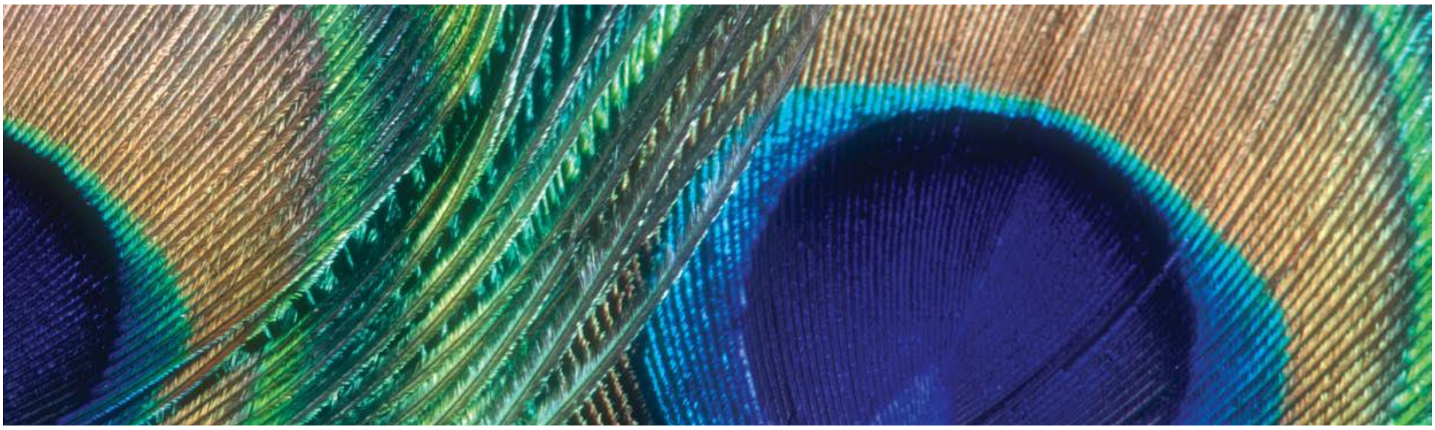
ARBUTHNOT BANKING GROUP PLC

Pillar 3 disclosures for the year ended 31 December 2018



Version: 1

Date: 27 March 2019

Contents

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

Overview

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

Background

The Group's lead regulator, the Prudential Regulatory Authority ("PRA"), sets and monitors capital requirements for the Group as a whole and for its regulated subsidiaries. The lead regulator adopted the Basel III capital requirements with effect from 1 January 2014. As a result, the Group's regulatory capital requirements were based on Basel III since 2014. The Capital Requirements Directive (CRD IV) sets out disclosure requirements for banks operating under the regime. The disclosure requirements (Pillar III) aim to complement the minimum capital requirements (Pillar I) and the supervisory review process (Pillar II) and aim to encourage market discipline by allowing market participants to assess key pieces of information on risk exposures and the risk assessment processes of the Group. This document should be read in conjunction with the Group's Annual Report and Accounts for 2018.

Scope

The disclosures have been prepared at a consolidated level for Arbuthnot Banking Group PLC. These disclosures cover the Pillar III qualitative and quantitative disclosure requirements. There are no differences between the basis of consolidation of the Group for accounting and regulatory purposes. The Group contains two subsidiaries authorised to undertake regulated business under the Financial Services and Markets Act 2000. Arbuthnot Latham & Co., Ltd ("AL") is regulated by the Prudential Regulatory Authority and the Financial Conduct Authority and is an authorised deposit-taking business. It in turn has a subsidiary, Renaissance Asset Finance Limited ("RAF"), which is regulated by the Financial Conduct Authority. AL, the Group's regulated banking subsidiary, reports to the PRA on a solo-consolidated basis. The solo-consolidated group includes RAF.

Disclosure Policy

The Pillar III disclosures will be issued as a minimum on an annual basis. The disclosures will be as at the Accounting Reference Date (ARD), i.e. as at 31 December.

The Pillar III disclosures are subject to internal review procedures broadly consistent with those undertaken for unaudited information published in the Annual Report. The information contained in this document has not been audited by the Group's external auditors, except to the extent it is deemed to be equivalent to those made under accounting or listing requirements.

The Pillar III disclosures have been prepared purely for explaining the basis on which the Group has prepared and disclosed certain capital requirements and information about the management of certain risks and for no other purpose. They do not constitute any form of financial statement and must not be relied upon in making any judgement on the Group.

Media and location

The report will be published on the Arbuthnot Banking Group PLC corporate website (www.arbuthnotgroup.com).

Regulatory developments

The Basel Committee on Banking Supervision ("BCBS") published revised Pillar III disclosure requirements. Some of these disclosures became effective in 2017 with further reporting requirements spread over the next 2 years. The BSBS also published its Basel III post-crisis regulatory reforms on 7 December 2017. These reforms include the revised standardised approach to credit risk and are due to take effect from 1 January 2022.

Risk Management

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

Principal governing bodies

The Group is led and controlled by the Board which comprises three executive directors and three non-executive directors. The Board, including its non-executive members takes a strong interest in risk management.

The Board endorses the principles of openness, integrity and accountability which underlie good governance and takes into account the provisions of the UK Corporate Governance Code in so far as they are considered applicable to and appropriate for it, given its size and circumstances, and the role and overall shareholding of its majority shareholder. Moreover, the Group contains two subsidiaries authorised to undertake regulated business under the Financial Services and Markets Act 2000, one of which (Arbuthnot Latham & Co., Ltd) is regulated by the Prudential Regulatory Authority and the Financial Conduct Authority and is an authorised deposit-taking business. It in turn has a subsidiary, Renaissance Asset Finance Limited, which is regulated by the Financial Conduct Authority. Arbuthnot Latham & Co., Ltd also operates a branch in Dubai, which is regulated by the Dubai Financial Services Authority. Accordingly, the Group operates to the high standards of corporate accountability and regulatory compliance appropriate for such a business.

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, 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, in relation to Arbuthnot Latham & Co., Limited, of each principal business unit, variances against budget and prior year, and other performance data.

Strategy/Business model – Arbuthnot Banking Group

Arbuthnot Banking Group PLC is an AIM listed company which has a free float of 43% with the remaining 57% of shares owned by the Chairman Sir Henry Angest (55 %) and held in the form of Treasury shares (2%) that have been purchased by the Company over time.

The Holding Company has investments in a number of subsidiaries several of which are either dormant or have no active business. The main trading subsidiary is Arbuthnot Latham & Co., Ltd and the Group also had a 15.53% investment in Secure Trust Bank PLC ("STB") as at 31 December 2018, which is accounted for as a financial investment. In April 2019, the investment in STB was reduced to 9.85%.

AL is a fully licensed deposit taker and as such is regulated by the PRA and the FCA. The Group is regulated by the PRA and then only on the basis of capital measures such as capital adequacy and large exposures.

The Group function is represented by the Arbuthnot Banking Group PLC Board but on a day to day basis it is the Executive Directors i.e. Arbuthnot Banking Group, Chairman & CEO, COO, and CFO, who ensure that the bank carries out its business firstly, in accordance with the Groups well laid out philosophy, then as per their strategy and budgets, secondly they remain in line with their risk appetites as articulated, in particular, with regard to the regulatory requirements. They also act as the interface to the regulators to ensure that the good relations with the regulatory bodies are maintained. Finally, to protect the interests of Arbuthnot Banking Group's shareholders.

At a strategic level Arbuthnot Banking Group can be seen as determining and agreeing the optimal strategies for both businesses to grow, while making the best use of the finite resources available to the management team not least of which is capital.

Strategy/Business model – Arbuthnot Latham & Co., Ltd

Arbuthnot Latham & Co., Limited's principal business is private and commercial banking. The Bank's strategy is to continue to build the private bank, and also to diversify into other areas of financial services.

During 2016 and 2017 the Company took significant steps to develop its commercial banking proposition, and has further accelerated its diversification and growth.

Private Banking

AL's core banking service looks to establish a long term relationship with its clients by providing a high quality personalised service.

Banking is comprised of current accounts, deposit accounts, loans, overdrafts and foreign exchange. The two main business lines within this are lending and deposits.

Lending

The Bank extends credit to borrowers, who are usually high net worth, either in their own names or to their operating companies. The lending is done on a secured basis with the usual security being residential property, but other assets are sometimes taken as security and additionally borrowers are asked to give personal guarantees to support the loans.

As a result, the Bank normally lends at LTV's that are below 75% of the value of the loan. The size of the loans varies but on average they are around £1-2m with a tenor of 3 to 5 years (reviewable annually). With credit mitigation taken into account, as a result of the collateral received, the maximum exposure the bank can take is up to c£25m.

The rates of interest are variable based upon either an external bench mark, such as LIBOR, or the AL base rate plus a margin (that currently results in a rate of approximately 4+%). Depending on the complexity of the loans, fees may be charged either at origination, repayment or both.

As a result of the Bank's secured position on high quality assets and the borrower's ability to access other sources of income, the loss rates on these loans is expected to be less than 0.25% of the loans extended.

Deposits

The Bank raises deposits from its clients via two products. Firstly, call deposits - these are deposits that are residual, as part of the clients floating balance on their current account. The rates of interest payable on these balances range from 0% to 0.5%.

The second source is via time, term or notice deposits - these have an agreed rate for an agreed term, which provides a good source of stable funding to the Bank. Rates payable on these balances currently range from between 1-2%.

These deposits are supplemented by funding from other sources including:
- SIPP deposit money received from wealth management platforms;
- Cash balances not invested in other assets by the Investment Management business (typically 5% of Assets under Management); and
- Funds drawn from the Term Funding Scheme (“TFS”).
- Arbuthnot Direct deposit platform launched during the year. This enables the Group to provide deposit products directly to the retail market via a newly created internet platform, with rates advertised on the best buy tables.

Overall, the blended rate on the portfolio of deposits is currently approximately 1%. This gives the banking business a healthy net margin in excess of 4% on its lending before bad debts.

Wealth Planning

The Wealth Planning service is built on long-term relationships that provide bespoke financial strategies to the Banks’ clients. These strategies are developed after understanding the client’s long term financial aspirations and plans, along with their attitude to risk. In general the strategies are focused on capital and wealth preservation. The advice given considers product offerings from other financial providers across the industry and is therefore considered “independent” or “whole of market”.

The Company’s approach generates a trusted advisor standing which enables the Bank to deepen its relationships with clients and ensures a high degree of stability in its client base and product usage.

Arbuthnot Latham was the first Private Bank in the UK to achieve Corporate Chartered status. This proves that all of the Wealth Planners in the Bank have qualified as Chartered Financial Planners and that the service has reached the highest levels of capability and ethical practice.

Investment Management

The final product offering is the Investment Management business. This service comprises discretionary fund management and alternative investments. Again, after careful consideration with the client, a suitable investment strategy is developed to ensure that each client’s specific investment objectives are met. The business is also considered to be “whole of market” as client funds are not invested within in-house products, but instead a portfolio is developed on a “fund of funds” basis.

Commercial Banking
The Commercial Bank was started in September 2015, with coverage initially aimed at London and the South East but subsequently extending to the South West and North West. The commercial bankers are co-located with the private bankers to enable synergies to be captured across the business units.

The teams seek to provide a "high touch relationship service" to commercial clients, with sector coverage of media, real estate financing and trading businesses including healthcare, professional practises and other specialist areas.

Commercial Banking is comprised of current accounts, deposit accounts, loans, overdrafts and foreign exchange. The two main business lines within this are lending and deposits.

Lending is similar to the private bank, with LTV's normally below 75% of the value of the loan. The size of the loans varies but on average they are around £1-2m with a tenor of 3 to 5 years (reviewable annually). With credit mitigation taken into account, as a result of the collateral received, the maximum exposure the bank can take is up to c£25m.

Similar to the private bank, commercial raises deposits from its clients via two products. Firstly, call deposits - these are deposits that are residual, as part of the clients floating balance on their current account. The rates of interest payable on these balances range from 0% to 0.5%.

The second source is via time, term or notice deposits - these have an agreed rate for an agreed term, which provides a good source of stable funding to the Bank. Rates payable on these balances currently range from between 1-2%.

Tay Mortgage Portfolio
In December 2014 the Bank completed the purchase of a residential mortgage portfolio from the administrators of the Dunfermline Building Society for a discounted price of £106m. The purpose of this acquisition was, in part, driven by the recognition that in order for the Bank to strengthen its liquidity resources, it would be advantageous to have residential property backed loans to offer as collateral, initially to the Funding for Lending Scheme ("FLS") and in time to the Sterling Monetary Framework.

The portfolio is closed to new business, has a proven track record of repayments and is supported by geographically diversified collateral.

Renaissance Asset Finance
In December 2016, Arbuthnot Latham reached agreement with the shareholders of Renaissance Asset Finance to acquire the company, with the transaction completing in April 2017.

The asset finance lending business specialises in financing high value cars and other business assets.

Arbuthnot Commercial Asset Based Lending ("ACABL")
Objective and Mission: To establish an Asset Based Lending business, dedicated to funding UK SMEs. The intention is to build a lending book of c£150m in 5 years with a gross yield of 7.5% to 8.5%.

The business will provide ABL facilities between £150k and £15m originated via a professional network of key business introducers. New business opportunities will be largely event driven in the SME space where revenues are between £1m and £100m. Typically this will include: MBO's, MBI's, mergers and acquisitions, growth opportunities, refinancing and restructuring, turnarounds, retirement exits and improvement of working capital.

Product: All clients will have an Invoice Discounting Facility. The rationale is that having the security over the sales ledger allows AL to control the assets of the business throughout the trading cycle – this is key to the provision of credit facilities. All products are cross collateralised and facilities co-terminus.

Credit Governance: Credit Policy approved by the Board of ACABL, Arbuthnot Latham Credit Committee and the Board of Arbuthnot Latham.

- ACABL will segregate roles and responsibilities between its own first and second lines of defence.
- Ongoing oversight will be by the Arbuthnot Latham second line of defence teams, plus internal audit.
- Credit due diligence will consider the businesses normal terms of trade, quality of debtors, overseas receivables, overdue debtors, debtor concentrations, trade value of stock and fixed assets, net of any potential recovery costs. The collateral loan to values will reflect the different types of assets the business is looking to fund.

Principal risks

The Group regards the monitoring and controlling of risks as a fundamental part of the management process. Consequently, senior management is involved in the development of risk management policies and in monitoring their application. The principal risks inherent in the Group's business are strategic, credit, market, liquidity, operational, cyber, conduct, regulatory and macroeconomic..

Strategic risk

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

Credit risk: overview

Credit risk is the risk of loss arising from a customer or counterparty failing to meet their financial obligations to the Group as and when they fall due. Of the risks the Group takes on, credit risk generates the largest regulatory capital requirement.

The Group has adopted the Standardised Approach to credit risk under Basel III, and has nominated Moody's Investor Services as its external credit assessment institution (ECAI) to provide ratings for financial institutions.

Credit risk: loan books

Credit risk is managed through the Credit Committee of Arbuthnot Latham & Co.

Credit risk management uses a combination of lending policy criteria, credit scoring, cash flow forecasting and policy rules to make a decision on applications for credit. The primary factors considered are the borrower's background (including management), proposal and rationale, source of repayment, analysis of security, pricing / return, and analysis of business and financial risk. In addition, confirmation of borrower identity and an assessment of the value of any security are undertaken prior to granting a credit facility. When considering applications, the primary focus is placed on the willingness and ability to repay.

Credit scoring is used to support the retail customer account management process in the following ways:

- To set customer maximum lending limits.
- To pre-determine lending limits for selected further advances.
- To determine account specific recommended limits and product types.
- To set shadow limits to manage unauthorised borrowing.
- To prioritise collections activity.

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 lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

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

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

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

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

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

- Future economic scenarios
- Probability of default
- Loss given default
- Exposure at default

Credit risk: treasury assets

The Group can have exposures to a range of banks, building societies and the Bank of England in its treasury portfolio of bank deposits, Certificates of Deposit, money market instruments and Government securities. These exposures arise due to the placement in the market of surplus client cash which is held under a banking relationship. These exposures are held purely for liquidity purposes, and all have a minimum rating of credit step quality 2 or higher (as per PRA guidance).

Policy limits and approved counterparties are recorded on the Counterparty Schedule and are advised to the PRA, together with a copy of the policy on an annual basis. Counterparty exposures are monitored against limits by the Treasury department on a daily basis and limits are formally approved by the Board annually.

Concentration risk

Management assesses the potential concentration risk from a number of areas including:

- product concentration
- geographical concentration

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

Market risk

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

The Group is exposed to changes in the market value of properties. The current carrying value of Investment Property is £67.1m. Any changes in the market value of the property will be accounted for in the Income Statement and as a result could have a significant impact on the profit or loss of the Group.

The Group has a 15.5% interest in STB. This is currently recorded in the Group's balance sheet as a Financial Investment. The carrying value is adjusted to market value at each balance sheet date, according to the share price of STB. Any gains or losses that arise are recorded in Other Comprehensive Income.

Interest rate risk

Interest rate risk is the potential adverse impact on the Group's future cash flows from changes in interest rates and arises from the differing interest rate risk characteristics of the Group's assets and liabilities. In particular, fixed rate savings and borrowing products expose the Group to the risk that a change in interest rates could cause either a reduction in interest income or an increase in interest expense relative to variable rate interest flows.

The Group seeks to "match" interest rate risk on either side of the Statement of Financial Position. However, this is not a perfect match and interest rate risk is present on:

- Money market deposits of a fixed rate nature;
- Fixed rate loans; and
- Fixed rate savings accounts.

There is interest rate mismatch in Arbuthnot Latham. This is monitored on a daily basis in conjunction with liquidity and capital. The interest rate mismatch is daily monitored, throughout the maturity bandings of the book on a parallel shift scenario of 50, 100 and 200 basis points movement. The risk appetite that the business is prepared to accept for a 100bps parallel shift in interest rates is losses of £1.5m.

Securitisation risk

The Group currently has not securitised any assets. Therefore, the Board has concluded that securitisation risk is not applicable to the Group.

Liquidity risk

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

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The liquidity requirements of the Group are met through withdrawing funds from its Bank of England Reserve Account to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

The Group has formal governance structures in place to manage and mitigate liquidity risk on a day to day basis. The Board of AL sets and approves the liquidity risk management strategy. The Assets and Liabilities Committee ("ALCO"), comprising senior executives of the Group, monitors liquidity risk. Key liquidity risk management information is reported by the finance teams and monitored by the Chief Executive Officer and Finance Director on a daily basis. The ALCO meets monthly to review liquidity risk against set thresholds and risk indicators including early warning indicators, liquidity risk tolerance levels and Individual Liquidity Adequacy Assessment Process ("ILAAP") metrics.

The PRA requires the Board to ensure that the Group has adequate levels of liquidity resources and a prudent funding profile, and that it comprehensively manages and controls liquidity and funding risks. The Group maintains deposits placed at the Bank of England, and highly liquid unencumbered assets that can be called upon to create sufficient liquidity to meet liabilities on demand, particularly in a period of liquidity stress.

Arbuthnot Latham & Co., Limited ("AL") has a Board approved ILAAP, and maintains liquidity buffers in excess of the minimum requirements. The ILAAP is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. At a minimum, the ILAAP is undated annually. The Liquidity Coverage Ratio ("LCR") regime has applied to the Group from 1 October 2015, requiring management of net 30 day cash outflows as a proportion of high quality liquid assets. The actual LCR at 282% (2017: 222%) has significantly exceeded the regulatory minimum of 90% (2017: 80%) throughout the year.

The Group is exposed to daily calls on its available cash resources from current accounts, maturing deposits and loan draw-downs. The Group maintains significant cash resources to meet all of these needs as they fall due. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types.

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

Operational risk

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, systems failure or from external events. It is inherent to every business organisation and covers a wide spectrum of issues. The terms 'error', 'omission' and 'inefficiency' include process failures, systems/machine failures and human error. The largest exposure to this risk exists in Arbuthnot Latham as mis-selling risk via its wealth management advisory service and its structured product distribution business. The Group is exposed to operational risks from its Information Technology and Operations platforms. There are additional internal controls in these processes that are designed to protect the Group from these risks.

In each of the Group's subsidiaries, business managers are responsible for maintaining an appropriate level of internal control, commensurate with the scale and nature of operations. They are responsible for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls.

Operational risk self assessments are performed by individual business units and functions. The risk assessment process is designed to support the management rather than the total avoidance of risk. Management attention is focused on those risks where additional work is likely to provide the greatest economic benefit from reducing losses or exposure.

The Group has adopted the Basic Indicator Approach for calculating the Pillar 1 capital requirements for operational risk.

Cyber risk

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

Conduct risk

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

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

Regulatory risk

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

Regulatory change also exists as a risk to the Group's business. Notwithstanding the assessments carried out by the Group to manage the regulatory risk, it is not possible to predict how regulatory and legislative changes may alter and impact the business. Significant and unforeseen regulatory changes may reduce the Group's competitive situation and lower its profitability.

Macroeconomic and competitive environment

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

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

Statement of Risk Appetite

Introduction

Arbuthnot Banking Group has benefited from continuity of management over a long period of time. The Chairman and Chief Executive of the Group has held office for 32 years, and the Chief Operating Officer has been with the Group for 21 years. The executive team share a philosophy of management which emphasises prudence, stability and a long-term approach to the creation of shareholder value.

The Group conducts its business in accordance with its Corporate Philosophy, which is reproduced annually in its Report and Accounts as shown below:

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

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

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

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

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

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

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

In formulating and applying this philosophy the Board has drawn on the experience of the Chairman and other senior bankers currently and formerly on the Board regarding the risks to small banks and how they can be managed to ensure long-term stability. The key elements involved in applying this philosophy may be summarised as:

- maintain a diversified portfolio of businesses to achieve a balance of risk in all phases of the cycle
- maintain a strong balance sheet, placing a particular emphasis on liquidity and security of funding
- maintain a conservative risk profile, which includes careful lending

To achieve this the Group has maintained a level of deposits significantly greater than was necessary to finance its lending. In this way the Group has sacrificed profits each year to ensure stability. However, this approach has stood the Group in good stead; in the recent banking crisis AL experienced minimal losses and maintained strong liquidity throughout.

Overall Risk Appetite Statement

The business plan is prepared on the basis that the Group takes a balanced view towards risk and return. The business plan includes a number of lines of business within the trading subsidiary. The planned growth in the Group over the medium term is well spread across these business lines. The Board will approve the risk appetite statement and will review the appropriateness of the risk appetite at least annually.

ABG generally has a low risk appetite fully aligned with the scale and nature of the business model. The Group is exposed to liquidity, credit and market risks as a consequence of its activities and the Group chooses to accept these risks subject to the constraints and framework established in this risk appetite statement. The Risk Appetite Statement is for ABG to:

- Achieve its stated business objectives as outlined in the Board approved business plan.
- Maintain a comprehensive credit risk management framework focused on UK consumer finance, SME and High Net Worth secured lending.
- Maintain acceptable levels of interest rate risk exposure.
- Invest surplus deposits in money market restricted counterparties with a minimum rating of Moody’s A3 or via the Bank of England reserve account facilities.
- Maintain robust capital and liquidity levels under “normal” and “stressed” conditions.
- Manage balance sheet and market risks to ensure minimal earnings volatility.
- Operate with low tolerances for Operational and Compliance risk exposures by ensuring that staff are properly trained, procedures are documented and supervision is in place to ensure that the controls continue to operate effectively.
- Ensure full compliance with the spirit (and letter) of all legal and regulatory requirements.
- Never allocate capital to an exposure such that any resultant losses could reduce the Group’s capital to a level of insolvency (never “bet the shop”).

The following sub sections contain more detailed statements around appetite levels and tolerance limits in specific risk categories.

AL has a clear policy regarding credit and liquidity which is set out in a policy document approved by the Board. These policies deal with all relevant parameters with regard to business quality, limits and procedures, and specify that any departure from the approved policy may only be made with the approval of the Board or an executive or group of executives to whom the Board delegates such authority. Also the Risk appetite of the individual Bank Board and the overall Group for the financial risks (both balance sheet and earnings) can be further articulated by way of the annual budget and three year plan. This shows the lending and proportion of lending in each asset class that the bank is prepared to undertake in the next three years. This is approved by the AL and Group Board.

AL Risk Appetite Statement
AL's risk appetite is to ensure that adequate capital resources are held to maintain at least the Pillar 1 minimum requirement in a 1-in-40 year stress event. This is in line with the Company's prudent approach, as it exceeds the industry standard of withstanding a 1-in-25 year scenario.

Strategic Risk
Achieve business objectives in line with the approved Board business plan, which includes the diversification of income streams and introducing a broader spread of operational and credit risk. Through regular reporting from Change Management the Board and Exco monitor the progress against the business plan and take appropriate management action to address any issues identified.

Capital Risk
- Maintain robust capital levels under "normal" and "stressed" conditions.
- Manage balance sheet and market risks to ensure minimal earnings volatility.

Liquidity Risk
- The primary source of funding is client deposits from high net worth individuals, small to medium enterprises, personal pension fund providers. A retail deposit program via a new venture, Arbuthnot Latham Direct, is due to start in H2 2018.
- Lending to clients will generally be funded, over the long term, by client deposits. Additionally, AL are benefitting from funding through the Bank of England Term Funding Scheme (TFS). However, where appropriate and economic, use may be made of wholesale bank funding or other schemes offered by the Bank of England.
- Facilities are maintained with the Bank of England to enable liquidity to be raised, particularly in periods of stress, by pledging assets that qualify for the liquidity buffer.
- Committed bank lines may be maintained to enable access to wholesale bank funding.
- Excess deposits will generally be invested at call or counterparty term instruments maturing in under 12 months. AL will also invest in longer term instruments up to 5 years which have a floating interest rate benchmarked to the market.
- The investment limits for each of the counterparties are approved in accordance with the Treasury Policy and in line with PRA large exposure limits.
- Call and short term placements will generally be invested with the BOE, UK Treasury (T-Bills/ Gilts) or UK banks deemed systematic and therefore subject to a high level of regulatory scrutiny.
- Medium term (over 3 months) instruments will generally be invested in UK Treasury (T-Bills/ Gilts) or with financial institutions which are rated Aa3 or above at the time of deposit. Instruments up to 5 years will generally be covered bonds which are rated Aaa and are able to be utilised as collateral for schemes offered by the Bank of England.
- Large depositors and exposures will be identified and managed individually to reduce concentration risk.

Credit Risk

- Credit facilities are sanctioned and monitored in accordance with AL Credit Policy and AL Credit Committee Terms of Reference, which includes membership details and sanctioning limits as approved by Arbuthnot Latham (AL) Board. All credit facilities are subject to an annual review in line with AL Credit Committee Terms of Reference to ensure there has not been a material change in the client's financial circumstances that may impact upon their ability to meet the terms of the agreed facilities. The process for submitting new / increase / variation and annual reviews is contained in the published Credit Process and Procedure document.
- The portfolio mix of client lending by Sector/ Asset / Product Type is maintained in accordance with the concentration review triggers approved annually by AL Board, are measured monthly and reported to the Board as well as ExCo monthly and Credit Committee & Risk Committee quarterly
- In terms of Large Exposure Policy, credit applications where the resultant exposure is in excess of 25% of the Bank's capital base will only be allowed if the Bank is able to treat a portion of the counterparty exposure as exempt from the 25% limit. The strict requirements for exemption are detailed within the AL Credit Policy.
- Expected credit losses from normal course of business are targeted to be below 0.25% of the loan portfolio, this recognising the historical low level of losses seen in the lending book, in part driven by our conservative LTV appetite.
- Pricing reflects the level of risk, capital utilised and is offered on a commercial basis. A Return on Capital Employed model is completed for all facilities.
- Where clients are demonstrating signs of financial difficulty then we work with clients to manage the situation and monitor closely through the established Watch process. For clients with non-performing debt / Forbearance is evident then we follow the methodology detailed within the Impairment and Provisioning Policy which is reviewed and approved annually by AL Board.
- Where a request is outside of Credit Policy but is considered to be supportable, this is presented to Credit Committee for approval as per AL Credit Committee Terms of Reference. If approved, this is considered to be an Exception to Policy, is recorded as such and reported to AL Board quarterly. A maximum of 6 Exceptions are allowed each quarter.
- For standalone business units e.g. Renaissance Asset Finance, Arbuthnot Commercial Asset Based Lending and TAY mortgages, the Bank has in place a specific Credit Policy for each unit governing the type of lending activity expected to be undertaken.

Private Banking

- Private Banking client needs can be complex, on occasion involving multiple types of security, different ownership structures and a variety of borrowing purposes. As such, it is not always possible to define a single policy or product to meet such client's requests. The overriding principle in lending to Private clients is to ensure that the bank is lending responsibly and to ensure the client does not become over leveraged as a result of any lending request considered by the bank, alongside any existing and known future financial obligations. Our approach is detailed within the overarching AL Credit Policy, Responsible Lending Policy and Buy to Let Policy, which are approved annually by AL Board or Credit Committee if there has not been a material change.
- Serviceability / affordability is key and is fully assessed in line with the Responsible Lending Policy. From a governance perspective, we ensure lending requests comply with the appropriate regulation, including the Consumer Credit Act, Mortgage Conduct of Business (MCOB) and the PRA's SS13/16 in respect of Buy-to-Let lending.

- Term loans to Private Banking clients are for a maximum of 5 years with the exception of Regulated Mortgage Contracts, which have a maximum term of 15 years in order to meet client and regulatory suitability needs. Repayment profiles can vary to meet clients needs within an acceptable risk profile. This ranges from interest only, partial amortisation with a bullet repayment to full amortisation with no residual debt at expiry.
- The majority of lending to Private Banking clients is secured, typically by residential property (Principle Private Residence, Buy to Let) albeit can also include marketable securities / investment backed lending, cash and commercial real estate. The appropriate Risk Weighting is applied as per the standard capital rules.

Commercial Banking
- AL Commercial Banking target clients are Small Medium sized Enterprises, typically owner manager with turnover between £1m - £50m. AL Commercial Banking includes Real Estate (residential and commercial development and investment), Media and Specialist Sectors, each have specific Credit Policy, which forms part of overarching AL Credit Policy. Each Credit Policy is reviewed annually.
- o All lending requests are assessed on a case-by-case basis, considering the sustainable cashflow to service debt, track record, sector risk, security, client contribution, gearing, leverage etc. There are a number of specific credit policy metrics to comply with as per related Credit Policy, for example, in Real Estate Net Interest Cover Ratio at exit on stressed interest rates min 1.1x or for Specialist Commercial Banking, Net Cashflow : Debt Service Cost min 1.15x.
- A sector review is undertaken annually and some sectors are outside of credit appetite on risk / reputational grounds, for example, nightclubs and gambling.

Renaissance Asset Finance
- The company provides asset finance solutions to well-established SMEs and HNW individuals. Lending typically ranges from £10,000 to £1m with an average deal size of £70,000 and tenor up to 5 years. Business is primarily sourced from known asset finance brokers across a range of asset types.
- RAF is a solo consolidated entity and as such is run independently and governed by its own Board, which includes AL Directors. Underwriting is governed by the bounds of its risk appetite as defined in RAF’s (AL Board approved) Credit policy and second line credit assurance is provided by a specialist third party (VLS).

Asset Backed Lending
- Newly launched (May 2018) business for the bank, dedicated to funding UK SMEs. The business provides asset backed lending facilities between £150k and £15m originated via a professional network of key business introducers. New business opportunities are largely event driven in the SME space where revenues are between £1m and £100m. Typically this will include: MBO’s, MBI’s, mergers and acquisitions, growth opportunities, refinancing and restructuring, turnarounds, retirement exits and improvement of working capital.
- The business is run independently and governed by its own Board, which includes AL Directors. It provides lending facilities secured against a company’s assets, including accounts receivable (AR), inventory, plant & machinery (P&M) and property and can also include a cashflow loans.

Market Risk

- AL seeks to minimise interest rate risk, with 12 month value at risk not exceeding the Board approved limit for interest rate shifts of £1m.
- The Board have set a £0.5m FX exposure limit for both overnight and intra-day positions which are monitored daily. The Bank does not operate an FX trading book.

Operational and Conduct Risk

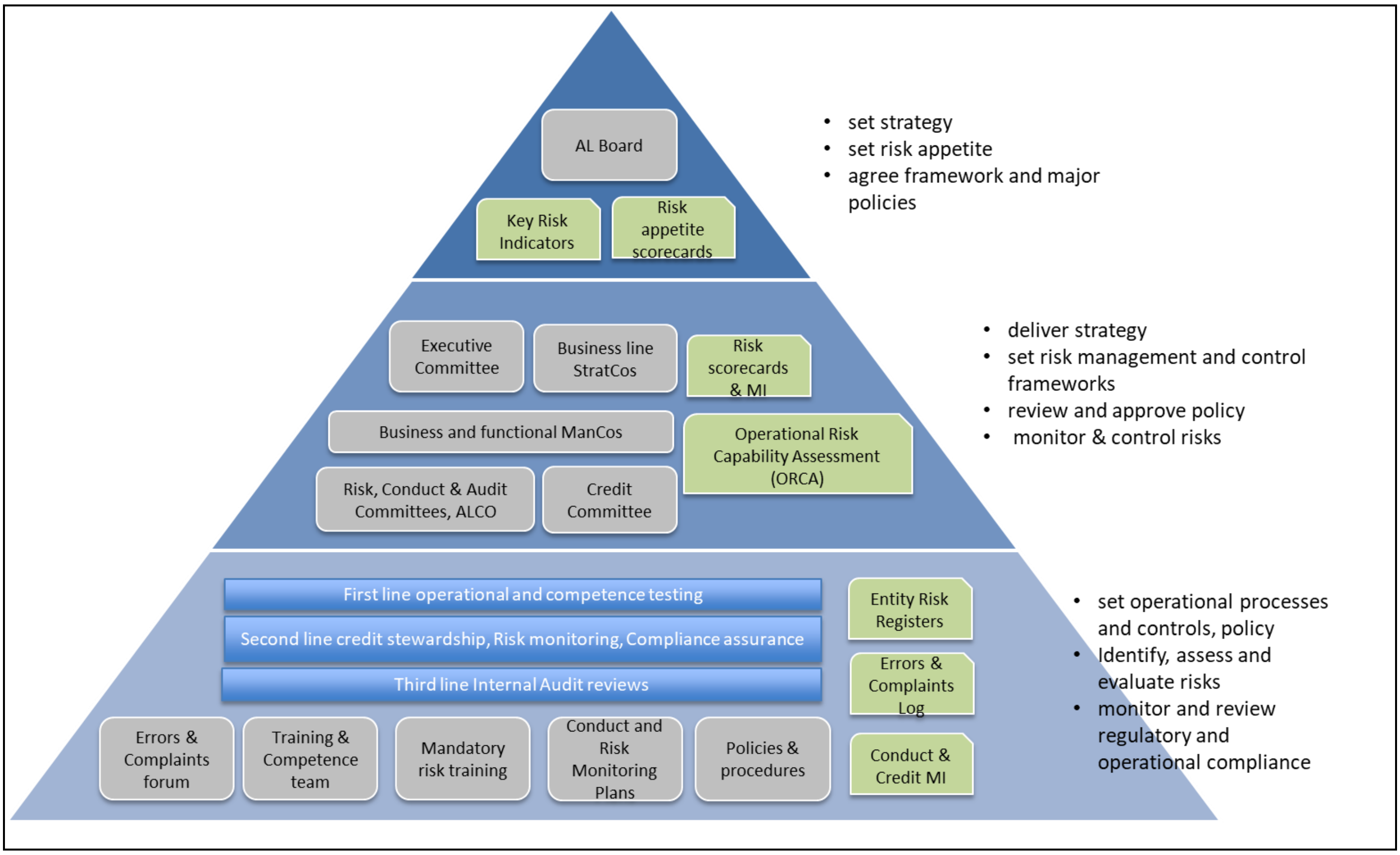
- Monitored via a range of metrics within the Operational and Conduct Risk Scorecards.

Cyber Risk

- Monitored via a range of metrics developed by IT and reported to Risk Committee.

Risk Management Framework diagram

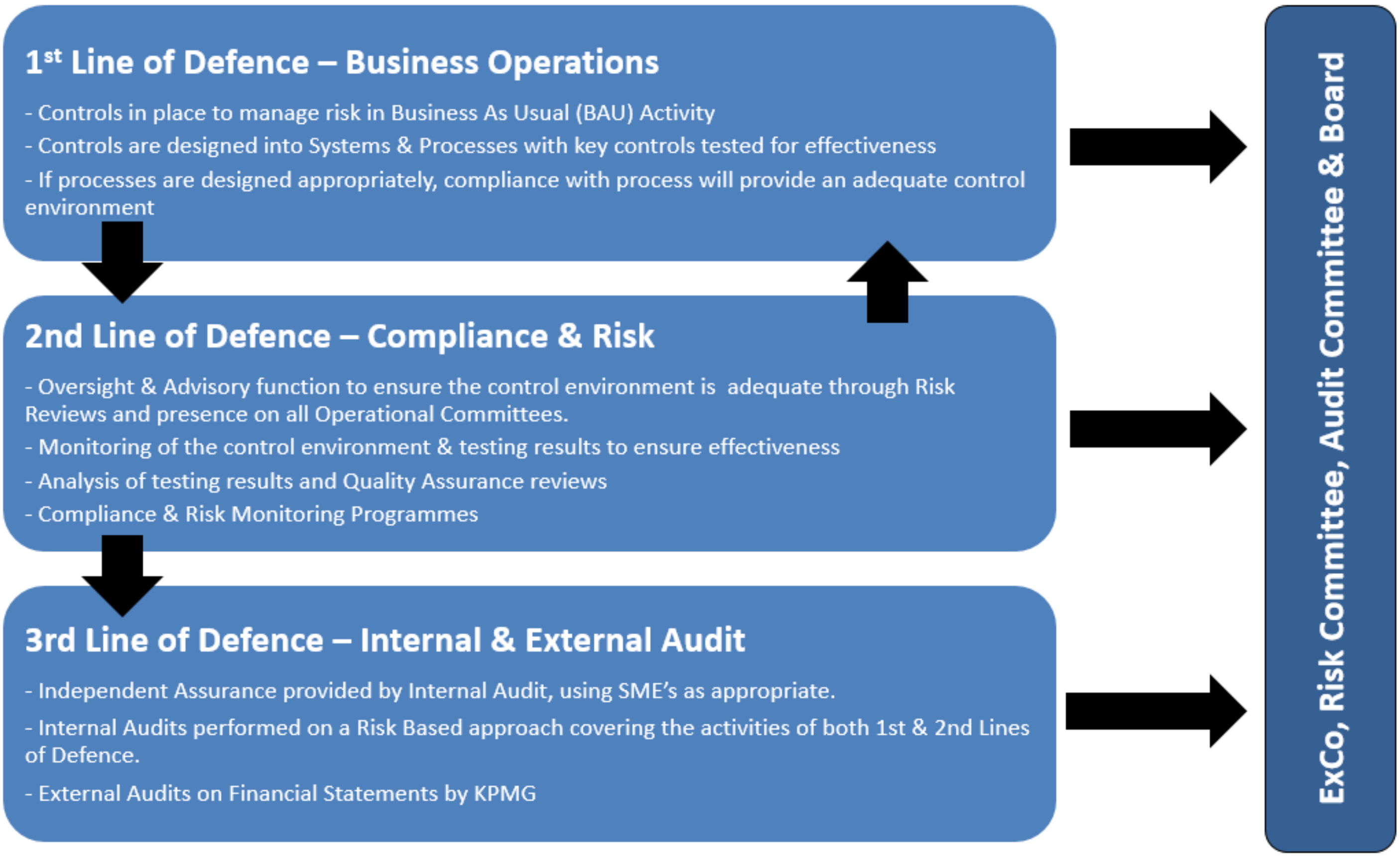
The Risk Management Framework diagram below links the AL Board level strategy with the operational level delivery.



Risk Management

Three Lines of Defence Model

AL incorporates the three lines of defence control model.



Key Regulatory Metrics

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

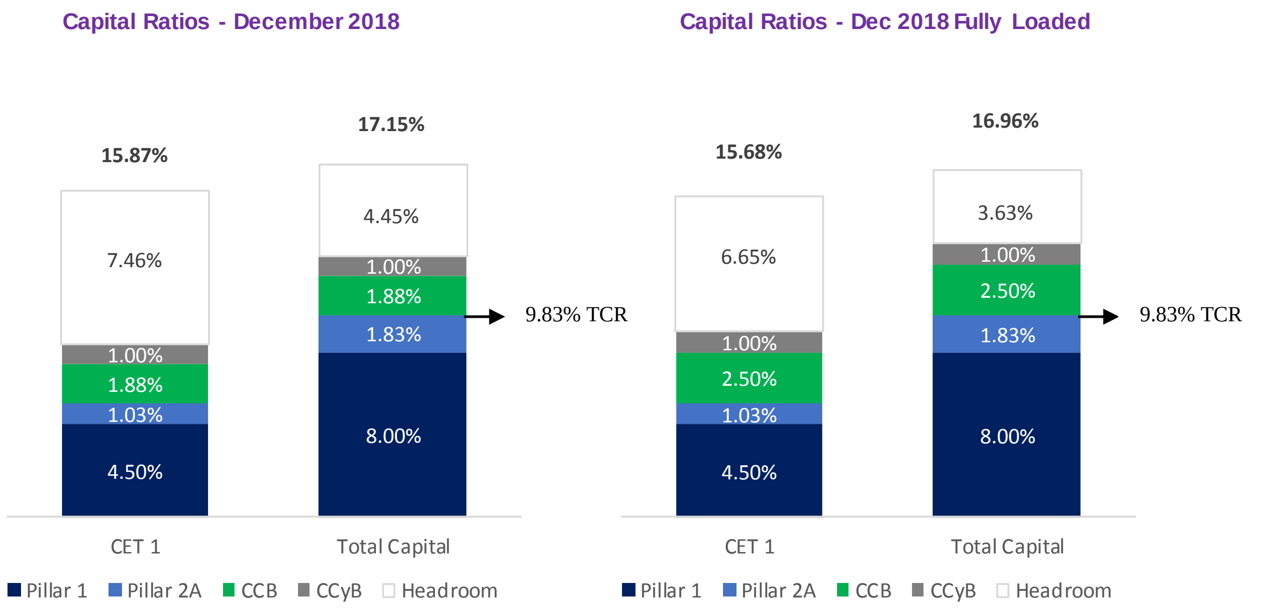
Key Metrics		Dec* 2018	Sep 2018	Jun 2018	Mar 2018	Dec* 2017
	Available capital (£'000)					
1	Common Equity Tier 1 ("CET 1")	164,291	150,139	153,417	155,360	158,614
1a	Fully loaded ECL accounting model CET 1	162,305	148,481	150,951	152,805	
2	Tier 1	164,291	150,139	153,417	155,360	158,614
2a	Fully loaded accounting model Tier 1	162,305	148,481	150,951	152,805	
3	Total capital	177,574	163,273	166,507	168,298	171,718
3a	Fully loaded ECL accounting model total capital	175,588	161,615	164,040	165,743	
	Risk weighted assets (£'000)					
4	Total risk weighted assets ("RWA")	1,036,307	1,026,562	995,187	972,732	918,717
	Risk-based capital ratios as a percentage of RWA (%)					
5	CET 1 ratio	15.9%	14.6%	15.4%	16.0%	17.3%
5a	Fully loaded ECL accounting model CET 1	15.7%	14.5%	15.2%	15.7%	
6	Tier 1 ratio	15.9%	14.6%	15.4%	16.0%	17.3%
6a	Fully loaded accounting model Tier 1 ratio	15.7%	14.5%	15.2%	15.7%	
7	Total capital ratio	17.1%	15.9%	16.7%	17.3%	18.7%
7a	Fully loaded ECL accounting model total capital ratio	16.9%	15.7%	16.5%	17.0%	
	Additional CET1 buffer requirements as a percentage of RWA (%)					
8	Capital conservation buffer requirement (2.5% from 2019)	1.9%	1.9%	1.9%	1.9%	1.3%
9	Countercyclical buffer requirement	1.0%	0.5%	0.5%	0.0%	0.0%
10	Bank D-SIB additional requirements	0.0%	0.0%	0.0%	0.0%	0.0%
11	Total of bank CET1 specific buffer requirements (row 8 + row 9 + row 10)	2.9%	2.4%	2.4%	1.9%	1.3%
12	CET1 available after meeting the bank's minimum capital requirements	8.5%	7.8%	8.5%	9.6%	11.5%
	Basel III Leverage Ratio					
13	Total Basel III leverage ratio measure	2,127,352	2,117,316	1,997,149	1,830,275	1,800,380
14	Basel III leverage ratio (%) (row 2/row 13)	7.7%	7.1%	7.7%	8.5%	8.8%
14a	Fully loaded ECL accounting model Basel III leverage ratio (row 2A/row 13)	7.6%	7.0%	7.6%	8.3%	
	Liquidity Coverage Ratio					
15	Total HQLA	514,896	540,501	416,520	330,217	340,633
16	Total net cash outflow	182,895	171,750	232,243	94,123	153,270
17	LCR ratio (%)	281.5%	314.7%	179.3%	350.8%	222.2%
	Net Stable Funding Ratio					
18	Total available stable funding	1,730,500	1,684,565	1,573,878	1,421,790	1,426,055
19	Total required stable funding	1,131,445	1,091,238	1,048,477	1,007,518	957,303
20	NSFR ratio (%)	152.9%	154.4%	150.1%	141.1%	149.0%

* - Includes year end verified reserves.

The Bank of England announced an increase in the countercyclical buffer for all UK banks to 0.5%, effective June 2018 with a further increase to 1.0% effective November 2018. The Capital Conservation Buffer is phased in until 2019 when it will be 2.5%. Based on the individual capital guidance received from the PRA the Group has a total capital requirement ("TCR") of 9.83% as at 31 December 2018. This was reduced to 9.00% effective from 4 January 2019.

Key Regulatory Metrics

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018



CCB – Capital Conservation Buffer; CCyB – Countercyclical Buffer

The fully loaded graphs above, include the Capital Conservation Buffer at 2.5% and the full IFRS 9 deduction without transitional relief.

Capital Resources

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

The table below summarises the composition of regulatory capital for the Group as at 31 December 2018.

Capital Resources	Notes	2018 £000	2017 £000
Tier 1			
Ordinary share capital		153	153
Retained earnings		209,083	237,171
Capital redemption reserve		20	20
IFRS 9 - Transitional add back		1,986	-
Deduction for significant investment		(34,219)	(83,804)
Add back 10% of CET1 (risk weighted at 250%)		18,137	22,038
Available-for-sale reserve		(12,169)	162
Deductions from Tier 1			
Goodwill		(5,202)	(5,202)
Other intangibles		(11,336)	(10,793)
Treasury shares		(1,131)	(1,131)
Prudent valuation deduction		(38)	-
Total Tier 1 after deductions		**165,284**	**158,614**
Tier 2			
Subordinated loans		13,283	13,104
Total Tier 2		**13,283**	**13,104**
Total Tier 1 and Tier 2		**178,567**	**171,718**

Notes

1. The subordinated debt was raised in order to increase the capital base of the Group and was issued on 7 November 2005, denominated in Euros. The principal amount outstanding at 31 December 2018 was €15 million. The notes carry interest at 3% over interbank rate for three month deposits in Euros and repayable at par in August 2035 unless redeemed or repurchased earlier by the Group.

Capital Adequacy

In order to protect the solvency of the Group, internal capital is held to provide a cushion for unexpected losses. In assessing the adequacy of its capital, the Group considers its risk appetite, the material risks to which the Group is exposed and the appropriate management strategies for each of the Group's material risks, including whether or not capital provides an appropriate mitigant.

The Internal Capital Adequacy Assessment Process (ICAAP) is a key element of the Group's implementation of the EU Capital Requirements Directive (CRD). It is a process that brings together the risk management framework that the Group has previously implemented to identify, manage and mitigate its risks within the financial discipline of budgeting and business planning.

The intention is that the ICAAP will be reviewed and updated each year in conjunction with the annual budget process, unless there are any changes in the control environment or other events that warrant a more immediate update. When performing the annual update the Board will review the continued appropriateness of the stated risk appetite and compare it against actual performance. It will also request the recalculation of the stress tests if they are still appropriate for the Group. If not it will devise additional stress tests.

The Board will monitor performance against the ICAAP through its key committees and operating company boards all of which have main board representation and report to the main board.

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

Capital Adequacy

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

The table below gives the linkages between the financial statements and the regulatory exposures:

	a	b	c	d	e	f	g
			Carrying values of items:				
	Carrying values as reported in published financial statements	Carrying values under scope of regulatory consolidation	Subject to credit risk framework	Subject to counterparty credit risk framework	Subject to the securitisation framework	Subject to market risk framework	Not subject to capital requirements or subject to deduction from capital
ASSETS							
Cash and balances at central banks	405,325	405,325	405,325	-	-	-	-
Loans and advances to banks	54,173	54,173	-	54,173	-	-	-
Debt securities held-to-maturity	342,691	342,691	342,691	-	-	-	-
Assets classified as held for sale	8,002	8,002	8,002	-	-	-	-
Derivative financial instruments	1,846	1,846	-	-	-	1,846	-
Loans and advances to customers	1,224,656	1,224,656	1,224,656	-	-	-	-
Other assets	12,716	12,716	12,716	-	-	-	-
Financial investments	35,351	35,351	35,351	-	-	-	-
Deferred tax asset	1,491	1,491	1,491	-	-	-	-
Intangible assets	16,539	16,539	16,539	-	-	-	16,539
Property, plant and equipment	5,303	12,945	12,945	-	-	-	-
Investment property	67,081	59,439	59,439	-	-	-	-
Total assets	**2,175,173**	**2,175,173**	**2,119,154**	**54,173**	**-**	**1,846**	**16,539**
LIABILITIES							
Deposits from banks	232,675	232,675	232,675	-	-	-	-
Derivative financial instruments	188	188	-	-	-	188	-
Deposits from customers	1,714,286	1,714,286	1,714,286	-	-	-	-
Current tax liability	236	236	236	-	-	-	-
Other liabilities	18,549	18,549	18,549	-	-	-	-
Debt securities in issue	13,283	13,283	13,283	-	-	-	-
Total liabilities	**1,979,217**	**1,979,217**	**1,979,029**	**-**	**-**	**188**	**-**

The following table shows an overview of the Risk Weighted Assets:

	Overview of Risk Weighted Assets	a	b	c
		RWA		Minimum capital requirement
		31/12/18 £000	30/09/18 £000	31/12/18 £000
1	Credit risk (excluding counterparty credit risk)	**949,552**	**939,565**	**75,964**
2	Of which: standardised approach (SA)	949,552	939,565	75,964
3	Of which: foundation internal ratings-based (F-IRB) approach	-	-	-
4	Of which: supervisory slotting approach	-	-	-
5	Of which: advanced internal ratings-based (A-IRB) approach	-	-	-
6	Counterparty credit risk (CCR)	-	-	-
7	Of which: standardised approach for counterparty credit risk	-	-	-
8	Of which: Internal Model Method (IMM)	-	-	-
9	Of which: other CCR	-	-	-
10	Credit valuation adjustment (CVA)	**369**	**126**	**30**
11	Equity positions under the simple risk weight approach	-	-	-
12	Equity investments in funds - look-through approach	-	-	-
13	Equity investments in funds - mandate-based approach	-	-	-
14	Equity investments in funds - fall-back approach	-	-	-
15	Settlement risk	-	-	-
16	Securitisation exposures in the banking book	**-**	**-**	**-**
17	Of which: securitisation internal ratings-based approach (SEC-IRBA)	-	-	-
18	Of which: securitisation external ratings-based approach (SEC-ERBA), including internal assessment approach	-	-	-
19	Of which: securitisation standardised approach (SEC-SA)	-	-	-
20	Market risk	**586**	**1,071**	**47**
21	Of which: standardised approach (SA)	586	1,071	47
22	Of which: internal model approaches (IMA)	-	-	-
23	Capital charge for switch between trading book and banking book	-	-	-
24	Operational risk	**85,799**	**85,799**	**6,864**
25	Amounts below thresholds for deduction (subject to 250% risk weight)	-	-	-
26	Floor adjustment	-	-	-
27	**Total (1+6+10+11+12+13+14+15+16+20+23+24+25+26)**	**1,036,307**	**1,026,561**	**82,905**

Impairment of financial assets: assets carried at amortised cost

The Group recognises loss allowances on an expected credit loss basis for all financial assets measured at amortised cost, including loans and advances, debt securities and loan commitments.

Credit loss allowances are measured as an amount equal to lifetime ECL, except for the following assets, for which they are measured as 12 month ECL:

- Financial assets determined to have a low credit risk at the reporting date
- Financial assets which have not experienced a significant increase in credit risk since their initial recognition.

Impairment model

The IFRS 9 impairment model adopts a three stage approach based on the extent of credit deterioration since origination:

- Stage 1: 12-month ECL applies to all financial assets that have not experienced a significant increase in credit risk ("SICR") since origination and are not credit impaired. The ECL will be computed based on the probability of default events occurring over the next 12 months. This Stage 1 approach is different from the historic approach which estimates a collective allowance to recognise losses that have been incurred but not reported on performing loans. Stage 1 includes the current performing loans (up to date and in arrears of less than 10 days) and those within Heightened Business Monitoring ("HBM"). Accounts requiring HBM are classified as a short-term deterioration in financial circumstances and are tightly monitored with additional proactive client engagement, but not deemed SICR.

A financial asset is within HBM where:

- A loan is in arrears between 10 and 30 days;
- Bankers become aware of signs of potential future difficulties, such as
  - cash flow difficulties
  - unexpected hard core borrowing
  - regular requests for excesses
  - returned cheques
  - lack of engagement/failure to respond to information requests
  - breach of covenants/conditions
  - count court judgements

- Stage 2: When a financial asset experiences a SICR subsequent to origination, but is not in default, it is considered to be in Stage 2. This requires the computation of ECL based on the probability of all possible default events occurring over the remaining life of the financial asset. Provisions are higher in this stage (except where the value of charge against the financial asset is sufficient to enable recovery in full) because of an increase in credit risk and the impact of a longer time horizon being considered (compared to 12 months in Stage 1).

Evidence that a financial asset has experienced a SICR includes the following considerations:

- A loan is in arrears between 31 and 90 days;
- Forbearance action has been undertaken;

- Stage 3: Financial assets that are credit impaired are included in this stage. Similar to Stage 2, the allowance for credit losses will continue to capture the lifetime expected credit losses. At each reporting date, the Group will assess whether financial assets carried at amortised cost are in default. A financial asset will be considered to be in default when an event(s) that has a detrimental impact on estimated future cash flows have occurred.

Evidence that a financial asset is within Stage 3 includes the following data:
- A loan is in arrears in excess of 90 days;
- Breach of terms of forbearance;
- Recovery action is in hand; or
- Bankruptcy proceedings or similar insolvency process of a client, or director of a company.

The credit risk of financial assets that become credit impaired are not expected to improve such that they are no longer considered credit impaired.

Presentation of allowance for ECL in the statement of financial position
For financial assets measured at amortised cost, these are presented as the gross carrying amount of the assets minus a deduction for the ECL.

Write-off
Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the outstanding amount due.

(b) Renegotiated loans
Loans that are neither subject to ECLs nor individually significant, and whose terms have been renegotiated, are no longer considered to be past due but are treated as new loans.

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

(d) Assets classified as financial investments
Equity instruments at fair value through other comprehensive income
Equity investments are not subject to impairment charges recognised in the income statement. Any fair value gains and losses are recognised in OCI whch are not subject to reclassification to the income statement on derecognition.

Debt instruments at FVOCI
Changes in fair value are recognised in OCI, the loss allowance will be recognised in OCI and shall not reduce the carrying amount of the financial asset in the statement of financial position. Impairment costs will be recognised in the profit or loss with a corresponding entry to OCI. On derecognition, cumulative gains and losses in OCI are reclassified to the profit or loss.

Impairments to financial assets carried at FVOCI are recognised in the Statement of Comprehensive Income.

Impairment of assets carried at amortised cost (Policy applicable before 1 January 2018)
On an ongoing basis the Group assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. Objective evidence is the occurrence of a loss event, after the initial recognition of the asset, that impacts on the estimated contractual future cash flows of the financial asset or group of financial assets, and can be reliably estimated.

The criteria that the Group uses to determine whether there is objective evidence of an impairment loss include, but are not limited to the following:
- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower;
- Initiation of bankruptcy proceedings;
- Deterioration in the value of collateral;
- Deterioration of the borrower's competitive position.

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

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

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

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

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

The following tables provide an analysis of loans and advances to customers (as disclosed in the Group's Annual Report):

Analyses of loans and advances to customers:

	2018				
	IAS 39	Stage 1	Stage 2	Stage 3	Total
Group	£000	£000	£000	£000	£000
At 31 December 2017	1,050,631	-	-	-	1,050,631
IFRS 9 reclassification into Stages	(1,050,631)	992,252	29,502	28,877	-
Gross loans and advances at 1 January 2018	**-**	**992,252**	**29,502**	**28,877**	**1,050,631**
Originations		458,825	-	-	458,825
Repayments and write-offs		(266,890)	(8,809)	(2,526)	(278,225)
Transfer to Stage 1		7,975	(7,975)		-
Transfer to Stage 2		(27,929)	28,975	(1,046)	-
Transfer to Stage 3		(3,109)	(8,993)	12,102	-
Gross loans and advances at 31 December 2018	**-**	**1,161,124**	**32,700**	**37,407**	**1,231,231**
Less allowances for ECLs	-	(1,606)	(8)	(4,961)	(6,575)
Net loans and advances at 31 December 2018	**-**	**1,159,518**	**32,692**	**32,446**	**1,224,656**

	2017				
	IAS 39	Stage 1	Stage 2	Stage 3	Total
Group	£000	£000	£000	£000	£000
Gross loans and advances at 31 December 2017	**1,050,631**	**-**	**-**	**-**	**1,050,631**
Less allowances for impairments	(1,362)	-	-	-	(1,362)
Net loans and advances at 31 December 2017	**1,049,269**	**-**	**-**	**-**	**1,049,269**

Comparative data for 2017 has been prepared under IAS 39.

Loans and advances to customers by division (net of ECL / impairments):

	2018				
	Private Banking	Commercial Banking	RAF	All Other Divisions	Total
Group	£000	£000	£000	£000	£000
Stage 1	618,486	431,630	84,276	25,126	1,159,518
Stage 2	20,034	11,478	1,180	-	32,692
Stage 3	31,944	-	502	-	32,446
At 31 December 2018	**670,464**	**443,108**	**85,958**	**25,126**	**1,224,656**

	2017				
	Private Banking	Commercial Banking	RAF	All Other Divisions	Total
Group	£000	£000	£000	£000	£000
At 31 December 2017	**650,245**	**305,055**	**71,265**	**22,704**	**1,049,269**

Analyses of past due loans and advances to customers by division:

	2018				
Group	Private Banking £000	Commercial Banking £000	RAF £000	All Other Divisions £000	Total £000
Up to 30 days	47,766	20,784	2,519	-	71,069
Stage 1	47,766	20,784	2,078	-	70,628
Stage 2	-	-	154	-	154
Stage 3	-	-	287	-	287
30 - 60 days	662	2,300	775	-	3,737
Stage 2	662	2,300	565	-	3,527
Stage 3	-	-	210	-	210
60 - 90 days	385	4,177	297	-	4,859
Stage 2	385	4,177	175	-	4,737
Stage 3	-	-	122	-	122
Over 90 days	49,415	-	546	-	49,961
Stage 2	12,901	-	272	-	13,173
Stage 3	36,514	-	274	-	36,788
At 31 December	**98,228**	**27,261**	**4,137**	**-**	**129,626**

	2017				
Group	Private Banking £000	Commercial Banking £000	RAF £000	All Other Divisions £000	Total £000
Up to 30 days	90,527	24,599	-	-	115,126
30 - 60 days	11,043	-	-	-	11,043
60 - 90 days	5,078	-	-	-	5,078
At 31 December	**106,648**	**24,599**	**-**	**-**	**131,247**

Prior year numbers are presented under IAS 39 and therefore has no Staging.

Allowances for impairment of loans and advances

An analysis of movements in the allowance for ECLs:

Group	IAS 39 £000	Stage 1 £000	Stage 2 £000	Stage 3 £000	Total £000
At 31 December 2017	1,362				1,362
IFRS 9 transition adjustment	2,580				2,580
Reclassification into IFRS 9 Stages	(3,942)	1,244	1,178	1,520	-
At 1 January 2018	**-**	**1,244**	**1,178**	**1,520**	**3,942**
Transfer to Stage 1		-	-	-	-
Transfer to Stage 2		(378)	378	-	-
Transfer to Stage 3		(81)	(1,548)	1,629	-
Current year charge		821	-	1,871	2,692
Adjustment due to variation in expected future cash flows		-	-	78	78
Repayments and write-offs		-	-	(137)	(137)
At 31 December 2018	**-**	**1,606**	**8**	**4,961**	**6,575**

Allowances for impairments of loans and advances - IAS 39 comparatives

Reconciliation of specific allowance for impairments:

Group	2017 £000
At 1 January	973
Impairment losses	329
On acquisition of RAF	51
Loans written off during the year as uncollectible	(15)
Amounts recovered during the year	(116)
At 31 December	**1,222**

Reconciliation of collective allowance for impairments:

Group	2017 £000
On acquisition of RAF	75
Impairment losses	65
At 31 December	**140**
Total allowance for impairments as at 31 December 2017	**1,362**

Credit Risk

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

Analysis of credit risk exposures
The following table analyses the Group's regulatory risk exposures as at 31 December by asset class:

Analysis of credit risk exposure	2018 £000	2017 £000
Central governments or central banks	491,100	365,197
Multilateral development banks	25,684	43,129
Institutions	42,524	26,219
Corporates	213,357	200,479
Retail	71,196	63,055
Secured on immovable property	980,395	890,938
Exposures in default	39,858	35,606
Items associated with particularly high risk	66,898	105,098
Covered bonds	117,949	86,789
Claims on insitutions and corporate with a short-term credit assessment	125,766	94,626
Equity	19,092	2,071
Other items	97,716	101,765
Total credit risk exposure as at 31 December	**2,291,534**	**2,014,972**

Note
The credit risk exposures above are disclosed on a regulatory basis and therefore do not reconcile to financial asset classifications as reported in the Group's Statutory Annual Report.

Credit Risk

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

	Exposures before CCF and CRM		Exposures post CCF and CRM		RWA and RWA density	
	On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
Effect of CRM by asset class - 2018	£000	£000	£000	£000	£000	%
Sovereigns and their central banks	491,100	-	491,100	-	-	0.00%
Multilateral development banks	25,684	-	25,684	-	-	0.00%
Banks	42,524	-	42,524	-	10,883	25.59%
Corporates	174,276	39,081	155,875	254	153,453	98.29%
Regulatory retail portfolios	59,534	11,663	29,401	48	29,449	100.00%
Secured by residential property	689,703	29,405	689,618	-	236,204	34.25%
Secured by commercial real estate	211,950	49,336	211,754	-	210,559	99.44%
Equity	19,092	-	19,092	-	46,033	241.11%
Past-due loans	39,469	389	37,225	-	40,866	109.78%
Higher-risk categories	56,349	10,549	56,296	-	84,444	150.00%
Other assets	341,430	-	341,430	-	137,663	40.32%
Total credit risk exposure as at 31 December	**2,151,111**	**140,423**	**2,099,999**	**302**	**949,554**	**898.78%**
		2,291,534		**2,100,301**		

Breakdown by asset class and risk weight - 2018	0%	10%	20%	35%	50%	75%	100%	150%	Others	Total credit exposures
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Sovereigns and their central banks	491,100	-	-	-	-	-	-	-	-	491,100
Multilateral development banks	25,684	-	-	-	-	-	-	-	-	25,684
Banks	-	-	34,597	-	7,927	-	-	-	-	42,524
Corporates	-	-	-	-	-	-	156,129	-	-	156,129
Regulatory retail portfolios	-	-	-	-	-	-	29,449	-	-	29,449
Secured by residential property	-	-	-	689,618	-	-	-	-	-	689,618
Secured by commercial real estate	-	-	-	-	-	-	211,754	-	-	211,754
Equity	-	-	-	-	-	-	1,131	-	17,960	19,091
Past-due loans	-	-	-	-	-	-	29,944	7,281	-	37,225
Higher-risk categories	-	-	-	-	-	-	-	56,296	-	56,296
Other assets	121	99,963	141,686	-	2,066	-	97,127	-	468	341,431
	516,905	**99,963**	**176,283**	**689,618**	**9,993**	**-**	**525,534**	**63,577**	**18,428**	**2,100,301**

Analysis of loans and advances to banks

The table below presents an analysis of loans and advances to banks by rating agency designation as at 31 December, based on Moody's long term ratings (as disclosed in the Group's Annual Report):

Analysis of loans and advances to banks	2018 £000	2017 £000
Aaa	709	-
Aa3	42,230	39,871
A1	8,880	20,553
A2	1,906	10,012
A3	10	-
Baa1	438	243
Total	**54,173**	**70,679**

Analysis of debt securities

The table below presents an analysis of debt securities by rating agency designation at 31 December, based on Moody's long term ratings (as disclosed in the Group's Annual Report):

Analysis of debt securities	2018 £000	2017 £000
Aaa	76,281	100,106
Aa1	84,218	51,389
Aa2	32,325	5,946
Aa3	56,046	18,384
A1	75,657	18,187
A2	18,164	-
A3	-	33,007
Total	**342,691**	**227,019**

Encumbrance

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

The Group primarily encumbers assets through positioning loans as collateral to support access to the Bank of England's Term Funding Scheme ("TFS").

	2018				2017			
	Encumbered assets		Unencumbered assets		Encumbered assets		Unencumbered assets	
Encumbered and unencumbered assets	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	£000	£000	£000	£000	£000	£000	£000	£000
Loans on demand	-		456,753		-		383,625	
Equity instruments	-	-	35,351	35,351	-	-	2,347	2,347
Debt securities	115,848	115,848	226,842	226,842	148,705	148,705	78,314	78,314
Loans and advances other than loans on demand	193,373		1,031,452		208,714		837,865	
Other assets	-		118,826		-		193,662	
Assets of the reporting institution	**309,221**		**1,869,224**		**357,419**		**1,495,813**	
Total on-balance sheet (encumbered and unencumbered)			**2,178,445**				**1,853,232**	

Leverage Ratio

The leverage ratio is a regulatory measure complementing capital. It is a comparable measure, as the on balance sheet amount used in the leverage exposure is free from risk weighting. The leverage exposure is calculated as Tier 1 capital divided by the leverage exposure. The leverage ratio together with the other regulatory metrics is actively monitored and assessed by the Group.

The following three tables follow the formats that are prescribed by the European Banking Authority (EBA). Rows without balances have been omitted.

Table LRSum: Summary reconciliation of accounting assets and leverage ratio exposures	2018 £000	2017 £000
Total consolidated assets as per published financial statements	2,175,173	1,853,232
Adjustments for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	14,313	26,040
Other adjustments	(33,790)	(78,892)
Total leverage exposure	**2,155,696**	**1,800,380**

LRCom: Leverage ratio common disclosure	2018 £000	2017 £000
On-balance sheet exposures (excluding derivatives and SFTs):		
Total consolidated assets as per published financial statements	2,173,326	1,850,681
Asset amounts deducted in determining Tier 1 capital	(33,790)	(78,892)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**2,139,536**	**1,771,789**
Derivative exposures:		
Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	1,847	2,551
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	-	-
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**1,847**	**2,551**
Other off-balance sheet exposures:		
Off-balance sheet exposures at gross notional amount	140,423	237,097
Adjustments for conversion to credit equivalent amounts	(126,110)	(211,057)
Other off-balance sheet exposures (sum of lines 17 to 18)	**14,313**	**26,040**
Capital and total exposures:		
Tier 1 capital	162,864	158,614
Total leverage ratio exposures	2,155,696	1,800,380
Leverage Ratio	**7.6%**	**8.8%**

Leverage Ratio

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

Table LRSpl: Split of on-balance sheet exposures (excluding derivatives, SFTs and exempted exposures)	2018 £000	2017 £000
Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**2,139,536**	**1,771,789**
Banking book exposures, of which:	**2,139,536**	**1,771,789**
Covered bonds	86,789	86,789
Exposures treated as sovereigns	365,197	365,197
Exposures to regional governments, MDB, international organisations and PSE NOT treated as sovereigns	43,129	43,129
Institutions	26,219	26,219
Secured by mortgages of immovable properties	804,233	804,233
Retail exposures	53,648	53,648
Corporate	108,402	108,402
Exposures in default	35,606	35,606
Other exposures (eg equity, securitisations, and other non-credit obligation assets)	616,313	248,566

Liquidity

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

Liquidity Coverage Ratio ("LCR")

		Total unweighted value (average)	Total weighted value (average)
High-quality liquid assets			
1	Total HQLA		514,896
Cash outflows			
2	**Retail deposits and deposits from small business customers, of which:**	**600,636**	**68,712**
3	Stable deposits	103,918	5,196
4	Less stable deposits	496,718	63,516
5	**Unsecured wholesale funding, of which:**	**538,865**	**213,951**
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	-	-
7	Non-operational deposits (all counterparties)	538,865	213,951
8	Unsecured debt	-	-
9	**Secured wholesale funding**		-
10	**Additional requirements, of which:**	**138,680**	**11,817**
11	Outflows related to derivative exposures and other collateral requirements	-	-
12	Outflows related to loss of funding of debt products	-	-
13	Credit and liquidity facilities	138,680	11,817
14	**Other contractual funding obligations**	7,805	-
15	**Other contingent funding obligations**	1,744	-
16	**TOTAL CASH OUTFLOWS**		**294,480**
Cash inflows			
17	**Secured lending (eg reverse repo)**	-	-
18	**Inflows from fully performing exposures**	149,452	111,584
19	**Other cash inflows**	-	-
20	**TOTAL CASH INFLOWS**	**149,452**	**111,584**
			Total adjusted value
21	**Total HQLA**		**514,896**
22	**Total net cash outflows**		**182,896**
23	**Liquidity coverage ratio (%)**		**282%**

High quality liquid assets principally consist out of the Group's Bank of England reserve account and covered bonds.

Remuneration Disclosures

Arbuthnot Banking Group PLC
Pillar 3 disclosures for the year ended 31 December 2018

The Remuneration Code (the "Code") requires a firm to maintain remuneration policies, procedures and practices that promote effective risk management. The Code requires the Group to identify Material Risk Takers ("MRTs"), also known as Code staff. MRTs have activities which have a material impact on the firm's risk profile. The Group identified 55 MRTs in respect of the 2018 performance year.

MRTs

The following have been identified as MRTs across the Group:

1. All Executive and Non-Executive Directors of Arbuthnot Banking Group PLC ("ABG") and Arbuthnot Latham & Co., Limited ("AL").
2. All other employees of AL who hold a Senior Management Function ("SMF")
3. Members of the Executive Committee of AL.
4. All other MRTs not caught by 1, 2 or 3.

During the performance year 2018, there were no other staff identified who are both highly remunerated and could have an impact on the Group's risk profile.

Aggregate Remuneration Expenditure (MRTs)

Group Directors	AL
£4,242,498	£7,790,865

Breakdown of remuneration between Fixed and Variable amounts

Dec 2018	Total	Directors	Others
Number of MRTs	55	11	44
Fixed	£9,595,127	£4,376,550	£5,218,577
Variable	£2,438.236	£1,330,000	£1,108,236

Decision making process used to determining the remuneration policy

The Group Remuneration Committee has responsibility for oversight of the Group Remuneration policy and the implementation of it, while the AL Remuneration Committee is responsible for the AL Remuneration policy and the implementation thereof.

Whilst it is the established practice for all pay rises and bonuses to be reviewed at Group level, any bonuses in excess of 33% of total remuneration to MRTs and/or any remuneration package in excess of £500,000 need to be specifically approved in advance by either the Group Remuneration Committee or the AL Remuneration Committee.

Where the Committee believe it is appropriate, significant bonuses will be subject to a deferred payment structure.

Composition of the Remuneration Committee

Membership of both Remuneration Committees is limited to non-executive directors together with Sir Henry Angest who is Chairman of both. The Group Committee met three times during the year and the AL Remuneration Committee met four times.

The present members of the Group Committee are Sir Henry Angest, Sir Christopher Meyer and Sir Alan Yarrow. The present members of the AL Remuneration Committee are Sir Henry Angest, Angela Knight, Sir Michael Peat and Paul Marrow.

The committees have responsibility for producing recommendations on their respective Remuneration Policies in respect of MRTs and for reviewing the remuneration of specific MRTs.

Link between pay and performance

The Group believes in the importance of attracting, retaining and motivating Staff of the appropriate calibre without paying more than is necessary for this purpose.

The general principle for the Group is that staff will be paid a salary, plus benefits and they will be eligible for an annual discretionary bonus.

Both salary increases and the payment of a discretionary bonus are subject to good performance, company profitability and compliance with risk policies and risk appetite limits.