevant maturity groupings at 31 December 2016:

At 31 December 2016	Carrying Amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Liabilities						
Deposits from banks	3,200	(3,200)	(3,200)	-	-	-
Derivative financial instruments	227	(227)	(227)	-	-	-
Deposits from customers	1,099,744	(1,102,479)	(818,380)	(243,247)	(40,852)	-
Other liabilities	15,146	(15,146)	(15,146)	-	-	-
Current Tax Liability	147	(147)	(147)	-	-	-
Total liabilities	**1,118,464**	**(1,121,199)**	**(837,100)**	**(243,247)**	**(40,852)**	**-**
Off-Balance Sheet						
Issued guarantee contracts		(274)	(274)	-	-	-
Unrecognised loan commitments		(54,934)	(54,934)	-	-	-
Total off balance sheet credit commitments		**(55,208)**	**(55,208)**	**-**	**-**	**-**

At 31 December 2016	Carrying Amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Assets						
Cash	100	100	100	-	-	-
Cash and balances at central banks	195,652	195,652	195,652	-	-	-
Loans and advances to banks	36,937	36,937	36,937	-	-	-
Debt securities held-to-maturity	107,300	130,360	70,082	41,334	18,944	-
Derivative financial instruments	1,516	1,516	85	-	-	1,431
Loans and advances to customers	770,299	852,783	229,927	130,870	447,253	44,733
Financial investments	2,025	2,025	2,025	-	-	-
Other assets	12,967	12,967	12,967	-	-	-
Total assets	**1,126,796**	**1,232,340**	**547,775**	**172,204**	**466,197**	**46,164**

The tables below analyse the contractual undiscounted cash flows for the Bank into relevant maturity groupings at 31 December 2015:

At 31 December 2015	Carrying Amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Liabilities						
Deposits from banks	25,649	(25,649)	(5,731)	(19,918)	-	-
Derivative financial instruments	135	(135)	(135)	-	-	-
Deposits from customers	921,685	(1,006,761)	(681,290)	(234,049)	(91,422)	-
Other liabilities	4,556	(4,556)	(4,556)	-	-	-
Current tax liability	71	(71)	(71)	-	-	-
Total liabilities	**952,096**	**(1,037,172)**	**(691,783)**	**(253,967)**	**(91,422)**	**-**
Off-Balance Sheet						
Issued guarantee contracts		(56)	(56)	-	-	-
Unrecognised loan commitments		(40,230)	(40,230)	-	-	-
Total off balance sheet credit commitments		**(40,286)**	**(40,286)**	**-**	**-**	**-**

At 31 December 2015	Carrying Amount £000	Gross nominal inflow/ (outflow) £000	Not more than 3 months £000	More than 3 months but less than 1 year £000	More than 1 year but less than 5 years £000	More than 5 years £000
Assets						
Cash	130	130	130	-	-	-
Cash and balances at central banks	236,684	236,684	236,684	-	-	-
Loans and advances to banks	24,110	24,110	24,110	-	-	-
Debt securities held-to-maturity	83,931	85,090	25,536	27,302	32,252	-
Derivative financial instruments	1,490	1,490	59			1,431
Loans and advances to customers	630,402	730,195	126,666	171,226	365,686	66,617
Financial investments	2,561	2,561	2,561	-	-	-
Other assets	10,122	10,122	10,122	-	-	-
Total assets	**989,430**	**1,090,382**	**425,868**	**198,528**	**397,938**	**68,048**

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

Arbuthnot Latham & Co., Limited

Notes to the financial statements

4.e.) *Fair value risk*

The table below sets out the Bank's financial assets and liabilities into the respective classifications:

At 31 December 2016	Derivatives held at Fair Value £000	Held to Maturity £000	Loans and Receivables £000	Available for Sale £000	Other Amortised Cost £000	Total Carrying Amount £000	Fair Valu £00
ASSETS							
Cash	-	-	100	-	-	100	10
Cash and balances at central banks	-	-	195,652	-	-	195,652	195,65
Loans and advances to banks	-	-	36,937	-	-	36,937	36,93
Loans and advances to customers	-	-	770,299	-	-	770,299	750,77
Debt securities held-to-maturity	-	107,300	-	-	-	107,300	107,34
Financial investments available for sale	-	-	-	2,025	-	2,025	2,02
Derivative financial instruments	1,516	-	-	-	-	1,516	1,51
	1,516	**107,300**	**1,002,988**	**2,025**	**-**	**1,113,829**	**1,094,35**
LIABILITIES							
Deposits from banks	-	-	-	-	3,200	3,200	3,20
Deposits from customers	-	-	-	-	1,099,744	1,099,744	1,099,74
Derivative financial instruments	227	-	-	-	-	227	22
	227	**-**	**-**	**-**	**1,102,944**	**1,103,171**	**1,103,17**

At 31 December 2015	Derivatives held at Fair Value £000	Held to Maturity £000	Loans and Receivables £000	Available for Sale £000	Other Amortised Cost £000	Total Carrying Amount £000	Fair Value £000
ASSETS							
Cash	-	-	130	-	-	130	130
Cash and balances at central banks	-	-	236,684	-	-	236,684	236,684
Loans and advances to banks	-	-	24,110	-	-	24,110	24,110
Loans and advances to customers	-	-	630,402	-	-	630,402	621,822
Debt securities held-to-maturity	-	83,931	-	-	-	83,931	83,778
Financial investments available for sale	-	-	-	2,561	-	2,561	2,561
Derivative financial instruments	1,490	-	-		-	1,490	1,490
	1,490	**83,931**	**891,326**	**2,561**	**-**	**979,308**	**970,575**
LIABILITIES							
Deposits from banks	-	-	-	-	25,649	25,649	25,649
Deposits from customers	-	-	-	-	921,685	921,685	921,685
Derivative financial instruments	135	-	-	-	-	135	135
	135	**-**	**-**	**-**	**947,334**	**947,469**	**947,469**

4.f.) Fiduciary activities

The Bank provides trustee, investment management and advisory services to third parties, which involve the Bank making allocation, purchase and sale decisions in relation to a wide range of financial instruments.

These services give rise to the risk that the Bank may be accused of maladministration or underperformance. At the Statement of Financial Position date, the Bank had assets under management amounting to £920m (2015: £739m). Additionally, the Bank provides wealth planning services.

4.g.) Operational risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risk.

The Bank's objective is to manage operational risk, including conduct risk, so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The Bank regards the monitoring and controlling of risks as a fundamental part of the management process. Operational and Conduct Risk is monitored via a range of metrics which are captured within the Board approved Operational Risk Scorecard.

Compliance with banking standards is supported by a programme of periodic reviews undertaken by the Chief Internal Auditor through externally outsourced Internal Audit firms. The results of the Internal Audit reviews are discussed with the Bank's senior management, with summaries submitted to the Arbuthnot Latham Audit Committee.

The most significant exposure is to mis-selling risk via the wealth planning service and the structured product distribution business. The bank recognises the increasing risk posed by cyber threats to its operational processes.

The Bank maintains operational and IT policies and procedures, clear compliance guidelines and provides on-going training to all staff. On-going sample checks and in-depth internal audits are performed to ensure the control framework is being maintained. The Bank also has insurance policies in place to cover any claims that may arise.

5. Capital management

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

Capital adequacy and the use of regulatory capital are monitored by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and European Community Directives, as implemented by the PRA, for supervisory purposes. Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar I plus" approach to determine the level of capital the Bank needs to hold. This method takes the Pillar I capital formula calculations (standardised approach for credit, market and operational risk) as a starting point, and then considers whether each of the calculations deliver a sufficient capital sum adequately to cover management's anticipated risks. Where the Board considered that the Pillar I calculations did not reflect the risk, an additional capital add-on in Pillar II is applied, and further modified by the Individual Capital Guidance issued by the FCA and PRA.

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

- Tier 1 comprises shareholders' funds after deducting goodwill and other intangible assets.
- Lower tier 2 comprises qualifying subordinated loan capital and other reserves. Lower tier 2 capital cannot exceed 50% of tier 1 capital.

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

		At 31 December
	2016	2015
	£000	£000
Tier 1		
Share Capital	15,000	15,000
Capital Contribution	41,000	19,000
AFS Reserve	60	1,047
Retained Earnings	24,638	17,306
Goodwill	(5,415)	(5,415)
Computer Software	(6,776)	(2,099)
Banking licence fees	(64)	(107)
Deferred tax Asset	(1,268)	(1,085)
Total tier 1 capital resources	**67,175**	**43,647**
Tier 2	-	-
Total tier 2 capital resources	-	-
Total tier 1 & tier 2 capital resources	**67,175**	**43,647**
Investment in subsidiaries	(0)	(0)
Total capital after deductions	**67,175**	**43,647**

The Board approved its ICAAP on the 15 March 2017. This document is embedded in the risk management framework and is subject to ongoing updates and revisions when necessary. However, at a minimum, the ICAAP is updated annually as part of the business planning process. The ICAAP is a process that brings together management framework (i.e. the policies, procedures, strategies, and systems that the Bank has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management.

The ICAAP includes a summary of the capital required to mitigate the identified risks in the Bank, and the amount of capital it has available. During the period no breaches of externally imposed capital requirements have been reported.

Pillar 3 complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). Its aim is to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes. Pillar 3 disclosures for the year ended 31 December 2016 are published as a separate document on the Arbuthnot Banking Group website under Investor Relations (Announcements & Shareholder Info).

6. Net interest income

Interest income from customers includes loan-related fees of £4.2m (2015: £3.6m) which have been recognised under the effective interest rate.

	Year ended 31 December	
	2016	2015
	£000	£000
Interest income		
Cash and balances at central banks	873	670
Loans and advances:		
- To banks	124	218
- To customers:		
- Private Banking	31,385	27,253
- Commercial	1,148	-
- Mortgage Book	3,871	4,294
Debt securities held-to-maturity	844	539
Total Interest Income	**38,245**	**32,974**
Interest expense		
Deposits from banks	(297)	(329)
Deposits from customers	(7,177)	(7,168)
Interest on subordinated loan	-	(194)
Total Interest Expense	**(7,474)**	**(7,691)**
Net interest income	**30,771**	**25,283**

In 2016, the Bank recognised £325k (2015: nil) of additional interest income to reflect actual cashflows received on the acquired mortgage book having been in excess of forecast cashflows.

7. Fee and commission income

	Year ended 31 December	
	2016	2015
	£000	£000
Other fee income	205	418
Banking commissions	1,947	1,666
Investment management fees and commissions	7,122	5,946
Wealth planning fees and commissions	2,156	1,969
Fee and commission income	**11,430**	**9,999**

8. Allowances for impairments of loans and advances

Total net impairment losses on financial assets are as follows:

	Year ended 31 December	
	2016	2015
	£000	£000
Impairment losses on loans and advances	427	1,250
Impairment losses on investment in associate	47	-
Net Impairment losses on financial assets	**474**	**1,250**

9. Other income

Other income includes cross charges made to other members of the Arbuthnot Banking Group PLC for the shared use of premises and information technology infrastructure.

10. Operating expenses

Operating expenses comprise:		Year ended 31 December	
		2016	2015
	Note	£000	£000
Staff costs, including Directors:			
- Salaries, wages and performance related pay		19,768	15,054
- Social security costs		2,206	1,541
- Pension		1,053	824
Amortisation	20	521	469
Depreciation	21	1,120	851
Operating lease rentals		2,610	1,941
Operating expenses for investment property generating rental income		115	-
Parent company management charge		1,483	1,227
Other administrative expenses		9,236	9,335
Total operating expenses		**38,112**	**31,242**

	Year ended 31 December	
	2016	2015
	£000	£000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	125	87
Fees payable to the Company's auditor for other services:		
Audit related assurance services	109	58
Taxation compliance services	15	14
Taxation advisory services	-	16
Other assurance services	15	55
Total fees payable	**264**	**230**

11. Average number of employees

	Year ended 31 December	
	2016	**2015**
	£000	**£000**
Central	146	113
Private banking	108	94
Commercial banking	14	2
Structured products	-	1
	268	**210**

12. Corporation tax

	Year ended 31 December	
	2016	**2015**
	£000	**£000**
United Kingdom corporation tax at 20.00% (2015: 20.25%)		
- Current	179	71
- Adjustment in respect of prior years	(32)	-
	147	**71**
Deferred tax		
- Current	(6)	(55)
- Adjustment in respect of prior years	70	(125)
	64	**(180)**
Income tax expense/(income)	**211**	**(109)**

Tax reconciliation	**Year ended 31 December**	
	2016	**2015**
	£000	**£000**
Profit before tax for the year	**7,543**	**4,478**
United Kingdom corporation tax at 20.00% (2015: 20.25%)	1,509	907
Permanent differences	(1,022)	(635)
Group relief	(382)	(257)
Change in tax rate	68	1
Prior period adjustments	38	(125)
Corporation tax charge/(income)	**211**	**(109)**

Reductions in the UK corporation tax rate to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. An additional reduction to 17% (effective from 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Bank's future current tax charge accordingly. The deferred tax asset at 31 December 2016 has been calculated based on the rate of 19%.

Income tax recognised in other comprehensive income

A credit of £247k (2015: £262k charge) for deferred tax has been recognised in Other Comprehensive Income in respect of movements in available-for-sale financial investments, as per Note 24.

13. Loans and advances to banks

	At 31 December	
	2016	**2015**
	£000	**£000**
Placements with banks included in cash and cash equivalents	**36,937**	**24,110**

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

	At 31 December	
	2016	**2015**
	£000	**£000**
Aa1	-	220
A1	36,272	15,834
A2	280	6,032
A3	110	1,262
Baa1	275	762
	36,937	**24,110**

None of the loans and advances to banks are either past due or impaired (2015: £nil)

14. Loans and advances to customers

	At 31 December	
	2016	**2015**
	£000	**£000**
Gross loans and advances	771,272	631,813
Less: allowances for impairments on loans and advances	(973)	(1,411)
	770,299	**630,402**

On the 18th December 2014 the Bank completed the purchase of a residential mortgage portfolio acquired from the administrators of the Dunfermline Building Society for a consideration of £106.3m. As at 31 December 2016, the carrying amount was £ 84.6m, which is included in loans and advances to customers.

On the 16th December 2016 the Bank completed the purchase of a loan portfolio from Duncan Lawrie Limited for a consideration of £42.7m, £8.0m of which is deferred and held in other liabilities on the balance sheet.

At 31 December 2016 £421.4m (2015: £367.3m) of loans and advances to customers are expected to be recovered more than 12 months after the reporting date. For a maturity profile of loans and advances to customers refer to Note 3.

A reconciliation of the allowance for impairment losses on loans and advances is as follows:

	At 31 December	
	2016	**2015**
	£000	**£000**
At 1 January	1,411	4,355
Impairment losses	474	1,250
Loans written off during the year as uncollectable	(962)	(4,227)
Amounts recovered during the year	50	33
At 31 December	**973**	**1,411**

The Directors have assessed the loans and advances with similar risk profiles collectively for any impairment and concluded that a material collective provision is not required (2015: £nil).

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

	At 31 December	
	2016	**2015**
	£000	**£000**
Neither past due nor impaired	731,015	588,577
Past due but not impaired	23,379	23,792
Impaired	16,878	19,444
Gross	771,272	631,813
Less: allowance for impairment	(973)	(1,411)
Net	**770,299**	**630,402**

a.) Loans and advances past due but not impaired

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

	At 31 December	
	2016	**2015**
	£000	**£000**
Past due up to 30 days	961	643
Past due 30 - 60 days	5,689	1,714
Past due 60 - 90 days	638	1,706
Over 90 days	16,091	19,729
Total	**23,379**	**23,792**

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

b.) Loans and advances renegotiated

Restructuring activities include external payment arrangements, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Renegotiated loans that would otherwise be past due or impaired totalled £nil (2015: £nil).

c.) Collateral held

An analysis of loans and advances to customers past due or impaired by reference to the fair value of the underlying collateral is as follows:

	At 31 December	
	2016	**2015**
	£000	**£000**
Past due but not impaired	83,034	75,256
Impaired	20,625	18,071
Fair value of collateral held	**103,659**	**93,327**

Collateral is measured at fair value less costs to sell. The fair value of the collateral held is £103.7m (2015: £93.3m) against loans of £40.3m (2015: £43.2m), giving an average loan-to-value of 39% (2015: 46%). The weighted average loan-to-value is 61% (2015: 63%).

The net amount of individually impaired loans and advances to customers after impairment but before taking into account the cash flows from collateral held is £15.9m (2015: £18.0m).

15. Debt securities held to maturity

Debt securities represent certificates of deposit, and fixed rated notes. The Bank's intention is to hold them to maturity. Amounts include £nil (2015: £nil) with a maturity, when placed, of 3 months or less included in cash and cash equivalents (Note 32).

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

	At 31 December	
	2016	**2015**
	£000	**£000**
At 1 January	83,931	75,400
Exchange difference on monetary assets	2,087	807
Additions	89,384	127,084
Redemptions	(68,102)	(119,360)
At 31 December	**107,300**	**83,931**

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

	At 31 December	
	2016	**2015**
	£000	**£000**
Aaa	40,337	38,822
Aa1	23	23,317
Aa2	26,089	8,913
Aa3	6,000	-
A1	31,953	6,311
A2	-	4,554
A3	2,898	2,000
Baa1	-	14
	107,300	**83,931**

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

16. Financial investments available for sale

	At 31 December	
	2016	**2015**
	£000	**£000**
Financial investments comprise:		
- Listed securities	13	13
- Debt securities	1,443	1,239
- Unlisted securities	569	1,309
Total financial investments	**2,025**	**2,561**

a.) Listed securities

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

b.) Debt securities

The Bank has made investments in unlisted special purpose vehicles set up to acquire and enhance the value of commercial properties. These investments are of a medium term nature. There is no open market for these investments and therefore the Bank has valued them using appropriate valuation methodologies, as referred to in Note 2. The Directors intend to dispose of these assets when a suitable buyer has been identified.

c.) Unlisted securities

On 23 June 2016 the Bank received €1.3m cash consideration following Visa Inc.'s completion of the acquisition of Visa Europe. As part of the deal the Bank also received preference shares in Visa Inc., these have been valued at their future conversion value into Visa Inc. common stock. Management has assessed the fair value of the Bank's investment as £569k, which includes a 31% haircut as referred to in Note 2.

17. Derivative financial instruments

At 31 December 2016	Contract/ Notional amount £000	Fair value assets £000	Fair value liabilities £000
Embedded Derivative	1,607	1,431	-
Currency swaps	6,566	85	218
Interest Rate Swap	3,800	-	9
	11,973	**1,516**	**227**

At 31 December 2015	Contract/ Notional amount £000	Fair value assets £000	Fair value liabilities £000
Embedded Derivative	1,607	1,431	-
Currency swaps	34,459	59	128
Interest Rate Swap	3,800	-	7
	39,866	**1,490**	**135**

The principal derivatives used by the Bank are exchange rate contracts. Exchange rate related contracts include forward foreign exchange contracts and currency swaps. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate.

Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; exchange of principal can be notional or actual. The Bank only uses investment graded banks rated A2 or above for derivative financial instruments.

Included in derivative financial instruments are structured notes. These notes are accounted for as embedded derivatives. These arise from contracts ('hybrid contracts') containing both a derivative (the 'embedded derivative'): options to buy and sell indices and a non-derivative (the 'host contract'): discounted bonds. Both the host and embedded derivative are presented net within derivative financial instruments.

18. Investments in subsidiary undertakings

	At 31 December 2016 £000	2015 £000
Investments in subsidiary undertakings	5	-

The subsidiary undertakings of the Bank at 31 December 2015 & 2016 were:

	Country of incorporation	Interest %	Principal activity
Artillery Nominees Limited	UK	100	Dormant
Arbuthnot Securities Limited	UK	100	Dormant
Arbuthnot Latham (Nominees) Limited	UK	100	Dormant
John K Gilliat & Co., Limited	UK	100	Dormant
Pinnacle Universal	BVI	100	Property Development

(i) All the above subsidiary undertakings are included in the Arbuthnot Banking Group PLC consolidated financial statements and have an accounting reference date of 31 December.
(ii) All the above interests relate wholly to ordinary shares.
(iii) No investments in subsidiary undertakings are impaired.

19. Investments in associates

	At 31 December 2016 £000	2015 £000
Investments in associates	900	943

On 11 October 2013, the Bank together with Praxis (Holding) Limited, formed a special purpose vehicle in the form of a separate legal entity (Tarn Crag Limited). The purpose of this legal entity is to refurbish and re-let a property in Glasgow, with the intention to exit via a sale to an institutional investor in circa 5 years' time. The investment is recognised at cost less impairment.

(a) Significant restrictions
Praxis (Holding) Ltd receives £0.1m per annum in its capacity as property manager. Arbuthnot Latham & Co., Ltd subscribed to £0.9m of loan notes and Praxis (Holding) Ltd subscribed to £0.5m of loan notes, which carry interest at 15% and is rolled up and payable on redemption. The bank debt and interest thereon and the loan notes and interest thereon as well as the property management fees need to be repaid, before further distributions to shareholders can take place.

(b) Risks associated with interests
Arbuthnot Latham & Co., Ltd agreed to subscribe to a further £0.2m of loan notes when required to fund working capital.

20. Intangible assets

	Goodwill	Computer Software	Banking Licence Fees	Total
	£000	£000	£000	£000
Cost or valuation				
At 1 January 2015	5,415	2,096	213	7,724
Additions	-	1,214	-	1,214
At 31 December 2015	**5,415**	**3,310**	**213**	**8,938**
Additions	-	5,155	-	**5,155**
At 31 December 2016	**5,415**	**8,465**	**213**	**14,093**
Accumulated amortisation				
At 1 January 2015	-	(784)	(64)	**(848)**
Amortisation charge	-	(427)	(42)	**(469)**
At 31 December 2015	**-**	**(1,211)**	**(106)**	**(1,317)**
Amortisation charge	-	(478)	(43)	**(521)**
At 31 December 2016	**-**	**(1,689)**	**(149)**	**(1,838)**
Net book amount				
At 31 December 2015	**5,415**	**2,099**	**107**	**7,621**
At 31 December 2016	**5,415**	**6,776**	**64**	**12,255**

Included within Computer Software is an amount of £5.5m which relates to intangible assets in the course of construction which management has assessed as not available for use as at 31 December 2016 and which are therefore not being amortised.

Assets with indefinite useful life

The Bank reviews goodwill for impairment at least annually, or when events or changes in economic circumstances indicate that impairment may have taken place. Management judgements are made in estimations to evaluate whether an impairment of goodwill is necessary. Impairment testing is done at cash-generating unit (CGU) level and the following two items, with judgements surrounding them, have a significant impact on the estimations used in determining the necessity of an impairment charge:

Future cash flows

Cash flow forecasts reflect management's view of future business forecasts at the time of the assessment. These are based on the board approved 3 year plan with management growth estimates for periods beyond the plan period.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. Management considers the value in use for the Arbuthnot Latham Wealth Management CGU, which is the sole CGU to which goodwill applies, to be the discounted cash flows over 3 years with a terminal value generated through its private banking and wealth management activities. The 3 year plan with a terminal value is considered to be appropriate as the goodwill relates to an on-going well established business and not underlying assets with finite lives. An annualised income growth rate of 11% was used for the 3 year period. Costs were forecast to grow 13%. A terminal growth rate of 3% was used. This is above the forecast UK growth rate of 1.8% to reflect the Bank's current growth strategy.

Discount rate

Management apply judgement in determining the discount rate used to discount future expected cash flows. The discount rate is derived from the cost of capital for each CGU.

Cash flows were discounted at a pre-tax rate of 12% to their net present value. The discount rate of 12% is considered to be appropriate after evaluating current market assessments of the time value of money and the risks specific to the assets or CGU's.

21. Property, plant and equipment

	Leasehold Improvements £000	Computer and other equipment £000	Total £000
Cost or valuation			
At 1 January 2015	2,896	4,316	7,212
Additions	1,564	409	1,973
Disposals	-	(2,419)	(2,419)
At 31 December 2015	4,460	2,306	6,766
Additions	127	222	349
At 31 December 2016	4,587	2,528	7,115
Accumulated depreciation			
At 1 January 2015	(166)	(2,798)	(2,964)
Depreciation charge	(354)	(497)	(851)
Disposals	-	2,419	2,419
At 31 December 2015	(520)	(876)	(1,396)
Depreciation charge	(697)	(423)	(1,120)
At 31 December 2016	(1,217)	(1,299)	(2,516)
Net book amount			
At 31 December 2015	3,940	1,430	5,370
At 31 December 2016	**3,370**	**1,229**	**4,599**

22. Investment property and rental income

Investment property represents one commercial building made up of a number of units which are leased to third parties. The leases have remaining terms of between 3 and 11 years with rent reviews every 5 years where applicable.

Investment property can be summarised as follows:

	31 December	
	2016	2015
	£000	£000
Purchase price	50,200	-
Acquisition costs	3,139	-
At 31 December	**53,339**	-

Investment property is initially recognised at cost then subsequently at fair value. The fair value is determined using the rental income on the property and the associated effective yield of similar properties in the surrounding area (see Note 2). At 31 December 2016 there was no material difference between the cost of the property and the fair value.

Rental income from investment property of £1.06m (2015: £nil) has been recognised in the Income Statement. Direct operating expenses arising from the investment property of £115k (2015: £nil) have been recognised in operating expenses.

The property, which is currently fully tenanted, generates annual rental income in excess of £1.8m, which will continue at this level until the end of the main lease in 2019.

23. Other Assets

	At 31 December	
	2016	2015
	£000	£000
Trade receivables	564	338
Prepayments and accrued income	5,423	4,478
Receivable from Pinnacle Universal	5,213	5,226
Amount due from group companies	1,767	80
	12,967	**10,122**

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

24. Deferred tax

	At 31 December	
	2016	2015
	£000	£000
At 1 January	1,085	1,167
Profit and loss account	(64)	180
Other comprehensive income	247	(262)
Deferred tax asset at 31 December	**1,268**	**1,085**

The above balance is made up as follows:

	At 31 December	
	2016	2015
	£000	£000
Unutilised tax losses	736	891
Other short-term timing differences	532	194
	1,268	**1,085**

Deferred tax assets are recognised for tax losses to the extent that the realisation of the related tax benefit through future taxable profits is probable.

Reductions in the UK corporation tax rate to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. This will reduce the Bank's future current tax charge accordingly. The deferred tax asset at 31 December 2016 has been calculated based on the rate of 19%.

25. Deposits from banks

	At 31 December	
	2016	2015
	£000	£000
Deposits from other banks	**3,200**	**25,649**

Included in deposits from other banks is £nil (2015: £5.3m) from Secure Trust Bank (an associated undertaking of Arbuthnot Banking Group PLC).

26. Deposits from customers

	At 31 December	
	2016	2015
	£000	£000
Retail customers:		
- current/demand accounts	712,607	484,485
- notice accounts	141,728	175,000
- term deposits	245,409	262,200
	1,099,744	**921,685**

27. Other liabilities

	At 31 December	
	2016	2015
	£000	£000
Trade payables	1,062	1,121
Accruals & deferred income	14,084	3,435
	15,146	**4,556**

The Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury.

At 31 December 2016, the Bank had accrued £68k (2015: £133k) in respect of the levy, based on the Bank's estimated share of total market protected deposits.

28. Contingent liabilities and commitments

Contingent liabilities

The Bank is subject to extensive regulation in the conduct of its business. A failure to comply with applicable regulations could result in regulatory investigations, fines and restrictions on some of the Bank's business activities or other sanctions. The Bank seeks to minimise this risk through the adoption of compliance and other policies and procedures, continuing to refine controls over business practices and behaviour, employee training, the use of appropriate documentation, and the involvement of outside legal counsel where appropriate.

Credit commitments

The contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers are as follows:

	At 31 December	
	2016	2015
	£000	£000
Guarantees and other contingent liabilities	274	56
Commitments to extend credit:		
- Original term to maturity of one year or less	54,934	40,230
	55,208	**40,286**

Capital commitments

At 31 December 2016, the Bank had capital commitments of £nil (2015: £nil).

Operating lease commitments

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

	At 31 December	
	2016	2015
	£000	£000
Expiring:		
Within 1 year	2,635	2,287
Later than 1 year and no later than 5 years	8,422	8,095
Later than 5 years	5,745	7,528
	16,802	**17,910**

In addition to the above commitments, ground rent of £230k per annum is payable in relation to the investment property.

29. Share capital

Authorised, allotted, called up and fully paid shares of £1 each:

	At 31 December	
	2016	2015
Number of Shares	**15,000,000**	**15,000,000**

	At 31 December	
	2016	2015
	£000	£000
Ordinary Share Capital	**15,000**	**15,000**

30. Reserves and retained earnings

	At 31 December	
	2016	2015
	£000	£000
Retained earnings	24,638	17,306
Capital contribution	41,000	19,000
Available-for-sale reserve	60	1,047
Total reserves at 31 December	**65,698**	**37,353**

The capital contribution relates to cash contributions from the parent company that are realised and available for distribution.

Movements in retained earnings were as follows:

	At 31 December	
	2016	2015
	£000	£000
At 1 January	17,306	12,719
Profit for the year	7,332	4,587
At 31 December	**24,638**	**17,306**

31. Share based payments

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

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

		31 December
	2016	**2015**
Expected stock price volatility	17.0%	17.0%
Expected dividend yield	2.7%	2.7%
Risk free interest rate	1.2%	1.2%
Average expected life (in years)	0.25	0.53

Cash settled
On the 14 June 2016, Mr. Henderson was granted phantom options pursuant to the Phantom Option Scheme to acquire 100,000 ordinary 1p shares in Arbuthnot Banking Group PLC at 1591p exercisable in respect of 50% on or after 15 June 2019 and in respect of the remaining 50% on or after 15 June 2021 when a cash payment would be made equal to any increase in market value. During the year there was a £58k charge to the Income Statement in relation to the scheme. The fair value of the options at grant date was £327k.

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

	31 December
	2016
Expected stock price volatility	33.0%
Expected dividend yield	2.3%
Risk free interest rate	0.4%
Average expected life (in years)	3.46

32. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

			At 31 December
		2016	**2015**
	Note	**£000**	**£000**
Cash		100	130
Cash and Balances at central banks		195,652	236,684
Loans and advances to banks	13	36,937	24,110
		232,689	**260,924**

33. Geographical analysis

The geographical analysis has been compiled on the basis of the location of the office where the transactions are recorded.

Year ended 31 December 2016	Nature of activity	Location	Average number of employees	Turnover £000	Profit/(loss) before tax £000	Tax paid/ (credit) £000
Arbuthnot Latham & Co., Limited	Private banking	UK	253	49,675	9,788	211
Arbuthnot Latham & Co., Limited - Dubai branch	Private banking	Dubai	15	-	(2,245)	-
			268	49,675	7,543	211

Year ended 31 December 2015	Nature of activity	Location	Average number of employees	Turnover £000	Profit/(loss) before tax £000	Tax paid/ (credit) £000
Arbuthnot Latham & Co., Limited	Private banking	UK	197	42,973	6,295	(109)
Arbuthnot Latham & Co., Limited - Dubai branch	Private banking	Dubai	13	-	(1,817)	-
			210	42,973	4,478	(109)

The Dubai branch income is booked through the UK, hence the turnover is nil in the above analysis. Offsetting this income against Dubai branch costs would result in a £0.9m profit (2014: £33k). No public subsidies were received during the current or prior reporting period.

The above analysis has been prepared in accordance with Capital Requirements (Country by Country Reporting) Regulations 2013.

34. Related party transactions

Related parties of the Bank include Arbuthnot Banking Group PLC and its subsidiaries, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

i. Transactions with group companies

		At 31 December
	2016	**2015**
	£000	**£000**
Loans		
Loans outstanding at 1 January	11,499	11,499
Loans issued during the year	23,000	-
Loan repayments during the year	(23,000)	-
Loans outstanding at 31 December	**11,499**	**11,499**
Interest income earned	191	165

		At 31 December
	2016	**2015**
	£000	**£000**
Deposits		
Deposits at 1 January	30,264	37,370
Deposits received during the year	166,898	36,823
Deposits repaid during the year	(90,160)	(43,929)
Deposits at 31 December	**107,002**	**30,264**
Interest expense on deposits	242	116

		At 31 December
	2016	**2015**
	£000	**£000**
Amounts recharged to the parent company	997	1,497
Amounts recharged to fellow subsidiaries and associates	676	397

		At 31 December
	2016	**2015**
	£000	**£000**
Amounts recharged from the parent company	1,483	1,227

	At 31 December	
	2016	**2015**
	£000	**£000**
Balances due from the parent company	1,767	(8)
Balances due from fellow subsidiaries and associates	5,308	5,314

The Bank paid dividends of £nil during the year (2015: £nil) to Arbuthnot Banking Group PLC.

ii. Transactions with Directors and Key Management Personnel

	2016	**2015**
	£000	**£000**
Loans		
Loans outstanding at 1 January	3,975	5,753
Loans issued during the year	6,266	3,420
Loan repayments during the year	(8,283)	(5,198)
Loans outstanding at 31 December	**1,958**	**3,975**
Interest income earned	170	150

All loans were on normal commercial terms and are all repayable on demand. No provisions have been recognised in respect of loans given to related parties (2015: £nil).

	2016	**2015**
	£000	**£000**
Deposits		
Deposits at 1 January	5,327	4,093
Deposits received during the year	17,065	4,148
Deposits repaid during the year	(15,555)	(2,914)
Deposits at 31 December	**6,837**	**5,327**
Interest expense on deposits	44	60

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

	2016	**2015**
	£000	**£000**
Salary payments	3,680	2,890
Pension contributions	206	254
Share options	58	14
	3,944	**3,158**

Pension contributions are being accrued under money purchase schemes for 3 directors (2015: 2 directors) in respect of qualifying service. The emoluments of Sir Henry Angest, JR Cobb, AA Salmon and IA Dewar were paid by the parent company. Their total emoluments are disclosed in the financial statements of the parent company.

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

	2016 £000	2015 £000
Emoluments	726	566
Amounts payable to a money purchase pension scheme	32	35
	758	**601**

iii. Other related party transactions

Sir Michael CG Peat is an independent non-executive board member of Deloitte LLP. During the year the Bank was invoiced £361k by Deloitte LLP in relation to professional fees. At the year end £226k of this amount remained payable.

35. Ultimate controlling party

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

36. Events after the balance sheet date

There are no post balance sheet events to report.