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ARBUTHNOT SANDFORD PLC

Annual Report 2005



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corporate philosophy

Arbuthnot has a 173 year history of serving its customers, as well as a long track record of profitability against the background of a continually changing environment. The ability of Arbuthnot to adapt and grow has come from managing the business on the basis of four key principles. These principles govern the activities ranging from major strategic issues to smaller day-to-day operational matters and are always applied with common sense.

**“ THE BUSINESS IS TO SERVE ITS
SHAREHOLDERS, ITS CUSTOMERS
AND ITS EMPLOYEES WITH
INTEGRITY AND HIGH ETHICAL
STANDARDS.**

**THE BUSINESS SHALL BE
INDEPENDENT, PROFITABLE AND
GROWING WHILE MAINTAINING A
CONTROLLED RISK PROFILE.**

**TO ACHIEVE ITS GOALS THE
BUSINESS REQUIRES DIVERSITY,
A LONG-TERM VIEW, AND
EMPOWERMENT OF MANAGEMENT.**

**IT FURTHER REQUIRES TO BE
CONDUCTED IN AN INNOVATIVE,
FLEXIBLE AND ENTREPRENEURIAL
MANNER, WITH AN OPPORTUNISTIC
AND CONTRARIAN ATTITUDE.”**

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

Henry Angest
Chairman
29 March 2006

highlights of the year

Operating income increased by 17% to £56.3 million and profit before tax was 156% higher at £7.7 million. This strong operating performance is reflected in the excellent returns to shareholders since January 2005, with the dividend being increased for the 17th successive year.

January 2005

- Successful Open Offer to shareholders 130% subscribed, raising £4 million.

June 2005

- Group name changed to Arbuthnot Banking Group PLC.
- Listing moved to AIM.
- Arbuthnot Securities sponsored its first closed-end fund launch (North American Banks Fund).

July 2005

- Arbuthnot Securities raised £52.5 million for Utilico Emerging Markets Fund and advised BUPA on the sale of 9 hospitals for £85 million.

August 2005

- Arbuthnot Securities placed 30% of PD Ports for Nikko Principal Investments.

October 2005

- Arbuthnot Insurance Brokers sold for £2 million.

November 2005

- Acquisition of the Musical Instrument Finance Company.

December 2005

- Merger of activities of Arbuthnot Latham division completed.
- Arbuthnot Securities raised £75 million for India Capital Growth Fund.

November 2005

- Ruth Lea appointed as a non-executive director of the Group.
- €15 million 30-year subordinated debt issued by the Group.
- Arbuthnot Securities underwrote £50 million rights issue for UMECO and £34 million placing for Hampson Industries.

chairman's statement

The doubling of earnings per share reflects the strength of our strategy to be a diversified financial services Group.

Our healthy finances underpin the development of our businesses into growth areas at home and abroad.

Arbuthnot Banking Group PLC achieved a total profit for 2005 before taxation and minority interests of £9.1 million (2004: £3.3 million). Earnings per share more than doubled to 45.8p (2004: 22.0p).

The profit on continuing activities before tax and exceptional gains increased to £7.4 million from £4.4 million in the previous year. Earnings per share on continuing activities before exceptional gains rose to 32.6p from 27.2p in 2004.

Including an exceptional accounting profit of £0.8 million arising on the sale of a minority interest in Arbuthnot Securities to its staff and exceptional operating costs of £0.5 million (2004: £1.4 million), profit on continuing activities before tax for 2005 was £7.7 million (2004: £3.0 million). After adding the profit on discontinued activity after taxation of £1.4 million, which relates to the sale of Arbuthnot Insurance Brokers in October 2005, and deducting the minority interest of £0.4 million relating to the proportion of the share capital of Arbuthnot Securities now owned by its staff, profit after taxation for the year attributable to equity holders of the Company was £6.5 million (2004: £2.9 million). These figures are presented under International Financial Reporting Standards.

The Board proposes an increase in the final dividend to 21.5p, from 21p last year, bringing the total dividend for the year to 32p (2004: 31.5p). If approved at the Annual General Meeting, the final dividend will be paid on 25 May 2006 to shareholders on the register at 28 April 2006.

These results reflect the benefits of the Group's strategy of developing a wide range of income streams from a diversity of financial services activities. Whilst this has been a difficult year for our retail banking division, Secure Trust Bank, this has been counterbalanced by a very strong performance

from the investment banking activities of Arbuthnot Securities, which increased revenues by some 58%, contributing to an overall increase in the Group's operating income of 17% to £56.3 million.

ARBUTHNOT SECURITIES

Building on the turnaround reported in the interim results, I am pleased to record that Arbuthnot Securities achieved a profit before tax and exceptional items in 2005 of £2.8 million. Gross revenues rose by 58% to £19.4 million, of which some £12.1 million was achieved in the second half of the year.

This reflects an increase in market share in all areas of the company's operations as well as a helpful market environment. In corporate finance, we raised some £285 million for clients during 2005, compared to £101 million in 2004. In particular, we have established a strong position in the launch of closed-end investment funds, having successfully carried out IPOs for the North American Banks Fund, Utilico Emerging Markets Fund and India Capital Growth Fund. The number of corporate clients that we act for has grown from 51 to 64.

We also advised on a number of high profile M & A transactions, including the sale by BUPA of a portfolio of nine hospitals to Legal & General Ventures, the acquisition of Little Chef and the takeover of regional brewer Jennings Brothers by Wolverhampton & Dudley Breweries. Significant transactions in the secondary market included placing 30% of the share capital of PD Ports on behalf of Nikko Principal Investments. We have also been active in bringing companies to AIM and in May 2005 sponsored the first ever survey of investors' attitudes towards AIM which reflected the views of over 50 of the top institutional investors in AIM, all of whom judged the market to have been a success.

The Directors look forward to the Group's future prospects with confidence.

ARBUTHNOT LATHAM

The past year has marked a period of further significant progress for the private banking division. We have completed the merger of the activities of Arbuthnot Latham & Co., Arbuthnot Fund Managers, Arbuthnot Pensions & Investments and Arbuthnot Pension Trustees to form a seamless wealth management offering for clients. At the same time, the division's investment management offering has been significantly restructured and improved.

Our range of alternative investment products has seen further development and, in particular, we continue to offer our clients interesting and profitable investment opportunities in the property market, building on a number of transactions completed successfully during the year. We are also developing a number of niche asset finance businesses, beginning with the acquisition of the Musical Instrument Finance Company in November. Specialist financing is an area where we intend to continue broadening the Group's activities in the future.

The number of banking clients grew by 10% during the year. The loan book increased by 20% compared with December 2004 to £107 million, customer deposits rose by 26% to £207 million and funds under management grew by 22%. As a result of this continued growth in volumes of business with recurring revenues, operating income rose by 11%. This has not been achieved without ongoing investment, such that costs rose faster than income and profit before tax and exceptional items was £0.4 million (2004: £0.7 million). Both of these figures exclude the results of Arbuthnot Insurance Brokers which was sold last October and the results of which are included as part of the profit on discontinued activity in the income statement. Including the profit on discontinued activity, the division's profit before tax was £1.9 million.

SECURE TRUST BANK

Against the background of a difficult environment for consumer lending and intense competition from other financial services providers affecting all aspects of Secure Trust Bank's operations, the business nevertheless achieved an increase in operating income. New personal lending volumes remained healthy and, together with higher cash balances, this contributed to a rise of 11% in interest receivable. At the same time, the bank's deposit-taking activities made good progress with balances in the flagship Secure Tracker product rising by 59%. As a result, interest payable was also higher than in 2004 and net interest income was at a similar level to the prior year.

During the course of the year, we decided to exit from two affinity arrangements in our motor insurance consultancy, SecureDirect, where the quality of the business provided by the introducers was unacceptable. As a result, the number of motor policies sold by SecureDirect fell slightly compared to the previous year.

In my interim statement, issued in September 2005, I referred to an increase in the level of bad debts arising on our consumer lending. The arrears profile of the consumer loan book has remained at a higher level than in 2004, as a result of which the division's charge for bad debt provisions in the year rose to £1.6 million (2004: £1.0 million). Combined with an increase in overheads, this resulted in the division's profit before tax and exceptional items being £5.5 million compared with £6.7 million in the prior year.

CORPORATE DEVELOPMENTS AND CAPITAL RAISING

At the Annual General Meeting last May, shareholders approved the change of the Company's name to Arbuthnot Banking Group PLC from Secure Trust Banking Group PLC. At the same time, the Board resolved to move the Company from the main market of the London Stock Exchange to AIM. This has enabled us to operate without the excessive

formality of The Combined Code on Corporate Governance and has improved the tax treatment for many of our private shareholders. In no way, however, does it diminish the degree of supervision of our operations by the FSA or the high importance we attach to looking after the best interests of our customers and shareholders at all times. Sadly, it also does not protect us against the ever increasing avalanche of regulation emanating from Brussels.

Looking to the future, we plan to develop our private banking offering overseas. This expansion will have two focuses. The first is to establish an offshore capability, where our research has led us to the conclusion that we should form a new bank in Switzerland, and the second is to develop into the high growth markets of the Far East, where we presently favour opening an office in Hong Kong. We are well advanced with these plans, particularly in relation to Switzerland, where we are now seeking regulatory approval, and we have announced a proposed placing and offer of 710,000 new ordinary shares at a price expected to be 600 pence per share to raise some £4 million to finance this expansion.

FINANCES

At the beginning of 2005, we strengthened the balance sheet by raising £3.8 million via an open offer of new ordinary shares to existing shareholders. This was followed in October by the sale of Arbuthnot Insurance Brokers, which realised £2 million in cash and resulted in a profit on sale of some £1.2 million. Then, in November, we raised €15 million (approximately £10 million) of 30 year subordinated loan notes, around £7.8 million of which is being used to redeem early the existing subordinated loan notes which are due to mature in 2009 and are therefore less efficient as regulatory capital. The Group's finances thus remain in a very healthy state and, together with the proposed placing and offer referred to earlier, this will put us in a strong position to continue investing in the future development of existing and new businesses.

STAFF AND MANAGEMENT

I am delighted that Ruth Lea, who initially served the Group for a short time as an economic adviser, accepted our invitation to become a non-executive director in November 2005. Her economic insights and advice are valued by the Board. Mark Brown joined the Board in February 2005, having been with the Group since September 2004 as Chief Executive of Arbuthnot Securities. I welcome both of these colleagues to the Board.

After 12 years with us, our Group Finance Director, Stephen Lockley, has concluded that the time is right for him to seek a fresh challenge and he will therefore be leaving the Group. In order to allow us time to find a replacement for Stephen and to achieve an orderly handover, he has agreed to remain on the Board until 30 September and to be available to us on a consultancy basis for a period thereafter. I thank Stephen for the significant contribution he has made to the Group over many years and wish him well in the future.

These results once again reflect the continuing hard work and dedication of our employees. On behalf of the Board I extend our thanks to all staff for their contribution to the Group's success in 2005.

OUTLOOK

The trends seen last year have continued into the early part of 2006. Arbuthnot Securities' stockbroking revenues continue to progress and its corporate finance pipeline is stronger than at this time a year ago, albeit that fees from this activity cannot be predicted with any certainty until the underlying transactions have been completed. Arbuthnot Latham has made a satisfactory start to the year but Secure Trust Bank has begun somewhat slowly. Taking all of these factors into account, we remain cautiously optimistic about the Group's outlook.

Henry Angest
Chairman
29 March 2006



business profile

responsive — SECURE TRUST BANK HAS PROVIDED ITS CUSTOMERS WITH
HIGHLY PERSONALISED FINANCIAL PRODUCTS AND SERVICES FOR OVER 50 YEARS

SECURE TRUST BANK

SECURE TRUST BANK WAS FOUNDED IN BIRMINGHAM MORE THAN 50 YEARS AGO AND IS NOW A WELL-ESTABLISHED BUSINESS, SERVING CUSTOMERS PREDOMINANTLY IN THE WEST MIDLANDS AND THE NORTH OF ENGLAND.

The core product of Secure Trust Bank is the Secure Homes Account, which is marketed under the “OneBill” brand and enables customers to keep track of exactly how much of their money is spent on bills by offering a single bill solution with just one regular weekly or monthly payment.

Secure Homes

The appeal of the “OneBill” account is wide-ranging, offering peace of mind afforded by carefully managed household finances and provides a fast and professional service. Customers come from all walks of life, from families with high financial commitments to single professionals who want a more convenient and simple way to pay their bills. For additional peace of mind they can protect their “OneBill” payment against sickness, accident and redundancy. As a customer there are a host of additional benefits, from discounted breakdown recovery to cheaper gas, electric and telephone bills.

Secure Trust Bank

Secure Trust Bank provides a full range of banking services including personal loans, current and savings accounts and financial advice. Combining these services with the “OneBill” account provides added convenience for customers in managing their financial affairs.

SecureDirect

The Group’s retail insurance business, SecureDirect, offers motor and household insurance to customers and the general public, operating from a network of high street branches as well as via the telephone-based call centre.

business profile cont.

discreet — ARBUTHNOT LATHAM'S OUTSTANDING REPUTATION FOR CUSTOMER SERVICE CONTINUES TO ATTRACT DISCERNING NEW PRIVATE BANKING CLIENTS

ARBUTHNOT LATHAM & CO.

THE ARBUTHNOT NAME HAS BEEN SYNONYMOUS WITH BANKING IN THE CITY OF LONDON SINCE 1833.

Arbuthnot Latham & Co.

Arbuthnot Latham provides a high quality and personalised banking and wealth management service, aimed at successful private and business clients, including entrepreneurs and high earning professionals. The service entails three core elements: full service banking, financial planning and investment management.

Banking comprises current accounts, deposit accounts, loans, overdrafts and foreign trade. We offer vendor financing solutions for both retail and corporate users of financial instruments. Each client deals with a dedicated personal relationship manager who ensures that the bank has a thorough understanding of the client's financial circumstances. This relationship is key to the bank's ability to provide an individual service.

The financial planning service is built on long-term relationships and bespoke financial strategies that are sufficiently flexible to accommodate changing requirements during a client's lifetime. Pensions form an increasingly important part of clients' overall wealth. In addition to advising on investments for pensions, we provide a highly personalised Self-Administered and Self-Invested pension service.

Our investment management services comprise discretionary fund management for individuals, trusts, pension funds and charities, developing tailored investment strategies to ensure that each client's specific investment objectives are met. Asset classes range from traditional equities and fixed income through alternative investments, such as hedge funds, private equity and structured products into property and other more esoteric asset classes.

A client's risk tolerance is carefully measured in a scientific way and portfolios are constructed by utilising direct instruments and specialist collective vehicles.

At the end of 2005, the financial planning activities of Arbuthnot Pensions & Investments and the fund management services of Arbuthnot Fund Managers were merged into Arbuthnot Latham & Co., so that these services are now delivered through one company.

Arbuthnot Commercial Finance

Invoice factoring is offered by Arbuthnot Commercial Finance to assist small and medium sized businesses with access to funding in the early stages of growth.

business profile cont.

dynamic — ARBUTHNOT SECURITIES OFFERS CORPORATE AND INSTITUTIONAL
CLIENTS UP-TO-THE-MINUTE ADVICE IN FAST MOVING FINANCIAL MARKETS

ARBUTHNOT SECURITIES

ARBUTHNOT SECURITIES AIMS TO BE THE LEADING INVESTMENT BANK FOR UK GROWTH COMPANIES. IT IS A FULL-SERVICE, INTEGRATED INVESTMENT BANK PROVIDING A FULL RANGE OF INSTITUTIONAL STOCKBROKING AND CORPORATE ADVISORY SERVICES FOCUSED ON UK GROWTH COMPANIES (MID AND SMALL CAP).

Arbuthnot Securities prides itself on an integrated approach to best serve both institutional and corporate clients. It is long term and relationship driven; dedicated to adding value to clients through the stocks it recommends and its advice to companies.

For institutional clients, it offers great insight into a limited number of stocks resulting in profitable investment ideas. It focuses on growth areas of the market where it has a genuine understanding and a competitive edge, and seeks to highlight stocks that are significantly mis-priced. Its analysts are sceptical rather than accepting of consensus and focus on the deep analysis of key issues rather than on minutiae. For corporate clients, it provides advice backed by a detailed understanding of their objectives, the views of investors and perceptive industry knowledge.

Corporate Finance

The Corporate Finance team specialises in providing financing and advisory solutions to quoted and unquoted companies and their owners across the UK. Companies are advised on their strategic and financing needs at all stages of their development, from early stage and private equity fund-raising to stock market quotations, from mergers and acquisitions to public-to-private transactions and demergers.

Corporate Broking

Corporate Broking provides assistance with the management of the relationships between the corporate client and their major institutional shareholders. The team is responsible for initial public offerings and secondary fund-raising and is there to provide constant advice and guidance to corporate clients on how to comply with an ever increasing regulatory environment.

Research

Research provides a deep understanding of companies, the valuation of their securities and

the environment in which they operate and forms part of the package of advice and service to both institutional and corporate clients.

Sales and Sales Trading

The sales team maintains relationships with all the significant institutional owners of equity in the UK and key international investors. The team acts as the prime contact with fund managers, ensuring that at all times they are aware of Arbuthnot's views and opinions. The sales trading team provides a specialist dealing service to institutional clients.

Market Making

Focused on corporate clients and other stocks covered by the research analysts, the market making team provides liquidity to facilitate the execution of client business, as well as trading with other banks and brokers in the market for the firm's own account.

business review

This Business Review should be read in conjunction with the Chairman's Statement on pages 4 to 7.

The aim of Arbuthnot Banking Group is to maximise revenues and profits through providing a range of financial services to customers and clients in its three chosen niche markets of retail banking (Secure Trust Bank), private banking (Arbuthnot Latham) and investment banking (Arbuthnot Securities). The Group's revenues are derived from a combination of net interest income from its lending, deposit-taking and money market activities; fees for services provided to customers and clients; commissions earned on the sale of financial instruments and products; and equity market-making profits.

Background market conditions were mixed during 2005. Whilst the FTSE 100 index rose by 17% and the IPO market was strong, base rates fell from 4.75% to 4.50% in November, limiting the opportunities for the Group to increase net interest margins. At the same time, the well-publicised pressures on the consumer have led to an increase in the provisions for bad debts. Against this mixed background, an improved operating performance from the Group's businesses enabled total operating income to grow by 17% to £56.3 million, profit before tax to rise by 156% to £7.7 million and earnings per share to increase by 108% to 45.8p.

As described under "Principal Accounting Policies" on page 35, this is the first full year for which the financial statements have been prepared under International Financial Reporting Standards (IFRS). The impact of adopting IFRS in 2005 was to increase the profit before tax by £30,000.

ADJUSTED PROFIT BEFORE TAX

The profit before tax on a statutory reporting basis includes certain items that do not relate to the profitability of the Group on an ongoing basis. The Board believes that a truer reflection of the performance of the Group's ongoing operating business is better presented by the measures

"Adjusted profit before tax" and "Adjusted earnings per share", as set out below:

| | 2005 £000 | 2004 £000 |
|---|--------------|--------------|
| Profit before tax as reported | 7,676 | 2,996 |
| Less: Gain on sale of minority interest in subsidiary | (850) | — |
| Add: Exceptional operating expenses | 541 | 1,386 |
| Adjusted profit before tax | 7,367 | 4,382 |
| Adjusted earnings per share | 32.6p | 27.2p |

On this basis, Adjusted profit before tax rose by 68% and Adjusted earnings per share rose by 20%. These figures are also referred to in the Chairman's Statement as "profit on continuing activities before tax and exceptional gains" and "earnings per share on continuing activities before exceptional gains".

REVIEW OF RESULTS

Higher levels of both lending and deposits contributed to net interest income growing by 9% to £9.5 million. Fees, commissions and equity market-making profits now account for over 83% of the Group's total operating income and these rose by 19% to £46.8 million, reflecting growth in all business areas but particularly in Arbuthnot Securities.

Operating expenses, excluding exceptional items and bad debts, increased by 12% to £47.3 million. The bad debt charge was £1.6 million (2004: £1.2 million). The exceptional items within administrative expenses of £0.5 million represent reorganisation and redundancy costs, together with the costs of moving to AIM.

Under the terms of the Arbuthnot Securities Long Term Incentive Plan, the Group has sold 35.8% of the issued ordinary share capital in Arbuthnot Securities Limited to its staff via the Arbuthnot No. 2 ESOP Trust for a total consideration of approximately £1.7 million. This has given rise to an accounting profit both before and after tax of £0.8 million. Following

this sale, the amount of the profit after tax for the year which is attributable to minority interests has increased to £0.4 million.

On 13 October 2005, the Group disposed of the entire issued share capital of Arbuthnot Insurance Brokers Limited for a cash consideration of approximately £2 million. The whole of the profit after tax of Arbuthnot Insurance Brokers Limited up to the date of sale of £0.2 million, together with the gain arising on disposal of £1.2 million, is shown as profit on discontinued activity in the Consolidated Income Statement.

RETAIL BANKING

The operations of the retail banking division encompass household cash management, personal lending and banking and retail insurance services. A detailed description of each of these activities is set out on page 9 of this Annual Report.

The division's principal source of income is the fees and commissions it earns from the provision of services to customers. It also earns an interest margin on its lending and deposit-taking activities. Operating profits of the division fell by 17% to £5.5 million.

Secure Homes

The major emphases in the household cash management business during 2005 continued to be on improving customer care and maintaining margins. Customer numbers for the household cash management service at the year end were 48,000.

In addition to charging a fee for providing the household cash management service, Secure Homes earns commission from the sale to its customers of ancillary financial products, the most significant of which is sickness, accident and redundancy insurance. Earnings from sales of insurance products improved marginally in 2005 due to several successful sales initiatives.

Secure Trust Bank

Outstanding personal loan balances in Secure Trust Bank at the year end increased by 3.1%. There are some 16,000 borrowers, most of whom are also customers of the household cash management service, and the average life of a loan is 28 months. The number of customers with cheque accounts is

approximately 1,300. Arrears patterns on personal lending deteriorated during 2005 in line with the experience of many other consumer lenders. As a result, the bad debt charge in Secure Trust Bank increased to £1.6 million (2004: £1.0 million). Provisions against personal lending at 31 December 2005 represented 7.4% of outstanding advances (2004: 5.9%).

SecureDirect

Following a decision to end certain affinity arrangements during the year as a result of unsatisfactory levels of policy cancellations, SecureDirect's motor insurance consultancy business experienced a fall in motor policy volumes of 2%. Despite this, an improvement in the average rate of commissions, coupled with higher volumes in mortgage broking, led to an increase in income of 4%.

PRIVATE BANKING

The companies forming the private banking division work closely together to provide clients with access to a wide range of services encompassing most of their wealth management requirements. The division's operating income rose by 11% but continuing investment in new staff led to a 17% rise in costs. Profits before tax were £0.4 million (2004: £0.7 million).

Arbuthnot Latham & Co.

Arbuthnot Latham's relationship-based approach to banking has continued to attract new clients. Business volumes were buoyant, with total assets increasing by 14%, loans by 20% and customer deposits by 26%. Reflecting these business gains, the bank's net interest income from operations grew by 19%, although fees and commissions derived from banking activities were unchanged on the prior year's total.

On 15 November 2005, the bank acquired the assets and undertaking of The Musical Instrument Finance Company (MIFCO), a specialist leasing business, for a cash consideration of £1.1 million, of which £0.8 million related to the purchase of the assets of the business and £0.3 million represented a payment for goodwill. The opportunities in this niche financing market should enable MIFCO to expand significantly as part of Arbuthnot Latham & Co.

Arbuthnot Latham & Co. Summarised Balance Sheet

| | 2005 £m | 2004 £m |
|---|--------------|--------------|
| Assets | | |
| Advances (including to group companies) | 107.7 | 90.0 |
| Liquid assets | 106.8 | 90.7 |
| Other assets | 31.7 | 34.6 |
| | 246.2 | 215.3 |
| Liabilities | | |
| Customer deposits | 206.9 | 163.9 |
| Other liabilities | 11.1 | 24.3 |
| Total liabilities | 218.0 | 188.2 |
| Capital resources | 28.2 | 27.1 |
| | 246.2 | 215.3 |

On 31 December 2005, the operations of Arbuthnot Fund Managers, Arbuthnot Pensions & Investments and Arbuthnot Pension Trustees were merged with those of Arbuthnot Latham & Co to create a single legal entity. This will enable the private banking division to offer clients a seamless approach to their wealth management needs. The impact of this merger on the balance sheet of Arbuthnot Latham & Co was not significant.

Arbuthnot Fund Managers

Arbuthnot Fund Managers is a portfolio manager looking after investments for private clients, trusts, charities and pension schemes. Market conditions were generally more favourable during 2005 than in the previous year and income rose by 10%.

Pensions and Financial Planning

Arbuthnot Pensions & Investments and Arbuthnot Pension Trustees also experienced improving market conditions with fee and commission income rising by 6%.

Arbuthnot Commercial Finance

Arbuthnot Commercial Finance faced a particularly competitive environment during 2005, despite which it achieved an increase in operating income of 14%.

INVESTMENT BANKING

The activities of Arbuthnot Securities encompass corporate finance and institutional stockbroking, with an emphasis on serving quoted UK growth companies and those that invest in them. Its stockbroking business includes corporate broking, equities research, institutional sales, sales trading and market-making.

Market conditions for corporate finance and institutional stockbroking were favourable during 2005 and, combined with further increases in market share, this led to an increase in operating income of 58% compared with 2004.

Cost control remained a priority during the year. Operating expenses of Arbuthnot Securities, including staff bonuses, rose by 17%, although this rise is attributable entirely to variable staff costs. The fixed element of overheads reduced by 6% compared with 2004. The business returned to profitability, achieving a profit before tax of £2.8 million (2004: loss £1.6 million).

OPEN OFFER

On 20 January 2005 a total of £3.8 million (net of expenses) was raised via an open offer of 1,282,245 new ordinary shares to existing shareholders at 310p per share. The proceeds of the issue were used to continue the programme of investing in the Group's businesses.

SUBORDINATED LOAN NOTES

On 7 November 2005, the Company completed the issue of €15 million of Floating Rate Subordinated Loan Notes 2035. The Notes bear interest at 3% over the rate for three-month deposits in euros. They are repayable in full in August 2035 and may be redeemed at the Company's option (subject to the consent of the Financial Services Authority) on any interest payment date occurring after November 2010. The Notes rank in priority to distributions on all classes of share capital of the Company but are subordinated in right of payment to the claims of all unsubordinated creditors of the Company. The terms

of the subordination allow the Notes to qualify as Lower Tier 2 capital of the Company under the rules of the Financial Services Authority.

The proceeds of the issue are to be used for working capital purposes and to redeem early the Company's pre-existing Floating Rate Subordinated Loan Notes 2009, totalling £7.8 million, of which £5.2 million were redeemed prior to the year end and a further £2.3 have been redeemed subsequently. It is planned that the remaining £0.3 million will be redeemed on 30 April 2006, being the next interest payment date.

RISK MANAGEMENT

The Group regards the monitoring and controlling of risks as a fundamental part of the management process. Consequently, senior management are involved in the development of risk management policies and in monitoring their application. The Group's overall approach to managing internal control and financial reporting is described in the Corporate Governance section of this Annual Report.

The principal non-operational risks inherent in the Group's business are credit, liquidity and market risks. A detailed description of the risk management policies in these areas is set out in Note 31 to the financial statements. Credit risk is managed through the Credit Committees of Secure Trust Bank and Arbuthnot Latham & Co, with significant exposures also being approved by the Group Risk Committee. Of the total gross loan book of £143.2 million at 31 December 2005, some £32.3 million represents largely unsecured loans to customers of Secure Trust Bank and £110.9 million represents the commercial lending portfolio, most of which is well secured against cash, property, factored debts or other assets. A provision of £3.0 million (2.1% of total outstandings) is carried against the loan book.

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

Through Arbuthnot Securities the Group is also involved in market-making and underwriting in UK equities. The market-making book is well controlled

and is relatively modest in relation to the Group's overall financial resources (net long positions outstanding at 31 December 2005 being only some £2.6 million). The market-making book is subject to Group-approved limits, both in aggregate and in relation to individual stocks. Outstanding positions are monitored against these limits both intraday and overnight. All significant underwriting transactions are individually approved by the Group Risk Committee.

A conservative approach is also taken to managing the liquidity profile and capital of the Group. Both of the banking subsidiaries operate with liquidity margins and risk asset ratios in excess of the minimum levels set by the regulators.

FINANCES

Equity shareholders' funds were £31.8 million at the year-end (2004: £26.0 million). Total assets rose from £290.4 million to £326.1 million. During the year, the Group's total liquid resources (cash, advances to banks and building societies and highly liquid certificates of deposit) rose by £14.2 million to £117.2 million. The major outflows during the year were in respect of an increase in customer advances of £11.3 million, net capital expenditure of £1.4 million, acquisition of £1.1 million and repayment of debt securities of £5.3 million. Financing of these outflows came from an increase in deposits of £14.8 million, disposal proceeds (net of cash disposed) of £2.6 million, shares issued of £3.8 million, debt securities issued of £10.1 million and an operating cash inflow, after taxation and dividends, of £2.0 million.

SUBSEQUENT EVENT

On 21 March 2006 the Company announced a proposed Placing and Offer to raise £4 million (net of expenses) to finance the expansion of Arbuthnot Latham into overseas markets, initially in Switzerland. Existing shareholders are to be offered one new ordinary share for every 20 shares held at a price expected to be 600 pence per share. The Placing and Offer are conditional, *inter alia*, on shareholder approval.

group directors & secretary

1 Henry Angest

Chairman and Chief Executive of the Group and Chairman of Secure Trust Bank PLC, Arbuthnot Latham & Co., Limited and Arbuthnot Securities Limited. He is Chairman of the Banking Committee of the London Investment Banking Association and Junior Warden of the Guild of International Bankers.

2 Mark Brown

Appointed a director on 10 February 2005. He joined the Group in September 2004 as Chief Executive of Arbuthnot Securities Limited. He was previously global head of research at ABN AMRO and HSBC Investment Bank and Chief Executive of ABN AMRO Equities (UK).

3 Keith Deakin

Joined Secure Trust Bank in 1973 and with over 17 years of overall responsibility for the IT function was appointed IT director in June 1992. In 1999 he assumed overall responsibility for IT development in all companies in the Group. He became joint managing director of Secure Trust Bank PLC in January 2001 and was appointed a director of Arbuthnot Banking Group PLC on 1 January 2003.

4 David Lascelles

Independent non-executive director appointed on 1 June 2003. He is Co-Director and Joint Founder of the Centre for the Study of Financial Innovation, is an author of reports and books about the banking scene and writes for the international press. He previously held senior positions with the Financial Times.

5 Ruth Lea

Independent non-executive director since 1 November 2005. She is a director of the Centre for Policy Studies, is on the University of London Council and is a Governor of the London School of Economics. She was previously Head of the Policy Unit at the Institute of Directors, Economics Editor at ITN, Chief UK Economist at Lehman Brothers and Chief Economist at Mitsubishi Bank.

6 Stephen Lockley FCA

Group Finance Director since 1994. He was also Chief Executive of Arbuthnot Securities Limited from 2003 to 2004 and Chief Executive of Arbuthnot Latham & Co., Limited from 1995 to 2003. He is a Chartered Accountant and a member of the Court of the Guild of International Bankers and was previously a director of Charterhouse Bank Limited and a member of the Council of the British Bankers Association.

7 Derek Pearson

Joined Secure Trust Bank in 1975 and after a variety of posts was appointed to its board in June 1992 as marketing director. In January 2001 he became joint managing director of Secure Trust Bank PLC and was appointed a director of Arbuthnot Banking Group PLC on 1 January 2003.

8 John Reed

Appointed a director on 1 June 2003. Chief Executive of Arbuthnot Latham & Co., Limited since April 2003. He was previously Group Chief Operating Officer of SG Hambros Bank & Trust Limited, prior to which he was a director of Hambros Bank Limited, having started his career with Midland Bank plc.

9 Andrew Salmon ACA

Appointed a director on 8 March 2004. He joined the Company in 1997 and is Chief Operating Officer and Head of Business Development. He was previously a director of Hambros Bank Limited and qualified as a Chartered Accountant with Peat Marwick (now KPMG).

10 Atholl Turrell ACA

Non-executive director appointed on 1 March 2004. He was formerly Head of Corporate Stockbroking at Schroder Salomon Smith Barney (now Citigroup), prior to which he held senior investment banking positions at Deutsche Bank, Merrill Lynch and Charterhouse. He is Vice-Chairman of Arbuthnot Securities Limited and is a non-executive director of Biotrace International plc.

11 Colin Wakelin

Independent non-executive director since 1999. He was formerly Chief Executive and Deputy Chairman of Investec Bank (UK) Limited.

12 Robert Wickham

Deputy Chairman and senior independent non-executive director. He was formerly on the Management Board of Bank of Scotland. He is also an independent non-executive director of Secure Trust Bank PLC, Arbuthnot Latham & Co., Limited, Rutland Trust Plc and Georgica PLC.

Secretary

Jeremy Robin Kaye FCIS

principal subsidiaries' directors

SECURE TRUST BANK PLC

Henry Angest, Chairman
Keith Deakin, Joint Managing Director
Derek Pearson, Joint Managing Director
John Shipley, Finance
Stephen Lockley, Group
Andrew Salmon, Group
Robert Wickham, Non-executive

ARBUTHNOT LATHAM & CO., LTD

Henry Angest, Chairman
John Reed, Chief Executive
Allan James, Banking
Peter Keech, Executive
David Kidd, Chief Investment Officer
Stephen Lockley, Vice-Chairman
Wayne Mathews, Finance
Clive Moore, Risk Management
Brian Rout, Executive
Andrew Whitton, Executive
Andrew Salmon, Group
Brian Collis, Non-executive
Robin Herbert, Non-executive
Robert Wickham, Non-executive

ARBUTHNOT SECURITIES LIMITED

Henry Angest, Chairman
Mark Brown, Chief Executive
Shai Hill, Head of Research
Neil Kirton, Deputy Chief Executive
Robert Taylor, Head of Sales
James Steel, Head of Corporate Finance
Stephen Lockley, Group
Andrew Salmon, Group
Atholl Turrell, Non-executive Vice-Chairman

ADDITIONAL NON-EXECUTIVE BIOGRAPHIES

Brian Collis
He joined Arbuthnot Latham & Co., Limited in 1994 and was risk management director until he retired from executive duties in June 2001. He previously spent 34 years with Midland Bank plc, during which he held several senior positions.

Robin Herbert CBE
Appointed a director of Arbuthnot Latham & Co., Limited on 23 March 2005. He was formerly Chairman of Leopold Joseph Holdings plc and has served as Deputy Chairman of Consolidated Gold Fields plc and a non-executive director of National Westminster Bank PLC, Marks & Spencer PLC and other companies.

directors' report

The directors submit their annual report and the audited consolidated financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES AND REVIEW

The principal activities of the Group are banking and financial services. A business review complying with the Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005 forming part of this report is set out on pages 14 to 17.

RESULTS AND DIVIDENDS

The results for the year are shown on page 29. The balance of profit for the year of £2.0 million after payment of dividends is included in reserves.

The directors recommend the payment of a final dividend of 21.5 pence on the ordinary shares which, together with the interim dividend of 10.5 pence paid on 28 October 2005, represents a total dividend for the year of 32.0 pence. The final dividend, if approved by members at the Annual General Meeting, will be paid on 25 May 2006 to shareholders on the register at close of business on 28 April 2006.

CHANGE OF NAME

The change in the name of the Company from Secure Trust Banking Group PLC to Arbuthnot Banking Group PLC took effect on 1 June 2005 following the passing of a Special Resolution at the last Annual General Meeting.

SHARE CAPITAL

Following the Extraordinary General Meeting on 20 January 2005 the Company allotted 1,282,245 ordinary shares at 310 pence per share.

Subject to shareholder approval, the directors have announced a proposed Placing and Offer of 710,000 ordinary shares at a price expected to be 600 pence per share.

At the Annual General Meeting shareholders will be asked to approve a Special Resolution continuing the authority of the directors to issue shares in nominal value equal to 5% of the existing share capital for cash, otherwise than to existing shareholders pro rata to their holdings. Except as stated herein, the directors have no present intention of issuing any shares and will not issue shares which would effectively change the control of the Company without the prior approval of shareholders in General Meeting. The authority granted by the Resolution will expire at the conclusion of the Annual General Meeting in 2007.

SUBSTANTIAL SHAREHOLDERS

The Company was aware at 28 March 2006 of the following substantial holdings in the ordinary shares of the Company, other than those held by one director shown below:

| Holder | Ordinary Shares | % |
|----------------|-----------------|-----|
| Prudential plc | 738,528 | 5.2 |
| Mr R Paston | 529,130 | 3.7 |

SHARE OPTION SCHEME

At the Annual General Meeting shareholders will be asked to approve an Ordinary Resolution to amend the rules of the Unapproved Executive Share Option Scheme to allow options to be granted by the Board at any time other than during a close period or when the Board is in possession of unpublished price-sensitive information (both as defined in the AIM Rules for Companies). Options can at present only be granted during a period commencing on the second stock exchange dealing day after the date of announcement of the annual or half-yearly results of the Company and ending 42 days following the relevant announcement.

SALE OF SUBSIDIARY

The Company announced on 13 October 2005 that it had completed the sale of Arbuthnot Insurance Brokers Limited to the Towergate Partnership for £2,000,000.

ISSUE OF LOAN NOTES

The Company announced on 7 November 2005 the issue of €15,000,000 Floating Rate Subordinated Notes 2035 to provide working capital and to redeem the existing £7,817,000 Floating Rate Subordinated Notes 2009. At the date of this report £7,550,000 of the 2009 Notes had been redeemed.

DIRECTORS

| | |
|----------------|------------------------|
| H Angest | <i>Chairman</i> |
| R J J Wickham | <i>Deputy Chairman</i> |
| M F Brown | |
| K N F Deakin | |
| D R Lascelles | |
| Ms R J Lea | |
| S J Lockley | |
| D Pearson | |
| J Reed | |
| A A Salmon | |
| Dr A D Turrell | |
| A C Wakelin | |

Apart from Mr M F Brown, who was appointed a director on 10 February 2005, and Ms R J Lea, who was appointed a director on 1 November 2005, all the directors served throughout the year.

Mr Lascelles retires under Article 109 of the Articles of Association and, being eligible, offers himself for re-election. He does not have a service agreement.

Ms R J Lea retires under Article 87 of the Articles of Association and, being eligible, offers herself for re-election. She does not have a service agreement.

directors' report cont.

According to the register maintained under Section 325 of the Companies Act 1985, the interests of directors and their families in the ordinary 1p shares of the Company at the dates shown were, and the percentage of the current issued share capital held is, as follows:

| Beneficial Interests | 1 January 2005 | 31 December 2005 | 28 March 2006 | % |
|----------------------|-------------------|---------------------|------------------|------|
| H Angest | 6,120,033 | 6,980,294 | 6,980,294 | 49.0 |
| M F Brown | — | 20,000 | 20,000 | 0.1 |
| K N F Deakin | 721 | 2,820 | 2,820 | — |
| S J Lockley | 18,832 | 30,696 | 30,696 | 0.2 |
| J Reed | 10,000 | 10,000 | 10,000 | 0.1 |
| A D Turrell | 10,000 | 20,383 | 20,383 | 0.1 |
| A C Wakelin | 4,319 | 4,319 | 4,319 | — |
| R J J Wickham | 1,500 | 1,678 | 1,678 | — |

Following approval at the Extraordinary General Meeting on 20 January 2005 of the Arbuthnot Securities Long Term Incentive Plan, Mr Brown and Dr Turrell have acquired 160,000 and 10,000 shares respectively in that subsidiary.

Apart from the interests disclosed above, no director was interested at any time in the year in the share capital of Group companies.

No director, either during or at the end of the financial year, was materially interested in any contract with the Company or any of its subsidiaries which was significant in relation to the Group's business. At 31 December 2005 three directors had loans from Secure Trust Bank PLC amounting to £661,000 in aggregate and two directors had loans from Arbuthnot Latham & Co., Limited amounting to £399,000, all on normal commercial terms as disclosed in note 24 to the financial statements.

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

BOARD COMMITTEES

The report of the Remuneration Committee on pages 25 and 26 will be the subject of an Ordinary Resolution at the Annual General Meeting.

Information on the Audit Committee, Nomination Committee and Risk Committee is included in the Corporate Governance section of the Annual Report on pages 23 and 24.

ARTICLES OF ASSOCIATION

No substantive changes have been made to the Articles of Association since the flotation of the Company in December 1988. In view of subsequent changes to law and practice and proposals in the Company Law Reform Bill, a revision of the Articles has been undertaken with the assistance of external lawyers. Details of the changes are set out in a

circular to shareholders and a Special Resolution to adopt new Articles of Association will be proposed at the Annual General Meeting.

EMPLOYEES

The Company gives due consideration to the employment of disabled persons and is an equal opportunities employer. It also regularly provides employees with information on matters of concern to them, consults on decisions likely to affect their interests and encourages their involvement in the performance of the Company through share participation and in other ways.

SUPPLIER PAYMENT POLICY

The Company's policy is to make payment in line with terms agreed with individual suppliers, payment being effected on average within 30 days of invoice.

STATUS

The Company is not a close company as defined in the Income and Corporation Taxes Act 1988.

AUDITORS

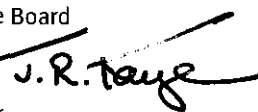
A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the Company will be proposed at the forthcoming Annual General Meeting at a fee to be agreed in due course by the directors.

The directors have disclosed to the auditors to the best of their knowledge and belief all relevant information necessary to assist the auditors in the preparation of their report.

By order of the Board

J R Kaye
Secretary

29 March 2006



corporate governance

AIM companies are not required to comply with The Combined Code. Nevertheless, the Board endorses the principles of openness, integrity and accountability which underlie good corporate governance and intends to take into account the provisions of The Combined Code in so far as they are appropriate to the Group's size and circumstances. Moreover, the Group contains subsidiaries authorised to undertake regulated business under the Financial Services and Markets Act 2000 and regulated by the Financial Services Authority, including two which are authorised deposit taking businesses. Accordingly, the Group operates to the high standards of corporate accountability and regulatory compliance appropriate for such businesses.

DIRECTORS

The Group is led and controlled by an effective Board which comprises seven executive directors and five non-executive directors, each of whose role is outlined on pages 18 and 19.

The senior independent non-executive director is Robert Wickham, who in addition is Deputy Chairman. Although Mr Wickham has served on the Board for twelve years from the date of his first election, he displays independence in both character and judgement and there are no other relationships or circumstances which could affect his judgement. Accordingly, the Board considers him to be independent.

THE BOARD

The Board meets regularly throughout the year. Substantive agenda items have briefing papers, which are circulated in a timely manner before each meeting. The Board is satisfied that it is supplied with all the information that it requires and requests, in a form and of a quality to enable it to discharge its duties. In addition to ongoing matters concerning the strategy and management of the Company and of the Group, the Board has determined certain items which are reserved for decision by itself. These matters include the acquisition and disposal of other than minor businesses, the issue of capital by any Group company and any transaction by a subsidiary company that cannot be made within its own resources, or that is not in the normal course of its business.

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

The Board has delegated certain of its responsibilities to Committees. All Committees have written terms of reference.

AUDIT COMMITTEE

Membership of the Audit Committee is limited to non-executive directors and comprises Robert Wickham (as Chairman), Colin Wakelin, David Lascelles, Atholl Turrell and Ruth Lea.

The Audit Committee provides a forum for discussing with the Group's external auditors their report on the annual accounts, reviewing the scope, results and effectiveness of the internal audit work programme and considering any other matters which might have a financial impact on the Company, including the Group's arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The Audit Committee's responsibilities include reviewing the Group's system of internal control and the process for evaluating and monitoring risk. The Committee also reviews the appointment, terms of engagement and objectivity of the external auditors, including the level of non-audit services provided, and ensures that there is an appropriate audit relationship.

REMUNERATION COMMITTEE

Information on the Remuneration Committee and details of the directors' remuneration are set out in the separate remuneration report.

NOMINATION COMMITTEE

The Nomination Committee is chaired by Henry Angest and its other members are Robert Wickham and Colin Wakelin. Before a Board appointment is made the skills, knowledge and experience required for a particular appointment are evaluated.

corporate governance cont.

RISK COMMITTEE

The Risk Committee is chaired by Henry Angest and its other members are Stephen Lockley, John Reed, Atholl Turrell, Robert Wickham and Colin Wakelin. The role of the Risk Committee is to approve specific risk policies for Group subsidiaries and significant individual credit or other exposures.

SHAREHOLDER COMMUNICATIONS

The Company maintains a regular dialogue with its shareholders and makes full use of the Annual General Meeting and Extraordinary General Meetings to communicate with investors.

The Company aims to present a balanced and understandable assessment in all its reports to shareholders, its regulators and the wider public. Key announcements and other information can be found at www.arbuthnotgroup.com.

INTERNAL CONTROL AND FINANCIAL REPORTING

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

The directors and senior management of the Group have formally adopted a Group Risk and Controls Policy which sets out the Board's attitude to risk and internal control. Key risks identified by the directors are formally reviewed and assessed at least once a year by the Board, in addition to which key business risks are identified, evaluated and managed by operating management on an ongoing basis by means of procedures such as physical controls, credit and other authorisation limits and segregation of duties. The Board also receives regular reports on any risk matters that need to be brought to its attention. Significant risks identified in connection with the development of new activities are subject to consideration by the Board. There are 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 effectiveness of the internal control system is reviewed regularly by the Board and the Audit Committee, which also receives reports of reviews undertaken by the internal audit function. The Audit Committee also receives reports from the external Auditors, PricewaterhouseCoopers LLP, which include details of significant internal control matters that they have identified. Certain aspects of the system of internal control are also subject to regulatory supervision, the results of which are monitored closely by the Board.

GOING CONCERN

The directors confirm that they are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit and cash flows of the Group for the year.

The directors confirm that suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used in the preparation of the financial statements.

The directors confirm that applicable accounting standards have been followed.

In addition, the directors are responsible for maintaining adequate accounting records, and taking reasonable steps to safeguard the assets of the Group and to prevent and detect fraud or any other irregularities.

remuneration report

REMUNERATION COMMITTEE

Membership of the Remuneration Committee is limited to non-executive directors together with Henry Angest as Chairman. The present members of the Committee are Henry Angest, Robert Wickham and Colin Wakelin.

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

REMUNERATION POLICY

The Remuneration Committee determines the remuneration of individual directors having regard to the size and nature of the business; the importance of attracting, retaining and motivating management of the appropriate calibre without paying more than is necessary for this purpose; remuneration data for comparable positions; the need to align the interests of executives with those of shareholders; and an appropriate balance between current remuneration and longer term performance-related rewards. The remuneration package can comprise a combination of basic annual salary and benefits (including pension), a discretionary annual bonus award related to the Committee's assessment of the contribution made by the executive during the year and longer term incentives, including executive share options. Pension benefits take the form of annual contributions paid by the Company to individual money purchase schemes. The Remuneration Committee reviews salary levels each year based on the performance of the Group during the preceding financial period. This review does not necessarily lead to increases in salary levels. The Group is increasingly changing the remuneration policy from fixed salaries to a more flexible system with lower base salaries and a bigger bonus element which can be discretionary or formulaic. The purpose of this policy is to align costs more closely with income. The acquisition of Arbuthnot Securities has accelerated this process. The payment of large bonuses, some transactional and some formulaic but both based on income to the company, is common in the investment banking industry.

DIRECTORS' SERVICE CONTRACTS

Henry Angest, Stephen Lockley, Andrew Salmon, John Reed and Mark Brown each have service contracts terminable at any time on 12 months' notice in writing by either party.

Neither Keith Deakin nor Derek Pearson has a service agreement.

SHARE OPTION AND LONG TERM INCENTIVE SCHEMES

This part of the remuneration report is auditable information.

At the date of this remuneration report, there are no outstanding options to directors under the Unapproved Executive Share Option Scheme nor any shares held in the Arbuthnot ESOP Trust.

In May 2005, the Company extended its Unapproved Executive Share Option Scheme for a further period of 10 years.

The Company has an ESOP ("the Arbuthnot ESOP Trust") under which trustees may purchase shares in the Company to satisfy the exercise of share options by employees including executive directors.

In January 2005, shareholders approved a long term incentive plan for employees of Arbuthnot Securities Limited, which involves the purchase by such employees of shares in Arbuthnot Securities Limited. This scheme is open to employees of Arbuthnot Securities Limited including those who are also directors of Arbuthnot Banking Group PLC. On 31 March 2005, Mark Brown and Atholl Turrell acquired 160,000 and 10,000 shares respectively in Arbuthnot Securities Limited under the plan at a price of £2.35 per share.

remuneration report cont.

DIRECTORS' EMOLUMENTS

This part of the remuneration report is auditable information.

| | 2005 £000 | | 2004 £000 | |
|--|--------------|--|--------------|--|
| Fees (including benefits in kind) | 254 | | 220 | |
| Salary payments (including benefits in kind) | 1,795 | | 1,642 | |
| Pension contributions | 328 | | 160 | |
| | 2,377 | | 2,022 | |

| | Salary £000 | Bonus £000 | Benefits £000 | Pension contributions £000 | Fees £000 | Total 2005 £000 | Total 2004 £000 |
|---------------|----------------|---------------|------------------|----------------------------------|--------------|-----------------------|-----------------------|
| H Angest | 250 | — | 64 | — | — | 314 | 302 |
| M F Brown | 197 | 25 | 23 | 64 | — | 309 | — |
| K N F Deakin | 140 | — | 27 | 31 | — | 198 | 238 |
| S J Lockley | 300 | — | 35 | 50 | — | 385 | 484 |
| D Pearson | 140 | — | 30 | 31 | — | 201 | 220 |
| J Reed | 160 | 100 | 25 | 32 | — | 317 | 317 |
| A A Salmon | 160 | 100 | 19 | 120 | — | 399 | 241 |
| Non-executive | | | | | | | |
| D R Lascelles | — | — | — | — | 30 | 30 | 30 |
| Ms R J Lea | — | — | — | — | 7 | 7 | — |
| A D Turrell | — | — | — | — | 152 | 152 | 125 |
| A C Wakelin | — | — | — | — | 30 | 30 | 30 |
| R J Wickham | — | — | — | — | 35 | 35 | 35 |
| | 1,347 | 225 | 223 | 328 | 254 | 2,377 | 2,022 |

The emoluments of the Chairman were £314,000 (2004: £302,000). The emoluments of the highest paid director were £399,000 (2004: £484,000) including pension contributions of £120,000 (2004: £50,000).

Mr A C Wakelin is a director of Wakelin Partners Limited which received fees totalling £30,000 (2004: £30,000) in respect of his services to the Group.

Mr R J J Wickham is a director of Broughfame Limited which received an annual fee of £35,000 (2004: £35,000) in respect of his services to the Group.

Dr A D Turrell received a fee of £30,000 (2004: £25,000) for his services as a non-executive director

and fees of £122,000 (2004: £100,000) in respect of investment banking advice.

These fees are included in the above figures.

Retirement benefits are accruing under money purchase schemes for six directors who served during 2005 (2004: six directors).

Henry Angest

Chairman of the Remuneration Committee

29 March 2006



independent auditors' report

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF ARBUTHNOT BANKING GROUP PLC

We have audited the Group and Parent Company financial statements (the "financial statements") of Arbuthnot Banking Group PLC for the year ended 31 December 2005 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statement of Changes in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion,

the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report, the unaudited part of the Directors' Remuneration Report, the Chairman's Statement, the Operating and Financial Review and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

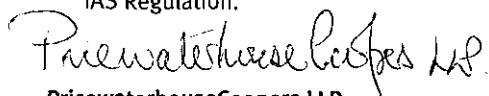
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

independent auditors' report cont.

OPINION

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of the Group's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2005 and cash flows for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.



PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

Birmingham

29 March 2006

consolidated income statement

FOR THE YEAR ENDED 31 DECEMBER 2005

| | Note | Year ended 31 December | |
|---|----------|------------------------|---------------|
| | | 2005 £000 | 2004 £000 |
| Interest and similar income | | 18,070 | 14,973 |
| Interest expense and similar charges | | (8,573) | (6,285) |
| Net interest income | | 9,497 | 8,688 |
| Fee and commission income | | 44,869 | 38,721 |
| Fee and commission expense | | (1,088) | (578) |
| Net fee and commission income | | 43,781 | 38,143 |
| Net trading income | | 3,069 | 1,158 |
| Operating income | 1 | 56,347 | 47,989 |
| Gain on sale of minority interest in subsidiary | 25 | 850 | — |
| Impairment losses on loans and advances | 9 | (1,641) | (1,235) |
| Operating expenses | 1 | (47,880) | (43,758) |
| Profit on continuing activities before tax | | 7,676 | 2,996 |
| Taxation | 3 | (2,197) | (421) |
| Profit on discontinued activity after taxation | 27 | 1,405 | 294 |
| Profit for the year | | 6,884 | 2,869 |
| Attributable to: | | | |
| Equity holders of the Company | | 6,489 | 2,852 |
| Minority interest | 25 | 395 | 17 |
| | | 6,884 | 2,869 |
| Earnings per share for profit attributable to the equity holders of the Company during the year (expressed in pence per share): | | | |
| — basic and fully diluted | 4 | 45.8p | 22.0p |

consolidated balance sheet

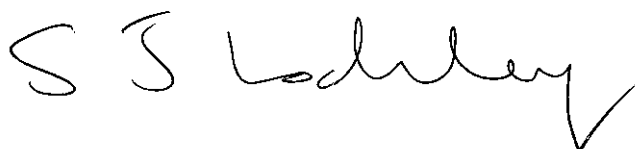
AT 31 DECEMBER 2005

| | Note | At 31 December | |
|--|------|----------------|----------------|
| | | 2005 £000 | 2004 £000 |
| Assets | | | |
| Cash | 5 | 188 | 139 |
| Loans and advances to banks and building societies | 6 | 28,587 | 52,367 |
| Trading securities — long positions | 7 | 5,383 | 5,899 |
| Loans and advances to customers | 8 | 140,151 | 129,809 |
| Debt securities held-to-maturity | 10 | 88,389 | 50,500 |
| Intangible assets | 11 | 3,000 | 3,642 |
| Property, plant and equipment | 12 | 31,458 | 32,125 |
| Current tax asset | | — | 1,224 |
| Other assets | 13 | 28,948 | 14,681 |
| Total assets | | 326,104 | 290,386 |
| Liabilities | | | |
| Deposits from banks | 14 | 9,190 | 30,830 |
| Trading securities — short positions | 7 | 2,785 | 1,159 |
| Deposits from customers | 15 | 239,433 | 202,996 |
| Debt securities in issue | 16 | 12,716 | 7,923 |
| Other liabilities | 17 | 26,998 | 20,311 |
| Current tax liabilities | | 790 | — |
| Deferred tax liabilities | 18 | 1,116 | 1,077 |
| Total liabilities | | 293,028 | 264,296 |
| Equity | | | |
| Share capital | 20 | 143 | 130 |
| Share premium account | 20 | 17,115 | 13,370 |
| Retained earnings | 21 | 11,111 | 9,106 |
| Other reserves | 21 | 3,395 | 3,395 |
| Capital and reserves attributable to the Company's equity holders | | 31,764 | 26,001 |
| Minority interest | 25 | 1,312 | 89 |
| Total equity | | 33,076 | 26,090 |
| Total equity and liabilities | | 326,104 | 290,386 |

The financial statements on pages 29 to 54 were approved by the Board of directors on 29 March 2006 and were signed on its behalf by:

H Angest Director

S J Lockley Director

statements of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2005

consolidated

| | Attributable to equity holders of the Company | | | | | Total £000 |
|---|---|-------------------------------------|---------------------------|------------------------------|------------------------------|---------------|
| | Share capital £000 | Share premium account £000 | Other reserves £000 | Retained earnings £000 | Minority interest £000 | |
| | £000 | £000 | £000 | £000 | £000 | |
| Balance at 1 January 2004 | 130 | 13,370 | 2,314 | 9,684 | 77 | 25,575 |
| Surplus on revaluation of freehold properties net of deferred tax | — | — | 1,666 | — | — | 1,666 |
| Profit for 2004 | — | — | — | 2,852 | 17 | 2,869 |
| Final dividend relating to 2003 | — | — | — | (2,655) | (5) | (2,660) |
| Interim dividend relating to 2004 | — | — | — | (1,360) | — | (1,360) |
| Transfer from general banking reserves | — | — | (585) | 585 | — | — |
| At 31 December 2004/1 January 2005 | 130 | 13,370 | 3,395 | 9,106 | 89 | 26,090 |
| Issue of shares | 13 | 3,745 | — | — | — | 3,758 |
| Sale of minority interest in Arbutnot Securities Limited | — | — | — | — | 832 | 832 |
| Profit for 2005 | — | — | — | 6,489 | 395 | 6,884 |
| Final dividend relating to 2004 | — | — | — | (2,989) | (4) | (2,993) |
| Interim dividend relating to 2005 | — | — | — | (1,495) | — | (1,495) |
| At 31 December 2005 | 143 | 17,115 | 3,395 | 11,111 | 1,312 | 33,076 |

company

| | Attributable to equity holders of the Company | | | | | Total £000 |
|------------------------------------|---|-------------------------------------|---------------------------|------------------------------|--|---------------|
| | Share capital £000 | Share premium account £000 | Other reserves £000 | Retained earnings £000 | | |
| | £000 | £000 | £000 | £000 | | |
| Balance at 1 January 2004 | 130 | 13,370 | 20 | 12,208 | | 25,728 |
| Profit for 2004 | — | — | — | 3,735 | | 3,735 |
| Final dividend relating to 2003 | — | — | — | (2,655) | | (2,655) |
| Interim dividend relating to 2004 | — | — | — | (1,360) | | (1,360) |
| At 31 December 2004/1 January 2005 | 130 | 13,370 | 20 | 11,928 | | 25,448 |
| Issue of shares | 13 | 3,745 | — | — | | 3,758 |
| Profit for 2005 | — | — | — | 2,049 | | 2,049 |
| Final dividend relating to 2004 | — | — | — | (2,989) | | (2,989) |
| Interim dividend relating to 2005 | — | — | — | (1,495) | | (1,495) |
| At 31 December 2005 | 143 | 17,115 | 20 | 9,493 | | 26,771 |

company balance sheet

AT 31 DECEMBER 2005

| | Note | At 31 December | |
|--|------|----------------|--------------|
| | | 2005 £000 | 2004 £000 |
| Non-current assets | | | |
| Shares in subsidiary undertakings | 28 | 27,592 | 28,374 |
| Property, plant and equipment | 12 | 163 | 1 |
| Due from subsidiary undertakings | | 7,350 | 5,600 |
| Current assets | | | |
| Due from subsidiary undertakings | | 6,453 | 8,633 |
| Investment | 13 | 1,900 | — |
| Other debtors | | 2,221 | 524 |
| | | 10,574 | 9,157 |
| Current liabilities | | | |
| Bank borrowings | | — | 2,000 |
| Due to subsidiary undertakings | | 6,028 | 7,449 |
| Accruals | | 164 | 312 |
| Loan notes | 16 | — | 106 |
| | | 6,192 | 9,867 |
| Net current assets | | 4,382 | (710) |
| Total assets less current liabilities | | 39,487 | 33,265 |
| Non-current liabilities | 16 | 12,716 | 7,817 |
| | | 26,771 | 25,448 |
| Capital and reserves | | | |
| Called up share capital | 20 | 143 | 130 |
| Share premium account | 20 | 17,115 | 13,370 |
| Capital redemption reserve | 21 | 20 | 20 |
| Profit and loss account | 21 | 9,493 | 11,928 |
| Equity shareholders' funds | | 26,771 | 25,448 |

The financial statements on pages 29 to 54 were approved by the Board of directors on 29 March 2006 and were signed on its behalf by:

H Angest Director

S J Lockley Director

angest

S J Lockley

consolidated cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2005

| | Note | Year ended 31 December | |
|--|------|------------------------|--------------|
| | | 2005 £000 | 2004 £000 |
| Cash flows from operating activities | | | |
| Interest received | | 18,099 | 15,016 |
| Interest paid | | (8,573) | (6,285) |
| Fees and commissions received | | 45,193 | 39,858 |
| Net trading and other income | | 3,069 | 1,158 |
| Recoveries on loans previously written off | | 178 | 14 |
| Cash payments to employees and suppliers | | (47,062) | (43,226) |
| Taxation paid | | (226) | (1,499) |
| Cash flows from operating profits before changes in operating assets and liabilities | | 10,678 | 5,036 |
| Changes in operating assets and liabilities: | | | |
| — net decrease in trading securities | | 2,142 | (4,095) |
| — net increase in loans and advances to customers | | (11,328) | (20,395) |
| — net increase in other assets | | (16,604) | (3,559) |
| — net decrease in deposits from other banks | | (21,640) | 12,676 |
| — net increase in amounts due to customers | | 36,437 | 15,701 |
| — net increase in other liabilities | | 10,269 | 2,889 |
| Net cash from operating activities: | | | |
| Continuing activities | | 9,086 | 7,957 |
| Discontinued activity | | 868 | 296 |
| | | 9,954 | 8,253 |
| Cash flows from investing activities | | | |
| Investment in subsidiary | | (1,093) | — |
| Disposal of subsidiary, net of cash disposed | | 926 | — |
| Disposal of minority interest | | 1,682 | — |
| Purchase of property, plant and equipment | 12 | (1,273) | (4,587) |
| Purchase of computer software | 11 | (310) | (473) |
| Proceeds from sale of property, plant and equipment | | 209 | 914 |
| Net purchases of debt securities | | (782) | (6,736) |
| Net cash used in investing activities | | (641) | (10,882) |
| Cash flows from financing activities | | | |
| Issue of shares | 20 | 3,758 | — |
| Issue of debt securities | | 10,149 | — |
| Repayment of debt securities | | (5,356) | (162) |
| Dividends paid | | (4,488) | (4,020) |
| Net cash from financing activities | | 4,063 | (4,182) |
| Net increase in cash and cash equivalents: | | | |
| Continuing activities | | 11,582 | (7,107) |
| Discontinued activity | | 1,794 | 296 |
| | | 13,376 | (6,811) |
| Cash and cash equivalents at beginning of year | | 71,770 | 78,581 |
| Cash and cash equivalents at end of year | 23 | 85,146 | 71,770 |

company cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2005

| | Note | Year to 31 December | |
|--|------|---------------------|--------------|
| | | 2005 £000 | 2004 £000 |
| Cash flows from operating activities | | | |
| Dividends received from subsidiaries | | 4,129 | 4,344 |
| Interest received | | 394 | 316 |
| Interest paid | | (709) | (735) |
| Net trading and other income | | 95 | — |
| Cash payments to employees and suppliers | | (3,289) | (1,575) |
| Taxation received | | 825 | 665 |
| Cash flows from operating profits before changes in operating assets and liabilities | | 1,445 | 3,015 |
| Changes in operating assets and liabilities: | | | |
| — net decrease in group company balances | | 468 | 1,492 |
| — net increase in other assets | | (1,697) | (441) |
| — net decrease in other liabilities | | (148) | 112 |
| Net cash from operating activities | | 68 | 4,178 |
| Cash flows from investing activities | | | |
| Loans to subsidiary companies | | (1,750) | (1,000) |
| Disposal of minority interest | | 1,682 | — |
| Purchase of available-for-sale investment | 13 | (1,900) | — |
| Purchase of property, plant and equipment | 12 | (167) | (1) |
| Reduction in subsidiary share capital | | — | 2,000 |
| Net cash from investing activities | | (2,135) | 999 |
| Cash flows from financing activities | | | |
| Issue of shares | 20 | 3,758 | — |
| Issue of debt securities | | 10,149 | — |
| Repayments of borrowed funds and debt securities | | (7,356) | (1,162) |
| Dividends paid | | (4,484) | (4,015) |
| Net cash from financing activities | | 2,067 | (5,177) |
| Net increase in cash and cash equivalents | | — | — |
| Cash and cash equivalents at beginning of year | | — | — |
| Cash and cash equivalents at end of year | | — | — |

principal accounting policies

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

1. BASIS OF PRESENTATION

The Group's consolidated financial statements and the Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. This means those International Accounting Standards, International Financial Reporting Standards and related Interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB) that have been endorsed by the European Union. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain fixed assets and financial assets and financial liabilities held at fair value through profit or loss.

These consolidated financial statements are the first full financial statements prepared by the Group in accordance with IFRS. The impact of the change from UK Generally Accepted Accounting Policies (UK GAAP) is summarised in Note 30. The Group has elected not to restate business combinations that took place prior to 1 January 2004. Comparative information for 2004 has been restated to comply with IFRS.

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 Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 32.

2. CONSOLIDATION

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's shares of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

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

3. SEGMENT REPORTING

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

4. FOREIGN CURRENCY TRANSLATION

(a) Functional and presentation currency

All Group entities operate primarily in the United Kingdom and items included in their financial statements are measured using pounds sterling ('the functional currency'). The consolidated financial statements are presented in pounds sterling, which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. 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.

5. 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 method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group takes into account all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

6. FEE AND COMMISSION INCOME

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees are deferred and recognised as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party — such as the issue or the

principal accounting policies cont.

acquisition of shares or other securities or the purchase or sale of businesses — are recognised on completion of the underlying transaction. Asset and other management, advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis. The same principle is applied for financial planning and insurance services that are continuously provided over an extended period of time.

7. FINANCIAL ASSETS

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

(a) Financial assets at fair value through profit or loss
This category comprises financial assets held for trading.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable.

(c) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity.

(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.

Purchases and sales of financial assets at fair value through profit or loss are recognised on trade-date — the date on which the Group commits to purchase or sell the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are de-recognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Financial assets at fair value through profit or loss and available-for-sale financial assets are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss.

The fair values of quoted investments in active markets are based on current bid prices for long positions and offer prices for short positions (taking into account the size and liquidity of the holding).

8. OFFSETTING FINANCIAL INSTRUMENTS

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

9. IMPAIRMENT OF FINANCIAL ASSETS

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

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 income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

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

10. INTANGIBLE ASSETS

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

(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 five years).

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

11. PROPERTY, PLANT AND EQUIPMENT

Land and buildings comprise mainly branches and offices and are stated at latest valuation with subsequent additions at cost less depreciation. Plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

| | |
|--------------------|------------|
| Freehold buildings | 2% |
| Office equipment | 5% to 15% |
| Computer equipment | 20% to 33% |
| Motor vehicles | 25% |

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

12. CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash, loans and advances to banks and building societies and short-term highly liquid debt securities.

13. POST-RETIREMENT BENEFITS

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

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

There are no post-retirement benefits other than pensions.

14. DEFERRED TAX

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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

15. BORROWINGS

Borrowings are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

16. SHARE CAPITAL

(a) Share issue costs

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved.

17. FIDUCIARY ACTIVITIES

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

notes to the consolidated financial statements

1. OPERATING INCOME AND EXPENSES

Fee and commission income includes loan-related fees of £913,000 (2004: £1,428,000) which have been recognised under the effective interest method.

Operating expenses comprise:

| | 2005 £000 | 2004 £000 |
|--|---------------|---------------|
| Staff costs, including directors: | | |
| Wages and salaries | 25,513 | 21,008 |
| Social security costs | 2,435 | 2,237 |
| Other pension costs | 1,509 | 1,552 |
| Amortisation of computer software (Note 11) | 397 | 309 |
| Depreciation (Note 12) | 1,686 | 1,656 |
| Profit on disposals of property, plant and equipment | (65) | (104) |
| Operating lease rentals | 360 | 636 |
| Other administrative expenses | 15,504 | 15,078 |
| | 47,339 | 42,372 |
| Exceptional operating expenses | 541 | 1,386 |
| Total operating expenses | 47,880 | 43,758 |

Exceptional operating expenses comprise redundancy and reorganisation costs in Secure Trust Bank £163,000 (2004: £214,000), Arbutnot Latham £171,000 (2004: £Nil) and Arbutnot Securities £152,000 (2004: £741,000) together with the costs of moving to AIM of £55,000. In 2004, exceptional operating expenses also included the costs of the consolidation of the London offices into Arbutnot House of £431,000. The total cost of £541,000 (2004: £1,386,000) does not relate to the ongoing profitability of the Group and is accordingly disclosed as an exceptional item. Corporation tax relief at 30% applies to the total cost.

The auditors' remuneration for audit services was £282,000 (2004: £253,000), of which £7,000 (2004: £6,000) related to the Company.

Remuneration of the auditors for the provision of non-audit services to the Group was £68,000 (2004: £70,000). This comprises taxation compliance fees of £20,000 (2004: £20,000), taxation and other advisory fees of £45,000 (2004: £47,000) and services required by regulatory bodies of £3,000 (2004: £3,000).

2. AVERAGE NUMBER OF EMPLOYEES

| | 2005 | 2004 |
|--------------------|------|------|
| Retail banking | 407 | 381 |
| Private banking | 180 | 177 |
| Investment banking | 76 | 91 |
| Group | 15 | 12 |
| | 678 | 661 |

3. TAXATION EXPENSE

| | 2005 £000 | 2004 £000 |
|---|--------------|--------------|
| United Kingdom corporation tax at 30% (2004: 30%) | | |
| Current | 2,148 | 810 |
| Deferred | 45 | 388 |
| Under/(over) provided in previous years | | |
| Current | 10 | (254) |
| Deferred | (6) | (523) |
| Taxation expense | 2,197 | 421 |
| Tax reconciliation: | | |
| Profit before tax | 7,676 | 2,996 |
| Tax at 30% (2004: 30%) | 2,303 | 899 |
| Capital allowances in excess of depreciation | 7 | (530) |
| Short-term timing differences | — | 182 |
| Non-taxable income less disallowed expenses | (123) | 124 |
| Prior period adjustments | 10 | (254) |
| Corporation tax charge for the year | 2,197 | 421 |

4. EARNINGS PER ORDINARY SHARE

BASIC AND FULLY DILUTED

Earnings per ordinary share are calculated on the net basis by dividing the profit attributable to equity holders of the Company of £6,489,000 (2004: £2,852,000) by the weighted average number of ordinary shares 14,167,472 (2004: 12,951,974) in issue during the year. There is no difference between basic and fully diluted earnings per ordinary share.

5. CASH

| | 2005 £000 | 2004 £000 |
|--|--------------|--------------|
| Cash in hand included in cash and cash equivalents (Note 23) | 188 | 139 |

6. LOANS AND ADVANCES TO BANKS AND BUILDING SOCIETIES

| | 2005 £000 | 2004 £000 |
|--|--------------|--------------|
| Placements with other banks and building societies included in cash and cash equivalents (Note 23) | 28,587 | 52,367 |

7. TRADING SECURITIES

| | 2005 £000 | 2004 £000 |
|---------------------------|--------------|--------------|
| Listed equity securities: | | |
| Long positions | 5,383 | 5,899 |
| Short positions | 2,785 | 1,159 |

8. LOANS AND ADVANCES TO CUSTOMERS

| | 2005 £000 | 2004 £000 |
|--|--------------|--------------|
| Gross loans and advances | 143,168 | 132,051 |
| Less: allowances for losses on loans and advances (Note 9) | (3,017) | (2,242) |
| | 140,151 | 129,809 |

9. ALLOWANCE FOR LOSSES ON LOANS AND ADVANCES

Movement in allowance for losses on loans and advances:

| | 2005 £000 | 2004 £000 |
|--|--------------|--------------|
| At 1 January | 2,242 | 1,771 |
| Provision for loan impairment | 1,641 | 1,235 |
| Loans written off during the year as uncollectible | (1,044) | (778) |
| Amounts recovered during the year | 178 | 14 |
| At 31 December | 3,017 | 2,242 |

10. DEBT SECURITIES HELD-TO-MATURITY

Debt securities represent certificates of deposit. The Group's intention is to hold them to maturity and, therefore, they are stated in the balance sheet at amortised cost. Amounts include £56,371,000 (2004: £19,264,000) with a remaining maturity of 3 months or less included in cash and cash equivalents (Note 23).

notes to the consolidated financial statements cont.

11. INTANGIBLE ASSETS

| | 2005 £000 | 2004 £000 |
|------------------------------------|--------------|--------------|
| Goodwill: | | |
| Opening net book amount | 2,560 | 2,560 |
| Arising on acquisition (Note 26) | 260 | — |
| Disposal of subsidiary (Note 27) | (815) | — |
| Closing net book amount | 2,005 | 2,560 |
| Computer software: | | |
| Group: | | |
| At 1 January 2004 | | |
| Cost | 1,547 | |
| Accumulated depreciation | (629) | |
| Net book amount | 918 | |
| Year ended 31 December 2004 | | |
| Opening net book amount | 918 | |
| Additions | 473 | |
| Amortisation charge | (309) | |
| Closing net book amount | 1,082 | |
| At 31 December 2004 | | |
| Cost | 1,956 | |
| Accumulated depreciation | (874) | |
| Net book amount | 1,082 | |
| Year ended 31 December 2005 | | |
| Opening net book amount | 1,082 | |
| Additions | 310 | |
| Amortisation charge | (397) | |
| Closing net book amount | 995 | |
| At 31 December 2005 | | |
| Cost | 2,266 | |
| Accumulated depreciation | (1,271) | |
| Net book amount | 995 | |
| | 2005 £000 | 2004 £000 |
| Total intangible assets: | | |
| At 31 December | | |
| Goodwill | 2,005 | 2,560 |
| Computer software | 995 | 1,082 |
| Net book amount | 3,000 | 3,642 |

12. PROPERTY, PLANT AND EQUIPMENT

| Group: | Freehold land and buildings £000 | Computer and other equipment £000 | Motor vehicles £000 | Total £000 |
|------------------------------------|---|--|---------------------------|---------------|
| At 1 January 2004 | | | | |
| Cost or valuation | 24,457 | 9,035 | 1,692 | 35,184 |
| Accumulated depreciation | (218) | (6,622) | (720) | (7,560) |
| Net book amount | 24,239 | 2,413 | 972 | 27,624 |
| Year ended 31 December 2004 | | | | |
| Opening net book amount | 24,239 | 2,413 | 972 | 27,624 |
| Additions | 1,931 | 1,824 | 831 | 4,586 |
| Revaluation | 2,380 | — | — | 2,380 |
| Disposals | (43) | — | (273) | (316) |
| Transfer to other assets (note 13) | (493) | — | — | (493) |
| Depreciation charge | (349) | (899) | (408) | (1,656) |
| Closing net book amount | 27,665 | 3,338 | 1,122 | 32,125 |
| At 31 December 2004 | | | | |
| Cost or valuation | 27,665 | 9,652 | 1,765 | 39,082 |
| Accumulated depreciation | — | (6,314) | (643) | (6,957) |
| Net book amount | 27,665 | 3,338 | 1,122 | 32,125 |
| Year ended 31 December 2005 | | | | |
| Opening net book amount | 27,665 | 3,338 | 1,122 | 32,125 |
| Additions | 87 | 911 | 275 | 1,273 |
| Disposals | — | (109) | (145) | (254) |
| Depreciation charge | (276) | (982) | (428) | (1,686) |
| Closing net book amount | 27,476 | 3,158 | 824 | 31,458 |
| At 31 December 2005 | | | | |
| Cost or valuation | 27,752 | 10,454 | 1,895 | 40,101 |
| Accumulated depreciation | (276) | (7,296) | (1,071) | (8,643) |
| Net book amount | 27,476 | 3,158 | 824 | 31,458 |

Freehold property was professionally revalued at 31 December 2004 at market value by Dickens Watts & Dade, Chartered Surveyors, Grenville Smith & Duncan, Chartered Surveyors, and Fraser Wood Mayo & Pinson, Chartered Surveyors, resulting in a total revaluation surplus of £2.38 million.

These valuations were made in accordance with the RICS appraisal and valuation manual. The directors do not believe that the fair value of freehold property is materially different from the carrying value.

All freehold land and buildings are occupied and used by Group companies. The carrying value of freehold land not depreciated is £14.12 million.

notes to the consolidated financial statements cont.

12. PROPERTY, PLANT AND EQUIPMENT continued

The historical cost of freehold property included at valuation is as follows:

| | 2005 £000 | 2004 £000 |
|------------------------------------|--------------|--|
| Cost | 23,685 | 23,604 |
| Accumulated and depreciation | (1,085) | (892) |
| Net book value | 22,600 | 22,712 |
| | | Office equipment and fittings £000 |
| Company: | | |
| Cost | | |
| At 1 January 2005 | | 28 |
| Additions | | 75 |
| Group transfers | | 271 |
| 31 December 2005 | | 374 |
| Depreciation | | |
| At 1 January 2005 | | 27 |
| Charge for year | | 5 |
| Group transfers | | 179 |
| At 31 December 2005 | | 211 |
| Net book value at 31 December 2005 | | 163 |
| Net book value at 31 December 2004 | | 1 |

13. OTHER ASSETS

| | 2005 £000 | 2004 £000 |
|---|--------------|--------------|
| Trade debtors | 20,318 | 9,425 |
| Available-for-sale investment | 1,900 | — |
| Prepayments and accrued income | 6,730 | 4,763 |
| Freehold property in course of disposal (note 12) | — | 493 |
| | 28,948 | 14,681 |

14. DEPOSITS FROM BANKS

| | 2005 £000 | 2004 £000 |
|---------------------------|--------------|--------------|
| Deposits from other banks | 9,190 | 30,830 |

15. DEPOSITS FROM CUSTOMERS

| | 2005 £000 | 2004 £000 |
|---------------------------|--------------|--------------|
| Retail customers: | | |
| — current/demand accounts | 102,786 | 90,472 |
| — term deposits | 136,647 | 112,524 |
| | 239,433 | 202,996 |

16. DEBT SECURITIES IN ISSUE

| | 2005 £000 | 2004 £000 |
|------------------------------|--------------|--------------|
| Subordinated loan notes 2035 | 10,149 | — |
| Subordinated loan notes 2009 | 2,567 | 7,817 |
| Unsecured loan notes | — | 106 |
| | 12,716 | 7,923 |

The subordinated loan notes 2035 were issued on 7 November 2005 and are denominated in euros. The principal amount outstanding at 31 December 2005 was €15 million. The notes carry interest at 3% over the interbank rate for three month deposits in euros and are repayable at par in August 2035 unless redeemed or repurchased earlier by the Company.

The subordinated loan notes 2009 carry interest at 3% per annum over LIBOR for six month sterling deposits and are repayable at par on 31 December 2009 unless redeemed or repurchased earlier by the Company. During the year the Company redeemed loan notes with a value of £5,250,000 at par. Subsequent to the year end, further loan notes with a value of £2,300,000 have been redeemed at par.

The unsecured loan notes were redeemable, at the holder's option, at dates up to September 2005 and bore interest at 1% below Barclays Bank PLC base rate.

17. OTHER LIABILITIES

| | 2005 £000 | 2004 £000 |
|------------------------------|--------------|--------------|
| Trade creditors | 16,296 | 13,227 |
| Accruals and deferred income | 10,702 | 7,084 |
| | 26,998 | 20,311 |

18. DEFERRED TAXATION

| | 2005 £000 | 2004 £000 |
|--|--------------|--------------|
| The deferred tax liability comprises: | | |
| Unrealised surplus on revaluation of freehold property | 1,446 | 1,446 |
| Accelerated capital allowances | (326) | (364) |
| Short-term timing differences | (4) | (5) |
| | 1,116 | 1,077 |
| At 1 January | 1,077 | 498 |
| Profit and loss account | 39 | (135) |
| Revaluation reserve | — | 714 |
| At 31 December | 1,116 | 1,077 |

notes to the consolidated financial statements cont.

19. CONTINGENT LIABILITIES AND COMMITMENTS

CAPITAL COMMITMENTS

At 31 December 2005, the Group had capital commitments of £485,000 (2004: £36,000) in respect of equipment purchases.

CREDIT COMMITMENTS

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

| | 2005 £000 | 2004 £000 |
|---|--------------|--------------|
| Guarantees and other contingent liabilities | 577 | 450 |
| Documentary letters of credit | 15 | 26 |
| Commitments to extend credit: | | |
| — Original term to maturity of one year or less | 9,522 | 12,141 |
| | 10,114 | 12,617 |

OPERATING LEASE COMMITMENTS

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

| | 2005 £000 | 2004 £000 |
|---|--------------|--------------|
| Expiring: | | |
| No later than 1 year | 91 | 81 |
| Later than 1 year and no later than 5 years | 237 | 131 |
| Later than 5 years | 44 | 255 |
| | 372 | 467 |

20. SHARE CAPITAL

| | Number of shares | Ordinary shares £000 | Share premium £000 |
|--------------------------------------|---------------------|----------------------------|--------------------------|
| At 1 January 2004 and 1 January 2005 | 12,951,974 | 130 | 13,370 |
| Proceeds of shares issued | 1,282,245 | 13 | 3,745 |
| At 31 December 2005 | 14,234,219 | 143 | 17,115 |

The total authorised number of ordinary shares at 31 December 2004 and 31 December 2005 was 418,439,000 with a par value of 1 pence per share (2004: 1 pence per share). All issued shares are fully paid.

21. RESERVES AND RETAINED EARNINGS

| Group | 2005 £000 | 2004 £000 |
|---|---------------|---------------|
| Revaluation reserve | 3,375 | 3,375 |
| Capital redemption reserve | 20 | 20 |
| Retained earnings | 11,111 | 9,106 |
| Total reserves at 31 December | 14,506 | 12,501 |
| | 2005 £000 | 2004 £000 |
| Movements in retained earnings were as follows: | | |
| At 1 January | 9,106 | 9,684 |
| Profit for the year | 6,489 | 2,852 |
| Interim dividend for the year | (1,495) | (1,360) |
| Final dividend for prior year | (2,989) | (2,655) |
| Transfer from general banking reserve | — | 585 |
| At 31 December | 11,111 | 9,106 |

21. RESERVES AND RETAINED EARNINGS continued

| Company | 2005 £000 | 2004 £000 |
|----------------------------|--------------|--------------|
| Capital redemption reserve | 20 | 20 |

Movements in retained earnings were as follows:

| | 2005 £000 | 2004 £000 |
|-------------------------------|--------------|---------------|
| At 1 January | 11,928 | 12,208 |
| Profit for the year | 2,049 | 3,735 |
| Interim dividend for the year | (1,495) | (1,360) |
| Final dividend for prior year | (2,989) | (2,655) |
| At 31 December | 9,493 | 11,928 |

22. DIVIDENDS PER SHARE

Final dividends are not accounted for until they have been approved at the Annual General Meeting. At the meeting on 23 May 2006, a dividend in respect of 2005 of 21.5 pence per share (2004: actual dividend 21.0 pence per share) amounting to a total of £3,060,357 (2004: actual £2,989,000) is to be proposed. The financial statements for the year ended 31 December 2005 do not reflect this resolution, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2006.

23. CASH AND CASH EQUIVALENTS

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

| | 2005 £000 | 2004 £000 |
|---|---------------|---------------|
| Cash (Note 5) | 188 | 139 |
| Loans and advances to banks and building societies (Note 6) | 28,587 | 52,367 |
| Debt securities held to maturity (Note 10) | 56,371 | 19,264 |
| | 85,146 | 71,770 |

24. RELATED-PARTY TRANSACTIONS

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 relating expense and income for the year are as follows:

| | Directors and key management personnel | |
|---|---|--------------|
| | 2005 £000 | 2004 £000 |
| Loans | | |
| Loans outstanding at 1 January | 742 | 578 |
| Loans issued during the year | 1,224 | 164 |
| Loan repayments during the year | (906) | — |
| Loans outstanding at 31 December | 1,060 | 742 |
| Interest income earned | 64 | 32 |

No provisions have been recognised in respect of loans given to related parties (2004: nil).

notes to the consolidated financial statements cont.

24. RELATED-PARTY TRANSACTIONS continued

The loans to directors are secured on property or shares and bear interest at rates linked to base rate.

| | Directors and key management personnel | |
|-----------------------------------|---|-----------|
| | 2005 | 2004 |
| | £000 | £000 |
| Deposits | | |
| Deposits at 1 January | 50 | 49 |
| Deposits received during the year | 2,064 | 32 |
| Deposits repaid during the year | (539) | (31) |
| Deposits at 31 December | 1,575 | 50 |
| Interest expense on deposits | 12 | 1 |

Arbuthnot Securities Limited received a fee of £15,000 (2004: nil) in its capacity as stockbroker to the Group. Arbuthnot Pensions & Investments Limited and Arbuthnot Pension Trustees Limited received fees from the Group totalling £23,000 (2004: £23,000) for advisory and administration services provided to the Trustees of the Secure Trust Pension Scheme.

25. MINORITY INTERESTS

| | 2005 Group | 2004 Group |
|---|---------------|---------------|
| | £000 | £000 |
| At 1 January | 89 | 77 |
| Sale of minority interest in Arbuthnot Securities Limited | 832 | — |
| Profit and loss account | 395 | 17 |
| Dividends paid | (4) | (5) |
| | 1,312 | 89 |

As described in Note 28, the Group has sold 35.8% of the issued ordinary share capital in Arbuthnot Securities Limited to its staff via the Arbuthnot No. 2 ESOP Trust. The impact of the transaction on the Group's consolidated financial statements is summarised below:

| | £000 |
|--------------------------|------------|
| Sale proceeds | 1,682 |
| Share of net assets sold | (832) |
| Gain on sale | 850 |

26. ACQUISITION

On 15 November 2005, Arbuthnot Latham & Co., Limited acquired the assets and undertaking of The Musical Instrument Finance Company, a specialist leasing business, for a total cash consideration of £1,093,000, of which £833,000 related to the purchase of the leasing assets of the business and £260,000 represented a payment for goodwill. The fair values of the assets acquired were not materially different from their book values.

27. DISPOSAL OF SUBSIDIARY

On 13 October 2005, the Group disposed of the whole of its interest in Arbuthnot Insurance Brokers Limited for a cash consideration (net of expenses) amounting to £1,971,000. The transaction gave rise to a gain on disposal, as follows:

| | £000 |
|---|--------------|
| Cash consideration received (net of expenses) | 1,971 |
| Total assets disposed of: | |
| Arbuthnot Insurance Brokers Limited | 3,495 |
| Goodwill | 815 |
| Total liabilities disposed of: | |
| Arbuthnot Insurance Brokers Limited | (3,582) |
| | 728 |
| Gain on disposal before and after tax | 1,243 |

27. DISPOSAL OF SUBSIDIARY continued

The profit on discontinued activity comprises the results of Arbuthnot Insurance Brokers Limited up to the date of disposal plus the gain on disposal, as follows:

| | 2005 £000 | 2004 £000 |
|---|--------------|--------------|
| Operating income | 1,441 | 1,758 |
| Operating expenses | (1,200) | (1,328) |
| Profit before tax | 241 | 430 |
| Taxation expense | (79) | (136) |
| Profit after tax | 162 | 294 |
| Gain on disposal | 1,243 | — |
| Profit on discontinued activity after taxation | 1,405 | 294 |

Arbuthnot Insurance Brokers Limited was part of the private banking business segment and was previously a wholly owned subsidiary of Arbuthnot Latham & Co., Limited.

28. SHARES IN SUBSIDIARY UNDERTAKINGS

| | Share at cost £000 | Impairment provisions £000 | Net £000 |
|---|-----------------------|----------------------------------|---------------|
| Arbuthnot Banking Group PLC: | | | |
| At 1 January 2005 | 31,593 | (3,219) | 28,374 |
| Sale of minority interest in Arbuthnot Securities Limited | (1,017) | 235 | (782) |
| At 31 December 2005 | 30,576 | (2,984) | 27,592 |
| | | 2005 £000 | 2004 £000 |
| Subsidiary undertakings: | | | |
| Banks | | 24,444 | 24,444 |
| Other | | 3,148 | 3,930 |
| Total unlisted | | 27,592 | 28,374 |

On 1 June 2004, 31 March 2005, 30 June 2005 and 30 September 2005 under the terms of the Arbuthnot Securities Long Term Incentive Plan, the Group sold, respectively, 124,000, 547,000, 22,000 and 23,000 ordinary shares in Arbuthnot Securities Limited to its staff via the Arbuthnot No. 2 ESOP Trust for a total consideration of £1,682,600. These shares represent 35.8% of the issued ordinary share capital of Arbuthnot Securities Limited (see Note 25).

The principal subsidiary undertakings of Arbuthnot Banking Group PLC at 31 December 2005 were:

| Name | Interest % | Principal Activity |
|--------------------------------------|------------|---------------------------------------|
| Secure Trust Bank PLC | 100 | Household cash management and banking |
| OBC Insurance Consultants Limited | 100 | Motor and general insurance |
| Arbuthnot Latham & Co., Limited | 100 | Private banking |
| Arbuthnot Commercial Finance Limited | 91.9 | Factoring |
| Arbuthnot Securities Limited | 64.2 | Investment banking |

- (i) All the above subsidiary undertakings are incorporated in Great Britain and have their respective registered offices in England and Wales and operate within the United Kingdom.
- (ii) All the above subsidiary undertakings are included in the consolidated financial statements and have an accounting reference date of 31 December.
- (iii) All the above interests relate wholly to ordinary shares.

notes to the consolidated financial statements cont.

29. BUSINESS SEGMENTS

The Group is organised into three main business segments:

- 1) Retail banking — incorporating household cash management, personal lending and banking and insurance services.
- 2) Private banking — incorporating private banking, wealth management and invoice factoring services.
- 3) Investment banking — incorporating institutional stockbroking, equity trading and corporate finance advice.

Transactions between the business segments are on normal commercial terms. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet.

Year ended 31 December 2005

| | Retail banking £000 | Private banking £000 | Investment banking £000 | Subordinated loan stock £000 | Head office property £000 | Group total £000 |
|---------------------------------|---------------------------|----------------------------|-------------------------------|---------------------------------------|------------------------------------|------------------------|
| Segmental operating income | 25,938 | 12,377 | 18,650 | (618) | — | 56,347 |
| Segment profit | 5,549 | 449 | 2,801 | — | (814) | 7,985 |
| Subordinated loan note interest | — | — | — | (618) | — | (618) |
| Profit before exceptional items | 5,549 | 449 | 2,801 | (618) | (814) | 7,367 |
| Exceptional items | (218) | (171) | 698 | — | — | 309 |
| Profit before tax | 5,331 | 278 | 3,499 | (618) | (814) | 7,676 |
| Discontinued activity | — | 1,405 | — | — | — | 1,405 |
| Segment Net Assets | 23,240 | 18,429 | 2,811 | (12,716) | — | 31,764 |
| Segment Total Assets | 46,651 | 257,639 | 21,814 | — | — | 326,104 |
| Segment Total Liabilities | 23,411 | 239,210 | 19,003 | 12,716 | — | 294,340 |
| Other segment items: | | | | | | |
| Capital expenditure | 1,041 | 508 | 34 | — | — | 1,583 |
| Depreciation | 1,109 | 816 | 158 | — | — | 2,083 |
| Impairment charge — loans | 1,655 | (14) | — | — | — | 1,641 |

Year ended 31 December 2004

| | Retail banking £000 | Private banking £000 | Investment banking £000 | Subordinated loan stock £000 | Head office property £000 | Group total £000 |
|---------------------------------|---------------------------|----------------------------|-------------------------------|---------------------------------------|------------------------------------|------------------------|
| Segmental operating income | 25,307 | 11,490 | 11,775 | (583) | — | 47,989 |
| Segment profit | 6,728 | 746 | (1,622) | — | (887) | 4,965 |
| Subordinated loan note interest | — | — | — | (583) | — | (583) |
| Profit before exceptional items | 6,728 | 746 | (1,622) | (583) | (887) | 4,382 |
| Exceptional items | (214) | (431) | (741) | — | — | (1,386) |
| Profit before tax | 6,514 | 315 | (2,363) | (583) | (887) | 2,996 |
| Discontinued activity | — | 294 | — | — | — | 294 |
| Segment Net Assets | 16,818 | 16,835 | 165 | (7,817) | — | 26,001 |
| Segment Total Assets | 46,183 | 231,547 | 12,656 | — | — | 290,386 |
| Segment Total Liabilities | 29,365 | 214,712 | 12,491 | 7,817 | — | 264,385 |
| Other segment items: | | | | | | |
| Capital expenditure | 1,497 | 3,249 | 313 | — | — | 5,059 |
| Depreciation | 1,062 | 767 | 136 | — | — | 1,965 |
| Impairment charge — loans | 1,019 | 216 | — | — | — | 1,235 |

The profit before tax figures exclude the results of Arbuthnot Insurance Brokers Limited ("AIB") which was sold in October 2005 and the profits of which (up to the date of sale) are shown as a discontinued activity in the income statement. AIB was previously included within the private banking division.

The Group's operations are conducted wholly within the United Kingdom and geographical information is therefore not presented.

30. RECONCILIATION OF UK GAAP TO IFRS

The differences between IFRS and UK GAAP which affect the Group were set out in the document "Update on the Adoption of International Financial Reporting Standards" which was published on 14 July 2005 and is available on the Company's website.

PROFIT

Set out below is the reconciliation of the profit reported under IFRS to the profit reported under UK GAAP for the year ended 31 December 2004:

| | Year to 31.12.04 £000 |
|---|-----------------------------|
| Profit for the period — UK GAAP | 3,370 |
| Effect of transition to IFRS: | |
| Timing of revenue recognition, net of tax effect | (81) |
| Calculation of specific loan loss provisions, net of tax effect | (37) |
| Elimination of goodwill amortisation | 202 |
| Release of general bad debt provision | (585) |
| Profit for the period — IFRS | 2,869 |

EQUITY

Set out below is the reconciliation of equity reported under IFRS to equity reported under UK GAAP as at 1 January and 31 December 2004:

| | 1.1.04 £000 | 31.12.04 £000 |
|--|----------------|------------------|
| Total equity — UK GAAP | 23,569 | 24,965 |
| Effect of revenue recognition, net of tax effect | (380) | (461) |
| Calculation of specific loan loss provisions, net of tax effect | (121) | (159) |
| Elimination of goodwill amortisation | — | 202 |
| Release of general bad debt provision | 585 | — |
| Deferred taxation on unrealised revaluation surplus | (733) | (1,446) |
| Dividends approved since the period end removed from liabilities | 2,655 | 2,989 |
| Total equity — IFRS | 25,575 | 26,090 |

notes to the consolidated financial statements cont.

31. FINANCIAL RISK MANAGEMENT

STRATEGY IN USING FINANCIAL INSTRUMENTS

By their nature, the Group's activities are principally related to the use of financial instruments. The Group accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due. The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing.

The Group also trades in financial instruments where it takes positions in traded equities instruments to take advantage of short-term market movements in equities prices. The Board places trading limits on the level of exposure that can be taken in relation to market positions.

CREDIT RISK

The Group 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 balance sheet date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the balance sheet date.

Management therefore carefully manages its exposures to credit risk.

The Group 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. Limits on the level of credit risk are approved periodically by the Board of directors and actual exposures against limits are monitored daily.

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

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

MARKET RISK

The Group takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Board sets limits on the market risk that may be accepted, which is monitored on a daily basis. During the year ended 31 December 2005 the only material market risk exposures taken on by the Group were in relation to listed equity securities.

CURRENCY RISK

The Group 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 Group's exposure to foreign currency exchange rate risk at 31 December 2005. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by currency.

31. FINANCIAL RISK MANAGEMENT continued

At 31 December 2005

| | US\$ | £ | Other | Total |
|--------------------------------------|--------------|----------------|---------------|----------------|
| Assets | | | | |
| Loans and advances to banks | 896 | 17,507 | 10,184 | 28,587 |
| Loans and advances to customers | 298 | 138,971 | 882 | 140,151 |
| Debt securities | 3,489 | 84,900 | — | 88,389 |
| Other assets | 43 | 68,928 | 6 | 68,977 |
| Total assets | 4,726 | 310,306 | 11,072 | 326,104 |
| Liabilities | | | | |
| Deposits from banks | 37 | 9,140 | 13 | 9,190 |
| Deposits from customers | 4,608 | 223,956 | 10,869 | 239,433 |
| Debt securities in issue | — | 12,716 | — | 12,716 |
| Other liabilities | 111 | 64,492 | 162 | 64,765 |
| Total liabilities | 4,756 | 310,304 | 11,044 | 326,104 |
| Net on-balance sheet position | (30) | 2 | 28 | — |
| Credit commitments | 27 | 9,889 | 198 | 10,114 |
| At 31 December 2004 | | | | |
| Total assets | 4,392 | 284,519 | 1,475 | 290,386 |
| Total liabilities | (4,648) | (284,415) | (1,323) | (290,386) |
| Net on-balance sheet position | (256) | 104 | 152 | — |
| Credit commitments | — | 12,167 | — | 12,167 |

INTEREST RATE RISK

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce in the event that unexpected movements arise.

The table below summarises the Group's exposure to interest rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

At 31 December 2005

| | Not more than 3 months £000 | More than 3 months but less than 6 months £000 | More than 6 months but less than 1 year £000 | More than 1 year but less than 5 years £000 | More than 5 years £000 | Non-interest bearing £000 | Total £000 |
|------------------------------------|--------------------------------------|--|--|---|------------------------------|---------------------------------|----------------|
| Assets | | | | | | | |
| Loans and advances to banks | 28,034 | — | — | — | — | 553 | 28,587 |
| Loans and advances to customers | 117,831 | 4,039 | 4,316 | 8,866 | 3,834 | 1,265 | 140,151 |
| Debt securities | 56,371 | 17,008 | 15,010 | — | — | — | 88,389 |
| Other assets | — | — | — | — | — | 68,977 | 68,977 |
| Total assets | 202,236 | 21,047 | 19,326 | 8,866 | 3,834 | 70,795 | 326,104 |
| Liabilities | | | | | | | |
| Deposits from banks | 9,190 | — | — | — | — | — | 9,190 |
| Deposits from customers | 204,249 | 2,944 | 3,312 | 70 | — | 28,858 | 239,433 |
| Other liabilities | — | 12,716 | — | — | — | 31,689 | 44,405 |
| Equity | — | — | — | — | — | 33,076 | 33,076 |
| Total liabilities | 213,439 | 15,660 | 3,312 | 70 | — | 93,623 | 326,104 |
| Interest rate sensitivity gap | (11,203) | 5,387 | 16,014 | 8,796 | 3,834 | (22,828) | — |
| Cumulative gap | (11,203) | (5,816) | 10,198 | 18,994 | 22,825 | — | — |

notes to the consolidated financial statements cont.

31. FINANCIAL RISK MANAGEMENT continued

The table below summarises the effective interest rate at 31 December 2005 by major currencies for monetary financial instruments not carried at fair value through profit or loss.

At 31 December 2005

| | US\$ % | Euros % | £ % |
|---------------------------------|-----------|------------|--------|
| Assets | | | |
| Loans and advances to banks | 3.18 | 2.28 | 4.54 |
| Loans and advances to customers | 7.31 | 8.76 | 10.89 |
| Debt securities | 4.25 | — | 4.58 |
| Liabilities | | | |
| Deposits from banks | — | — | 5.10 |
| Deposits from customers | 1.28 | 2.05 | 3.40 |
| Debt securities in issue | — | 5.28 | 7.65 |

At 31 December 2004

| | Not more than 3 months £000 | More than 3 months but less than 6 months £000 | More than 6 months but less than 1 year £000 | More than 1 year but less than 5 years £000 | More than 5 years £000 | Non-interest bearing £000 | Total £000 |
|---------------------------------|--------------------------------------|--|--|---|------------------------------|---------------------------------|----------------|
| Assets | | | | | | | |
| Loans and advances to banks | 52,305 | — | — | — | — | 62 | 52,367 |
| Loans and advances to customers | 107,844 | 4,216 | 4,017 | 8,534 | 4,454 | 744 | 129,809 |
| Debt securities | 19,264 | 20,308 | 10,928 | — | — | — | 50,500 |
| Other assets | — | — | — | — | — | 57,710 | 57,710 |
| Total assets | 179,413 | 24,524 | 14,945 | 8,534 | 4,454 | 58,516 | 290,386 |
| Liabilities | | | | | | | |
| Deposits from banks | 30,830 | — | — | — | — | — | 30,830 |
| Deposits from customers | 160,219 | 4,318 | 7,183 | — | — | 31,276 | 202,996 |
| Other liabilities | 106 | 7,817 | — | — | — | 22,636 | 30,559 |
| Equity | — | — | — | — | — | 26,001 | 26,001 |
| Total liabilities | 191,155 | 12,135 | 7,183 | — | — | 79,913 | 290,386 |
| Interest rate sensitivity gap | (11,742) | 12,389 | 7,762 | 8,534 | 4,454 | (21,397) | — |
| Cumulative gap | (11,742) | 647 | 8,409 | 16,943 | 21,397 | — | — |

The table below summarises the effective interest rate at 31 December 2004 by major currencies for monetary financial instruments not carried at fair value through profit or loss.

At 31 December 2004

| | US\$ % | Euros % | £ % |
|---------------------------------|-----------|------------|--------|
| Assets | | | |
| Loans and advances to banks | 1.93 | 1.44 | 4.63 |
| Loans and advances to customers | 3.42 | 6.16 | 11.77 |
| Debt securities | — | — | 4.93 |
| Liabilities | | | |
| Deposits from banks | — | — | 5.39 |
| Deposits from customers | 0.69 | 0.74 | 3.45 |
| Debt securities in issue | — | — | 7.95 |

31. FINANCIAL RISK MANAGEMENT *continued*

LIQUIDITY RISK

The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled trading securities. The Group does not maintain cash resources to meet all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Group's liquidity is therefore managed on a mismatch basis, the mismatch being the difference between the levels of assets and liabilities in the same maturity bands. The Group's aim is to maintain a prudent liquidity margin when compared with the mismatch criteria set by the regulators. Use is made of long-term committed bank facilities and certificates of deposit (debt securities) in the management of liquidity.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses.

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

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

At 31 December 2005

| | 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 | Total £000 |
|---------------------------------|--------------------------------------|--|---|------------------------------|----------------|
| Assets | | | | | |
| Loans and advances to banks | 28,587 | — | — | — | 28,587 |
| Loans and advances to customers | 83,034 | 32,637 | 23,032 | 1,448 | 140,151 |
| Debt securities | 56,371 | 32,018 | — | — | 88,389 |
| Other assets | 34,469 | 50 | — | 34,458 | 68,977 |
| Total assets | 202,461 | 64,705 | 23,032 | 35,906 | 326,104 |
| Liabilities | | | | | |
| Deposits from banks | 90 | 2,100 | 7,000 | — | 9,190 |
| Deposits from customers | 191,515 | 47,848 | 70 | — | 239,433 |
| Other liabilities | 26,794 | — | 2,567 | 15,044 | 44,405 |
| Total liabilities | 218,399 | 49,948 | 9,637 | 15,044 | 293,028 |
| Net liquidity gap | (15,938) | 14,757 | 13,395 | 20,862 | 33,076 |
| At 31 December 2004 | | | | | |
| Total assets | 160,563 | 73,819 | 19,557 | 36,447 | 290,386 |
| Total liabilities | 169,587 | 63,415 | 30,217 | 1,077 | 264,296 |
| Net liquidity gap | (9,024) | 10,404 | (10,660) | 35,370 | 26,090 |

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The carrying amounts of those financial assets and liabilities not presented on the Group's balance sheet at fair value are not materially different from their fair values.

FIDUCIARY ACTIVITIES

The Group provides trustee, investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements. These services give rise to the risk that the Group may be accused of maladministration or under-performance. At the balance sheet date, the Group had investment management accounts amounting to approximately £125 million (2004: £102 million) and financial assets under administration or advice estimated to amount to approximately £580 million (2004: £510 million).

notes to the consolidated financial statements cont.

32. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

IMPAIRMENT LOSSES ON LOANS AND ADVANCES

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

HELD-TO-MATURITY INVESTMENTS

The Group follows the guidance of IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. The classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances — for example, selling an insignificant amount close to maturity — it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost.

TAXATION

Significant estimates are required in determining the provision for taxation. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current tax and deferred tax provisions in the period in which such determination is made.

five year summary

In the table below, the figures for 2004 and 2005 are presented in accordance with IFRS. Earlier years' figures have not been restated under IFRS and accordingly are shown on a UK GAAP basis.

| Group: | 2001 £000 | 2002 £000 | 2003 £000 | 2004 £000 | 2005 £000 |
|--|--------------|--------------|--------------|--------------|--------------|
| Profit before tax and exceptional items* | 8,150 | 8,341 | 5,789 | 4,382 | 7,367 |
| Profit before tax | 8,150 | 7,796 | 3,878 | 2,996 | 7,676 |
| Earnings per share | | | | | |
| Basic (p) | 40.8 | 39.2 | 20.1 | 22.0 | 45.8 |
| Adjusted* (p) | 40.8 | 42.0 | 31.9 | 27.2 | 32.6 |
| Dividends per share (p) | 29.0 | 30.0 | 31.0 | 31.5 | 32.0 |

* The exceptional items and the adjusted earnings per share reflect, in 2002, the cost of buying out outstanding share option entitlements, in 2003, redundancy and reorganisation costs together with the write-off of goodwill arising from the professional expenses of the acquisition of Arbuthnot Securities and, in 2004, redundancy and reorganisation costs together with the costs of the consolidation of the London offices into Arbuthnot House.

notice of meeting

NOTICE IS HEREBY GIVEN that the twentieth Annual General Meeting of the Company will be held at Arbuthnot House, 20 Ropemaker Street, London EC2Y 9AR on Tuesday, 23 May 2006 at 3 pm for the following purposes:

1. To receive and adopt the Report of the Directors and the Financial Statements for the year ended 31 December 2005.
2. To declare a dividend on the ordinary shares which the directors recommend should be 21.5 pence per ordinary share.
3. To receive the report of the Remuneration Committee.
4. To elect Mr D R Lascelles as a director.
5. To elect Ms R J Lea as a director.
6. To reappoint PricewaterhouseCoopers LLP as Auditors and to authorise the directors to fix their remuneration.

SPECIAL BUSINESS

To consider and, if thought fit, to approve the passing of the following Resolutions, of which Resolutions 7 and 8 will be proposed as Special Resolutions and Resolution 9 as an Ordinary Resolution.

7. That the directors be and they are hereby empowered pursuant to Section 95 of the Companies Act 1985 to allot equity securities (as defined in Subsection (2) of Section 94 of the Companies Act 1985) as if Subsection (1) of Section 89 of the Companies Act 1985 did not apply to any such allotment PROVIDED THAT such power shall be limited:
 - (i) to the allotment of equity securities in connection with any rights issue in favour of or general offer to holders of ordinary shares in the capital of the Company where the equity securities respectively attributable to the interests of all the shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them but subject to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with problems in connection with fractional entitlements, record dates, overseas shareholders or otherwise; and
 - (ii) to the allotment (otherwise than pursuant to subparagraph (i) above) of equity securities up to an aggregate nominal value of £7,100and shall expire at the next Annual General Meeting of the Company save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry.
8. That the draft Articles of Association in the form submitted to the meeting and signed for purposes of identification by the Chairman be approved and adopted as the new Articles of Association of the Company to the exclusion of all existing Articles of Association and that the directors be and they are hereby authorised to do all such things in respect of the adoption of the new Articles as they consider necessary.

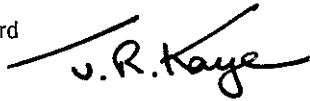
9. That approval is granted for the proposed amendment to the Unapproved Executive Share Option Scheme which is summarised in the Directors' Report dated 29 March 2006.

By order of the Board

J R Kaye Secretary

10 April 2006

One Arleston Way, Solihull, B90 4LH



NOTE:

1. To be entitled to attend and vote at the meeting (and for the purpose of determining the number of votes the member may cast) a member must be entered on the register of members by close of business on 19 May 2006.
2. A member entitled to attend and vote may appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a member of the Company.
3. There are no service contracts of directors other than ones which may be terminated on up to 12 months' notice at any time. Copies of these service agreements will be available for inspection at the registered office during usual business hours on any weekday (Saturdays and public holidays excepted) from the date of this Notice until the date of the meeting and at the place of meeting for 15 minutes prior to and during the meeting.

corporate contacts & advisers

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ADVISERS

Auditors
PricewaterhouseCoopers LLP

Principal Bankers
Barclays Bank PLC
Lloyds TSB plc

Stockbrokers
Arbuthnot Securities Limited

Registrars
Capita Registrars
The Registry, 34 Beckenham Road,
Beckenham, Kent, BR3 4TU

form of proxy

For use at the Annual General Meeting

ARBUTHNOT BANKING GROUP PLC

I/We (Block capitals, please)
a member/members of the above-named Company, hereby appoint the chairman of the meeting

.....
as my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held at 3 pm on Tuesday,
23 May 2006 and at any adjournment thereof.

Dated Signature

Please indicate with an X in the spaces below how you wish your vote to be cast.

- 1 To receive the Directors' Report and Financial Statements.
- 2 To declare a dividend.
- 3 To receive the Remuneration Committee report.
- 4 To elect Mr D R Lascelles* as a director.
- 5 To elect Ms R J Lea* as a director.
- 6 To reappoint PricewaterhouseCoopers LLP as auditors and to authorise the directors to fix their remuneration.
- 7 Special Resolution to give the directors authority to issue equity securities for cash.
- 8 Special Resolution to adopt new Articles of Association.
- 9 Ordinary Resolution to amend the Unapproved Executive Share Option Scheme.

| For | Against | Vote Withheld |
|-----|---------|---------------|
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| | | |

* Member of the Audit Committee

Notes:

- 1 A member may appoint a proxy of his/her own choice. If such an appointment is made, delete the words 'the chairman of the meeting' and insert the full name of the person appointed proxy in the space provided (any alterations to this form must be initialled). A proxy need not be a member of the Company but must attend the meeting to represent you.
- 2 If the appointor is a corporation, this form must be under its common seal or under the hand of some officer or attorney duly authorised in that behalf.
- 3 In the case of joint holders, the signature of any one holder will be sufficient, but the names of all the joint holders should be stated. The vote of the senior joint holder who tenders a vote, whether in person or by proxy, will be accepted to the exclusion of the votes of the other joint holders, and for this purpose seniority shall be determined by the order in which the names stand in the register of members in respect of the joint holding.
- 4 If this form is returned without any indication as to how the person appointed shall vote, he will exercise his discretion as to how he votes or whether he abstains from voting.
- 5 To be valid, this form must be completed and deposited at the office of the Registrars, Capita Registrars (Proxies), P.O. Box 25, Beckenham, Kent, BR3 4BR, not less than 48 hours before the time fixed for holding the meeting or any adjourned meeting.
- 6 Completion of this form of proxy will not preclude the member from attending and voting at the meeting in person.



Second fold

BUSINESS REPLY SERVICE
Licence No. MB 122

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Capita Registrars (Proxies)
P.O. Box 25
BECKENHAM
Kent
BR3 4BR

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Third fold
and tuck in flap opposite

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