

Arbuthnot Banking Group PLC

ANNUAL REPORT 2009

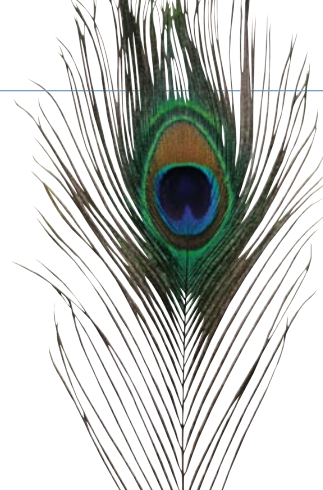


ARBUTHNOT BANKING GROUP PLC

Arbuthnot Latham offers outstanding **Private Banking** and **Wealth Management** services with an emphasis on individual attention.

Arbuthnot Securities provides integrated **Investment Banking** services, creating value for its clients with market-leading advice.

Secure Trust Bank provides **banking and insurance products** both direct to the consumer and through its branch network.



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Corporate Philosophy

Arbuthnot has a 177 year history of serving its customers, as well as a long track record of profitability against the background of a continually changing environment. The ability of Arbuthnot to adapt and grow has come from managing the business through seven key principles developed over time. These principles, always applied with pragmatism and common sense, govern the activities of the Group, ranging from major strategic issues to smaller day-to-day operational matters.

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

Sun Tzu
The Art of War
circa 500 BC

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 approach is based on **diversification**, a **long-term view**, **empowerment of management** and a culture of **rewards for achievements**.
5. Arbuthnot’s business is conducted in an **innovative**, **flexible** and **entrepreneurial** manner, with an **opportunistic** and **counter-cyclical attitude**.
6. Arbuthnot does not sacrifice **long term prospects** for short term gains – nor sacrifice **stability** for quick profits.
7. Ultimately, the success of Arbuthnot depends on the **teamwork**, **commitment**, and **performance** of its employees, combined with the **determination** to win.

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

Henry Angest
Chairman & CEO
10 March 2010

Group Highlights

Operating income

| | |
|------|--------|
| 2009 | £51.7m |
| 2008 | £41.9m |

Profit before tax/(loss)

| | |
|------|---------|
| 2009 | £5.1m |
| 2008 | (£2.2)m |

Profit attributable to Equity holders of the Company

| | |
|------|-------|
| 2009 | £3.5m |
| 2008 | £0.5m |

Basic earnings per share

| | |
|------|-------|
| 2009 | 23.4p |
| 2008 | 3.5p |

Total dividend per share

| | |
|------|-------|
| 2009 | 22.0p |
| 2008 | 21.0p |

Total assets

| | |
|------|---------|
| 2009 | £452.5m |
| 2008 | £359.8m |

Regulatory capital

| | |
|------|--------|
| 2009 | £44.3m |
| 2008 | £45.5m |

Private Banking

Despite the well documented turmoil in the economy and the financial services sector, the Private Banking Division delivered a pleasing growth in its underlying core profitability.

Retail Banking

The Retail Banking Division had a good year generating pre tax profits of £10.2m, an increase of 40% on the previous year.

Investment Banking

Arbuthnot Securities saw a strong turnaround and returned to profit in the second half.

This result reflects a marked improvement in the performance of the Group during the second half of the year.

Henry Angest, Chairman, Arbuthnot Banking Group



ARBUTHNOT LATHAM
Private Bankers

Arbuthnot Latham provides a high quality private banking and wealth management service, consisting of three core elements:

Private Banking

Private banking comprises current accounts, deposit accounts, loans, overdrafts and foreign exchange. Each client deals with a dedicated Private Banker who is key to providing an individual service.

Financial Planning

The financial planning service is built on long-term relationships and bespoke financial strategies. The service is independent and fee, not commission based, with clients receiving a service covering estate and tax planning, pensions and wealth preservation and generation.

Investment Management

Our investment management service comprises discretionary fund management, developing tailored investment strategies to ensure that each client's specific investment objectives are met.



SECURE TRUST BANK

Secure Trust Bank provides retail financial products through retail branches and directly via call centres. The business was rebranded Moneyway in 2007. The core products are the "OneBill" household account, unsecured lending and savings accounts.

"OneBill" Household Account

The core product of Secure Trust Bank is the Moneyway "OneBill" account that enables customers to keep track of exactly how much of their money is spent on bills by offering a single bill solution and just one regular weekly or monthly payment. The account is typically used for utility bills, council tax bills, mortgage payments, subscriptions and insurance payments.

Retail Banking

Secure Trust Bank also provides a full range of banking services including personal loans, current and savings accounts, financial advice and its new Prepaid Current Account. Combining these services with the "OneBill" account provides added convenience for customers in managing their financial affairs.



ARBUTHNOT SECURITIES

Arbuthnot Securities is a full service, integrated investment bank providing a full range of institutional stockbroking and corporate advisory services focused on UK growth companies comprising:

Corporate Finance

The Corporate Finance team specialises in providing financing and advisory solutions including stock market listings, mergers and acquisitions and public-to-private transactions.

Corporate Broking

Provides advice and guidance to corporate clients on how to manage relationships and communicate with major institutional shareholders and advises on compliance in 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.

Sales and Sales Trading

The sales team maintains relationships and provides a specialist dealing service to all the significant institutional owners of equity in the UK and key international investors.

Market Making

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.

Chairman's statement



Arbutnot Banking Group recorded a profit before tax of £5.1m for the year ended 31 December 2009 (2008: loss £2.2m). This result reflects a marked improvement in the performance of the Group during the second half of the year. It is an encouraging outturn, considering that the economic environment remains tough and that the results bear the cost of the investment the Group made in new business initiatives in 2009.

We continue to manage our business prudently and without any expectation of external support, and I am pleased to report that the Group is in robust financial health, with strong capital ratios, liquidity and balance sheets. This strength is, for once, reflected in the share price which has grown by 47% over the last 12 months and outperformed the FTSE Financial index by 7%.

We remain committed to a progressive dividend policy and we are proposing a 1p increase in the dividend, paying a final dividend of 11.5p per share, making it 22p for 2009 (2008: 21p).

In 2009, some of the consequences of the financial crisis have become clearer. On the positive side, it has provided us with opportunities to be corporately active. As a small banking group, it is our strategy to behave counter-cyclically and invest in people, products and businesses at the bottom of the cycle. We have taken full advantage of our opportunity by hiring high quality people, buying two books of consumer loans and investing in new business ventures. The market continues to present opportunities for us to grow our business.

On the negative side, the response to this crisis by government and regulators has produced some challenges both to us as a Group and to the wider financial services industry. The bank payroll tax, for example, fell indiscriminately on the banking sector, affecting both banks which required government assistance and those, like us, which managed their businesses prudently and forewent short-term profits to ensure stability. This grossly unfair tax epitomises government's policy on the financial crisis: all banks and bankers are regarded as equally culpable, and "one-size-fits-all" where taxation and regulation are concerned.

With an impending General Election in the UK, the development of President Obama's plans for the regulation of US banks and the increased regulation for banks proposed by the European Union, this is a critical year for the UK financial services industry. The threats to the industry are very real. Damage has already been done, and if a general heavy-handed approach continues, London's place as an international financial centre will continue to be seriously damaged. I believe strongly that banking regulations should be bespoke, case specific, based on a real appreciation of the individual banking business, its risks, management culture and the corresponding capital requirements.

The other threats to London are of course the punitive tax system, both personal and corporate and the ever increasing dead hand of excessive regulation, with employment laws being the most expensive.

Arbuthnot Banking Group looks forward with confidence to 2010 and beyond, provided the economy holds up and the UK does not experience a double dip. We are in the hands of the politicians.

Henry Angest, Chairman, Arbuthnot Banking Group

Private Banking Division

Arbuthnot Latham recorded a profit of £0.2m (2008: £2.1m). Although it is disappointing to report only a small profit in this division, it needs to be recognised that the result was heavily affected this year by two factors. In the first place, Arbuthnot Latham's results include £0.5m as part of the start-up cost associated with our structured products business, which began hiring staff in July 2009.

The second factor affecting Arbuthnot Latham's result is the reduced return generated by surplus liquidity invested in the money market. The bank continued to operate with a loan to deposit ratio of approximately 60% as its policy is to retain strong liquidity. The rates earned on this surplus liquidity declined from an average of 5.8% in 2008 to 2.7% in 2009. Although the interest rate spread between customer loans and deposits improved in 2010, the low money market rates had a negative effect on profitability.

Despite the severity of the economic recession, the quality of Arbuthnot Latham's loan book was demonstrated by the low level of provisions made for bad debts, which were less than 1% of the book.

Retail Banking Division

Pre-tax profits for Secure Trust Bank improved significantly to £10.2m (2008: £7.3m). The Bank has taken full advantage of the opportunity created by the financial crisis to re-enter the consumer lending market. It acquired two portfolios of loans in 2009 from Liverpool Victoria and Citigroup for considerations of £16.7m and £21.1m respectively, in both cases at a discount to the gross value of the loans. These portfolios have performed in line with expectations in terms of credit quality and have contributed strongly to profits in 2009.

The new motor finance business launched early in the year has steadily increased its business volumes and achieved a monthly lending runrate of £1m by the year end. This activity also made a positive profit contribution in 2009. The roll-out of the Prepaid Current Account has proceeded in line with plan and by the year end 2,740 accounts had been opened.

Secure Trust Bank has been able, without significant marketing spend, to generate customer deposits to finance lending activity. At 31 December, deposits stood at £93.4m, up 160% on the previous year end.

Investment Banking Division

Arbuthnot Securities moved strongly back into profit in the second half of the year after the disappointing first half and finished with a small full year loss of £0.1m (2008: loss of £5.2m). Corporate finance business improved markedly in the second half, with 15 transactions being completed compared with 2 in the first half. Arbuthnot Securities now has 98 clients and remains the firm with the second largest number of nominated adviser appointments on the AIM market. Strong results were achieved by the secondary market business, improving from £1.6m in 2008 to £7.8m in 2009.

During this difficult phase of the market, Arbuthnot Securities has taken advantage of the hiring window to substantially upgrade its people. Although staff numbers have remained stable at 72, approximately one third of staff have been hired since the middle of 2008.

Board Changes and Personnel

Apart from Mr. D.M. Proctor who was appointed a director on 3 November 2009 and Mr. M.A. Bussey who resigned from the Board on 3 November 2009, all directors served throughout the year.

These results once again reflect the continuing dedication and commitment of our employees who have done well in the current environment. On behalf of the Board I extend our thanks to all staff for their commitment and contributions made to the Group in 2009.

Dividend

The Board is proposing a final dividend of 11.5p, an increase of 1p on last year, making a total dividend for the year of 22p (2008: 21p). If approved, the dividend will be paid on 14 May 2010 to shareholders on the register as at 16 April 2010.

Outlook

Arbuthnot Banking Group looks forward with confidence to 2010 and beyond, provided the economy holds up and the UK does not experience a double dip. We are in the hands of the politicians.

Henry Angest

Chairman & CEO
10 March 2010

Arbuthnot Latham & Co.

Operating income

| | |
|------|--------|
| 2009 | £13.1m |
| 2008 | £14.6m |

Operating expenses

| | |
|------|--------|
| 2009 | £11.6m |
| 2008 | £13.4m |

Profit before tax

| | |
|------|-------|
| 2009 | £0.2m |
| 2008 | £2.1m |

Customer loans

| | |
|------|---------|
| 2009 | £177.7m |
| 2008 | £159.9m |

Customer deposits

| | |
|------|---------|
| 2009 | £292.0m |
| 2008 | £272.6m |

Total assets

| | |
|------|---------|
| 2009 | £370.1m |
| 2008 | £311.4m |

Net interest margin

| | |
|------|------|
| 2009 | 2.6% |
| 2008 | 3.1% |

Loan to deposit ratio

| | |
|------|------|
| 2009 | 0.61 |
| 2008 | 0.59 |

Arbuthnot Latham seeks to provide sound wealth management solutions to its clients through financial planning and discretionary investment management, and to grow its lending book with caution.

Despite the well documented turmoil in the economy and financial services sector, the Private Banking Division delivered a pleasing growth in its underlying core profitability. When the impacts of the prior year gain on the disposal of Arbuthnot Commercial Finance and the current year investment in the launch of Gilliat Financial Solutions are removed, the core business grew by £0.7m. This achievement reflects the continued fundamental strategy of maintaining a strong balance sheet and liquidity

During 2009 deposit balances returned to growth following the small decline in 2008 caused by the financial crisis. Customer balances grew by a net £19m to £292m. This achievement reflects the bank's ability to provide a quality service to its clients.

Loans grew by £18m to £177.7m, 11% growth over 2008 (£159.9m). The bank continued to lend throughout the credit cycle, and was able to achieve slightly wider lending margins on new business. The bank also ensured that this lending was of high quality and credit losses remained at less than 1% of the asset book.

The loan to deposit ratio was maintained at a conservative level of approximately 60%. The bank continued to keep a strong liquidity ratio despite the relatively low yield on treasury assets, compared to the cost of new deposits, and believes this is the right strategy going forward. Being part of the Arbuthnot Group allows the bank to adopt an opportunistic approach and this was seen clearly in the launch during the year of Gilliat Financial Solutions. This business packages and distributes structured products to the financial intermediary market. The investment resulted in a £0.5m cost for the bank.

After a number of years of trying to build a scalable platform with the Musical Instrument Finance business, the bank decided to exit this business line and as a result the consumer lending book was transferred within the Group to the retail banking division which is much better placed to operate this book as part of its asset finance book.

Arbuthnot Latham remains strong, profitable with growth led by enhanced client service.



Secure Trust Bank

Operating income

| | |
|-------------|---------------|
| 2009 | £22.1m |
| 2008 | £19.7m |

Operating expenses

| | |
|-------------|---------------|
| 2009 | £11.8m |
| 2008 | £14.0m |

Profit before tax

| | |
|-------------|---------------|
| 2009 | £10.2m |
| 2008 | £7.3m |

Customer loans – unsecured

| | |
|-------------|---------------|
| 2009 | £51.4m |
| 2008 | £12.8m |

Customer deposits

| | |
|-------------|---------------|
| 2009 | £93.4m |
| 2008 | £35.8m |

Customer numbers ('000)

| | |
|-------------|-----------|
| 2009 | 70 |
| 2008 | 42 |

Net interest margin

| | |
|-------------|--------------|
| 2009 | 15.1% |
| 2008 | 17.8% |

Cost income ratio

| | |
|-------------|-------------|
| 2009 | 0.45 |
| 2008 | 0.63 |

Despite the difficult economic environment the Retail Banking Division had a good year, generating pre tax profits of £10.2m, an increase of 40% on the previous year. This is mainly the result of two loan portfolio acquisitions and the positive impact of the strategy put in place since 2007.

The lending business has grown significantly as a result of the acquisition of discounted loan portfolios which have contributed substantially to the increased profit performance. Both of these books are performing in line with expectations. Additionally, the business has found that there is a marked opportunity to cross sell to these newly acquired customers.

In addition to the purchased loan books the bank now provides point of sale vendor finance to the motor and music industries and loans to customers of affinity partners. These are provided through automated credit decision systems, which are integrated with the retailer. The combination of these different lending activities has brought in a new customer base which in turn has started to create a sustainable lending business with critical mass.

The lending book grew to £51m (after provisions) in December 2009 up from £13m the previous year. In spite of this increase the impairment charge remained in line with expectations. All lending is entirely funded through retail deposit accounts which are predominantly in the form of 60, 90 and 120 day notice accounts. The deposit balances have risen from £36m to £93m during the year.

During 2009 the bank successfully launched a new fee based current account with a Mastercard prepaid card. This provides a highly functional account with full web and telephone banking capability. The product does not provide credit to the customer. The business had 2,740 customers in December 2009 and the numbers are growing.

The core product of OneBill has become less crucial to the business. In spite of the total customer base increasing from 42,000 in January to 70,000 in December the OneBill customer numbers have continued to decline. The business strategy will be to migrate the OneBill customer base to the more functional prepaid accounts over the next couple of years.

The 2008 exit from insurance broking had a further one-off impact of £1.1m in 2009. This was achieved from a combination of deferred consideration on the Swinton deal and the release of operational provisions that were no longer required following the cessation of the business.

The intention is to continue with this combined lending and Prepaid Current Account strategy during 2010. The division will remain alert to further opportunities to acquire loan portfolios but will focus on growing its organic loan portfolios through additional point of sale vendor finance schemes.

It will also seek to build out its distribution capabilities for its Prepaid Current Account and its newly introduced on-line account opening process will help to maintain this momentum.

Secure Trust Bank is positioning itself as a successful niche lender, while maintaining fee income via its leading Prepaid Current Account.



Arbuthnot Securities

Corporate finance fees

| | |
|------|-------|
| 2009 | £9.2m |
| 2008 | £7.2m |

Brokerage fees

| | |
|------|-------|
| 2009 | £4.1m |
| 2008 | £4.7m |

Gains less losses from dealing in securities

| | |
|------|---------|
| 2009 | £3.7m |
| 2008 | (£3.1m) |

Operating expenses

| | |
|------|--------|
| 2009 | £17.0m |
| 2008 | £14.0m |

(Loss)/profit before tax

| | |
|------|---------|
| 2009 | (£0.1m) |
| 2008 | (£5.2m) |

Corporate clients

| | |
|------|----|
| 2009 | 93 |
| 2008 | 97 |

Aggregate book

| | |
|------|-------|
| 2009 | £3.6m |
| 2008 | £4.6m |

Headcount

| | |
|------|----|
| 2009 | 72 |
| 2008 | 72 |

Arbuthnot Securities' performance in 2009 was a story of two halves. The first half, impacted by continuing market uncertainty and low levels of corporate activity, produced a pre-tax loss of £1.3m. The second half, benefiting both from more benign market conditions and the initiatives undertaken by management to improve the performance of the business, returned a profit of £1.2m. Overall, whilst it is clearly disappointing that the full year outturn was a small loss, the trends in the business, both in terms of financial results and operating performance, were positive and encouraging.

The number of corporate clients at the year end was 93, a slight fall attributable mainly to a number of clients de-listing. Arbuthnot Securities continues to have the second largest number of clients of any AIM nominated adviser. Notwithstanding our strong position in the AIM market, the average market capitalisation of our clients is now £147m.

Corporate Finance activity picked up strongly in the second half after a quiet start to the year. The main transaction type was secondary issues by listed companies; IPO's remained scarce in the AIM market throughout the year. In total, the company participated in raising £320m for clients. Corporate finance fee income totalled £9.2m (2008: £7.2m).

The secondary market continues to be very competitive. Nevertheless, we have invested to upgrade both our distribution and research, as well as building our connectivity to a number of trading platforms. We have positioned our execution capability to operate at the highest possible level for the benefit of our clients.

The trading book performed very strongly turning a loss of £3.1m in 2008 into a profit of £3.7m. This was achieved largely through tighter management control and improved trading discipline. The book remained at the low level to which it was reduced by management actions in 2008.

The secondary business has positioned its execution capabilities to operate at the highest possible level for the benefit of its clients.



Financial Review

Arbuthnot Banking Group adopts a conservative approach to risk taking and seeks to maximise long term revenues and returns. Given its relative size, it is able to remain entrepreneurial and capable of taking advantage of market opportunities when they arise.

It provides a range of financial services to customers and clients in its three chosen niche markets of Private Banking (Arbuthnot Latham), Investment Banking (Arbuthnot Securities) and Retail Banking (Secure Trust Bank). 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.

Summarised Income Statement

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Net interest income | 16,052 | 11,404 |
| Net fee and commission income | 31,885 | 34,280 |
| Gains less losses from dealing in securities (Group and Arbuthnot Securities) | 3,763 | (3,818) |
| Operating income | 51,700 | 41,866 |
| Other income | 2,118 | – |
| Operating expenses | (46,290) | (47,153) |
| FSCS levy | (110) | (491) |
| Gain on sale of business assets | – | 3,077 |
| Gain on sale of subsidiary | – | 1,528 |
| Impairment losses | (2,368) | (977) |
| Profit / (loss) on continuing activities before income tax | 5,050 | (2,150) |
| Basic earnings per share (pence) | 23.4 | 3.5 |

In the light of the deepest and longest economic recession in living memory, the fact that the Group was able to return a healthy profit was extremely encouraging and an indication of the business's ability to act opportunistically.

The year started slowly and we were cautiously optimistic at the time of publishing our interim results. The level of profitability accelerated in the second half as the purchased loans portfolios and the strengthening of our corporate pipeline began to impact our returns positively. The continued positive market sentiment allowed the trading book to deliver healthy gains, despite its much reduced size, reversing the losses suffered in the prior year. The net effect of this was that operating income grew to £51.7m, an increase of 23%.

During the second half of the year the Group also took the opportunity to invest in two new start up ventures, Gilliat Financial Solutions and Arbuthnot Real Estate Investment Management. Despite the additional cost associated with these ventures, the operating expense line reduced by 2% as continuing cost control and the full year impact of the prior year's disposals took effect.

Impairment losses increased during the year to £2.4m which was in line with the balance sheet growth and as a percentage of assets remains consistent at 1%.

The profit before tax of the Group for the full year was £5.1m compared to a loss of £2.2m in the prior year, which represents a £7.3m improvement.

In response to the Bank Payroll Tax, the Group adopted a policy of not awarding any discretionary bonuses above £25,000. While the legislation remains in draft form, it is our expectation that our financial results will not be affected by this indiscriminate tax.

Summarised Balance Sheet

| | 2009 £000 | 2008 £000 |
|-------------------------------------|----------------|----------------|
| Assets | | |
| Loans and advances to customers | 229,722 | 163,734 |
| Liquid assets | 182,677 | 159,947 |
| Other assets | 40,116 | 36,074 |
| Total assets | 452,515 | 359,755 |
| Liabilities | | |
| Customer deposits | 385,999 | 292,890 |
| Other liabilities | 32,373 | 32,451 |
| Total liabilities | 418,372 | 325,341 |
| Equity | 34,143 | 34,414 |
| Total equity and liabilities | 452,515 | 359,755 |

Balance Sheet Strength

The total assets of the Group increased by 26% to £452.5m (2008: £359.8m) as a result of a return to lending in the Retail Banking Division via purchases of two personal loan portfolios from Liverpool Victoria and Citigroup and organic growth in its asset finance portfolios launched in the year.

Following the small outflow of customer deposits in 2008, the Group is pleased to note that customer deposit balances showed strong growth of 32% to £386m (2008: £292.9m).

The Group continues with its conservative funding policy, remaining entirely funded by retail deposits and has maintained a loan to deposit ratio of 59% (2008: 56%). The surplus funding is invested in the liquid interbank certificate of deposit market with balances growing by 14% to £182.7m (2008: £159.9m).

Segmental Analysis

The segmental analysis in note 36 to the Consolidated Financial Statements to the Annual Report highlights the disclosures required under IFRS 8 'Operating Segments'. The operating segments are Private Banking (Arbuthnot Latham), International Private Banking (Arbuthnot AG), Investment Banking (Arbuthnot Securities) and Retail Banking (Secure Trust Bank). Group costs and intercompany elimination journals are shown separately to reconcile back to the Group consolidated result. The analysis presented below is prior to any consolidation adjustments to remove the impact of intergroup operating activities and is a fair reflection of the way the directors manage the Group.

Private Banking – Arbuthnot Latham

| | 2009 £000 | 2008 £000 |
|---|--------------|--------------|
| Net interest income | 8,880 | 8,225 |
| Net fee and commission income | 4,184 | 6,367 |
| Operating income | 13,064 | 14,592 |
| Gain on sale of business assets | – | 658 |
| Gain on sale of | | |
| Arbuthnot Commercial Finance Limited | – | 1,528 |
| Operating expenses | (11,598) | (13,352) |
| Impairment losses | (1,179) | (444) |
| Financial Services Compensation Scheme Levy | (81) | (450) |
| Restructuring costs | – | (413) |
| Profit before tax | 206 | 2,119 |

The profit before tax fell to £0.2m (2008: £2.1m) largely due to two significant items. First, the prior year profit included a one-off gain on sale of business assets totalling £2.1m that was not repeated in 2009. Second, the bank invested £1m in the start up venture, Gilliat Financial Solutions. The Group entity contributed 50% to this investment which resulted in a net cost to the bank of £0.5m in the second half of the year.

Net fee and commission income fell by £1.3m mainly due to the disposal of Arbuthnot Commercial Finance in the prior year. It is worthwhile noting that the business had managed to improve its lending margins throughout the year, this however was offset by the decline in returns earned on its surplus liquidity in the interbank market and the increasing cost of raising deposits in the retail market.

Operating expenses continued to decline as the full year effect of the prior year business disposals and restructuring actions took effect.

Impairment losses picked up in the year largely due to the failure of one customer in the musical instrument financing portfolio. Other than this the portfolio remains stable with losses under 1% of asset levels. The secured loan portfolio maintained an average loan to the collateral value of 54%.

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Assets | | |
| Advances | 177,745 | 159,908 |
| Liquid assets | 164,913 | 132,237 |
| Other assets (including Group companies) | 27,410 | 19,412 |
| Total assets | 370,068 | 311,557 |
| Liabilities | | |
| Customer deposits | 292,026 | 272,614 |
| Other liabilities (including Group companies) | 54,997 | 15,447 |
| Total liabilities | 347,023 | 288,061 |
| Capital | 23,045 | 23,496 |
| Total equity and liabilities | 370,068 | 311,557 |

Total assets increased by 19% to £370.1m (2008: £311.6m) with the customer loan portfolio increasing by 11%.

The liability side of the balance sheet saw strong growth in both customer and group deposits. Customer deposits grew by 7% to £292m (2008: £272.6m) as the business saw good inflows of new deposits.

The Private Bank remains well capitalised and funded, maintaining a total capital ratio of 11.2% and a core tier 1 ratio of 8.8% and a loan to deposit ratio of approximately 60%.

International Private Banking – Arbuthnot AG

Costs associated with establishing the Swiss Bank totalled £0.5m in the year (2008: £1.2m). The reduction is a result in a slowdown in expenditure by the Group while a partner is found to help launch the bank.

Retail Banking – Secure Trust Bank

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Net interest income | 8,587 | 4,214 |
| Net fee and commission income | 13,505 | 15,498 |
| Operating income | 22,092 | 19,712 |
| Gain on sale of business assets | – | 2,419 |
| Gain on sale of | | |
| Provision released relating to sale of business in prior year | 1,132 | – |
| Operating expenses | (11,786) | (13,960) |
| Impairment losses | (1,189) | (533) |
| Financial Services Compensation Scheme Levy | (30) | (41) |
| Restructuring costs | – | (320) |
| Profit before tax | 10,219 | 7,277 |

Profit Before tax in the business increased by 40% to £10.2m (2008: £7.3m).

Financial Review

The prior year results included the gain on sale of the insurance business to Swinton, which contributed £2.4m. Excluding this item the profits grew from £4.9m to £10.2m, an increase of £5.3m.

The purchase of the loan portfolios from LV and Citigroup contributed £5.5m to revenues. The profit also benefited by £1.1m as a result of the release of provisions related to the sale of the insurance business, these were offset by the investment in new business lines, the attrition in the OneBill account numbers and additional cost of surplus funding resulting from the continued conservative liquidity strategy.

| | 2009 £000 | 2008 £000 |
|--|----------------|---------------|
| Assets | | |
| Advances – Personal lending & asset finance | 25,960 | 12,551 |
| Advances – Acquired portfolios | 25,465 | – |
| Liquid assets | 16,615 | 24,725 |
| Other assets (including Group companies) | 46,027 | 14,193 |
| Total assets | 114,067 | 51,469 |
| Liabilities | | |
| Customer deposits | 93,350 | 35,836 |
| Other liabilities (including Group companies) | 6,177 | 4,589 |
| Total liabilities | 99,527 | 40,425 |
| Capital | 14,540 | 11,044 |
| Total equity and liabilities | 114,067 | 51,469 |

The personal lending asset balances ended the year at £51.4m (2008: £12.5m) a growth rate in excess of 300%. Excluding the purchased portfolios, the growth rate on the organic portfolios was still approximately 107%.

Customer deposit balances increased by 160% to £93.4m (2008: £35.8m).

Investment Banking – Arbuthnot Securities

| | 2009 £000 | 2008 £000 |
|--|---------------|----------------|
| Net interest income | (152) | (486) |
| Net fee and commission income | 13,350 | 12,415 |
| Gains less losses from dealing in securities | 3,662 | (3,116) |
| Operating income | 16,860 | 8,813 |
| Operating expenses | (17,007) | (14,038) |
| Restructuring costs | – | (691) |
| Loss before tax | (147) | (5,225) |

The business returned a loss before tax of (£0.1m) compared to the prior year loss of (£5.2m). The key item was the performance of the trading book which in the prior year suffered losses of £3.1m in revenues.

The fees earned by corporate finance transactions were £2m higher than in the prior year, however, 87% of the fees were earned in the second half of the year as the level of corporate activity increased during the year.

The non-controlling interest remained unchanged at 40.4% and therefore the Group's resultant share is 59.6%.

Group & Other Costs

| | 2009 £000 | 2008 £000 |
|--------------------------------------|----------------|----------------|
| Operating Income | 452 | (287) |
| Group costs | (3,583) | (2,921) |
| Group head office property costs | (973) | (989) |
| Subordinated loan stock interest | (618) | (964) |
| Total group & other costs | (5,174) | (4,874) |
| Loss before tax | (4,722) | (5,161) |

The Group and other costs decreased by 9% to £4.7m (2008: £5.2m) as the Group saw a positive change to the fair value of the investment securities it holds on its account, offset by the £0.5m contribution it made to the launch of Gilliat Financial Solutions.

Capital

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

In accordance with the EU's Capital Requirements Directive (CRD) and the required parameters set out in the FSA Handbook (BIPRU 2.2), the Individual Capital Adequacy Assessment Process (ICAAP) is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. However, at a minimum, the ICAAP is updated annually as part of the business planning process. The ICAAP is a process that brings together management framework (i.e. the policies, procedures, strategies, and systems that the Group has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management. The Group's regulated entities are also the principal trading subsidiaries as detailed in Note 35.

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

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

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

The ICAAP includes a summary of the capital required to mitigate the identified risks in its regulated entities and the amount of capital that the Group has available. The FSA's last review of the Group's ICAAP was conducted in December 2007 (the next review is scheduled to be completed in Q1 of 2010). All regulated entities have complied with all of the externally imposed capital requirements to which they are subject.

| | 2009 £000 |
|---|--------------|
| Core Tier 1 capital | 33,885 |
| Tier 1 capital after deductions | 30,979 |
| Tier 2 | 13,280 |
| Total capital | 44,259 |
| Core Tier 1 capital ratio (Net Core Tier 1 capital / Basel 2 RWAs) | 9.3% |
| Total capital ratio (Capital/Basel 2 RWAs) | 13.3% |

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 the 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 4 to the financial statements. Credit risk is managed through the Credit Committees of Secure Trust Bank and Arbuthnot Latham & Co., Limited with significant exposures also being approved by the Group Risk Committee. Of the total gross loan book of £236.4 million at 31 December 2009, some £57.2 million represents largely unsecured loans to customers of Secure Trust Bank and £179.2 million represents the lending portfolio of Arbuthnot Latham, most of which is well secured against cash, property or other assets. A provision of £7.2 million (3.1% of total lending) 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 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 capital ratios in excess of the minimum levels set by the regulators.

Dividend

The Board proposes a final dividend of 11.5 pence per share to be paid on 14 May 2010, giving a total dividend for the year of 22 pence (2008: 21 pence) per share.

Accounting Policies

This is the fourth set of Group consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS). This is the second set of accounts to include the disclosure requirements under IFRS 7 Financial Instruments.

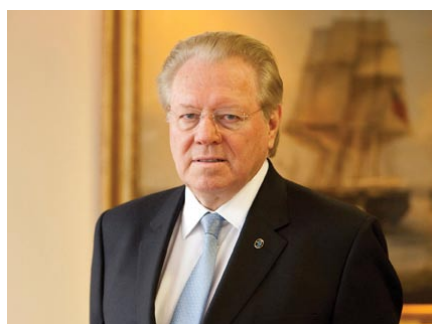
Going Concern

After making appropriate enquiries which assessed strategy, profitability, funding, risk management (see note 4) and capital resources (see note 5), the directors are satisfied that the Company and the Group have adequate resources to continue in operation for the foreseeable future. The financial statements are, therefore, prepared on the going concern basis.

James Cobb

Group Finance Director

Group Board



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 a past Master of the Worshipful Company of International Bankers.



James Cobb ACA

James Cobb joined the Board on 1 November 2008 as Group Finance Director. He was previously Deputy Chief Financial Officer and Controller of Citigroup's Global Consumer Group in Europe, Middle East and Africa and qualified as a Chartered Accountant with Price Waterhouse.



Gary Jennison

Gary Jennison joined the Board on 25 September 2006 as Chief Executive of Secure Trust Bank. He was previously Managing Director of Barclays Bank's branch network and has held senior positions at Lex Vehicle Leasing, GE Capital Auto Financial Services Europe and Hitachi Credit (UK) PLC.



Neil Kirton

Neil Kirton joined the Board on 1 June 2008 as Chief Executive of Arbuthnot Securities having joined Arbuthnot Securities as Deputy Chief Executive in January 2006. Prior to this he was with ABN Amro Hoare Govett from 1985 to 2002 where he was Global Head of Equity Sales, Deputy Chief Executive of Hoare Govett (UK) Limited and a Managing Director of ABN Amro Bank NV. He was also Head of Equities at Bridgwell Securities from 2002 to 2004.



Ruth Lea

Independent non-executive director since 1 November 2005 and Economic Adviser to the Group. She is the director of Global Vision and was previously director of the Centre for Policy Studies, 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. She also spent 16 years in the Civil Service in the Treasury, the Department of Trade and Industry, the General Statistical Office and the Civil Service College.



Sir Christopher Meyer

Independent non-executive director since 1 October 2007. He retired as Chairman of the Press Complaints Commission on 30 March 2009. He had a distinguished diplomatic career, in 1997 he was appointed as Ambassador to Germany and from 1997 – 2003 he was Ambassador to the USA. Between 1994 and 1996, he was Press Secretary to Prime Minister John Major. He is also non-executive director of GKN PLC and is on the International Advisory boards of Fleishman-Hillard and British American Business Inc.



Sir Michael Peat

Independent non-executive director appointed on 15 January 2008. He is currently Principal Private Secretary to TRH The Prince of Wales and The Duchess of Cornwall. Previously he was Keeper of the Privy Purse and Treasurer to the Queen and Receiver General of the Duchy of Lancaster. Prior to being appointed to work for the Royal Household Sir Michael was with KPMG for over 20 years and was a partner from 1985 to 1993.



Dean Proctor

Dean Proctor joined the Board on 3 November 2009 as Chief Executive Officer of Arbuthnot Latham & Co., Limited. Before, he was at Citi for 3 years and most recently was Managing Director of Wealth Management and Retail Banking for Citibank & Egg in the UK. Prior to Citi Dean worked at LloydsTSB Bank Plc for 13 years in various management positions in both Corporate and Consumer businesses.



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 KPMG.



Atholl Turrell ACA

Appointed a director on 1 March 2004. He was formerly Head of Corporate Stockbroking at Schroder Salomon Smith Barney. He is Vice-Chairman of Arbuthnot Securities Limited.



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 and Arbuthnot Latham & Co., Limited.



Jeremy Robin Kaye FCIS Secretary.

Directors' Report

The directors submit their annual report and the audited consolidated financial statements for the year ended 31 December 2009.

Principal Activities And Review

The principal activities of the Group are banking and financial services. A business review in accordance with Section 417 of the Companies Act 2006 forming part of this report is set out on pages 6 to 15.

Results And Dividends

The results for the year are shown on page 26. The profit after tax for the year of £3.4 million (2008: Loss of £1.0 million) is included in reserves.

The directors recommend the payment of a final dividend of 11.5 pence on the ordinary shares which, together with the interim dividend of 10.5 pence paid on 2 October 2009, represents a total dividend for the year of 22 pence (2008: 21 pence). A scrip dividend alternative is not being offered in respect of half of the final dividend for 2009. The final dividend, if approved by members at the Annual General Meeting, will be paid on 14 May 2010 to shareholders on the register at close of business on 16 April 2010.

Share Capital

Between 25 June, 2009 and 7 January 2010 the Company repurchased a total of 57,500 ordinary shares at prices ranging between 303p and 390p in accordance with the authority given by shareholders on 13 May 2009, such shares being held as Treasury Shares.

At the Annual General Meeting shareholders will be asked to approve two Special Resolutions; the authority granted by each of them will expire at the conclusion of the Annual General Meeting in 2011.

The first continues 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. 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 second renews the authority of the directors to make market purchases of shares not exceeding 10% of the existing issued share capital. The directors will keep the position under review in order to maximise the Company's resources in the best interests of shareholders.

Substantial Shareholders

The Company was aware at 9 March 2010 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 | 775,403 | 5.2 |
| Mr R Paston | 529,130 | 3.5 |

Directors

| | |
|-----------------------|-----------------|
| H Angest | Chairman |
| R J J Wickham | Deputy Chairman |
| J R Cobb | |
| G A Jennison | |
| N W Kirton | |
| Ms R J Lea | |
| Sir Christopher Meyer | |
| Sir Michael Peat | |
| D M Proctor | |
| A A Salmon | |
| Dr A D Turrell | |

Apart from Mr. D.M. Proctor who was appointed a director on 3 November 2009 and Mr. M.A. Bussey who resigned from the Board on 3 November 2009, all directors served throughout the year.

Mr. Proctor retires under Article 77 of the Articles of Association and, being eligible, offers himself for re-election. Mr. Proctor has a service agreement with a subsidiary company, terminable on six months' notice until 1 October 2010 and thereafter terminable on twelve months' notice.

Mr. H. Angest, Sir Christopher Meyer and Mr. A.A. Salmon retire under Article 80 of the Articles of Association and, being eligible, offer themselves for re-election. Mr. Angest and Mr. Salmon have service agreements with the Company terminable on twelve months notice. Sir Christopher Meyer does not have a service agreement.

According to the information kept under Section 3 of the Disclosure and Transparency Rules 2006, 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 2009 | 31 December 2009 | 9 March 2010 | % |
|----------------------|----------------|------------------|--------------|------|
| H Angest | 7,917,862 | 7,917,862 | 7,917,862 | 52.8 |
| G A Jennison | - | 25,000 | 25,000 | 0.2 |
| N W Kirton | 12,000 | 22,000 | 22,000 | 0.1 |
| A A Salmon | 50,000 | 50,000 | 50,000 | 0.3 |
| A D Turrell | 21,402 | 21,402 | 21,402 | 0.1 |
| R J J Wickham | 3,600 | 3,600 | 3,600 | - |

Mr. Kirton and Dr. Turrell held 40,000 and 10,000 ordinary £1 shares respectively in Arbuthnot Securities Limited under that company's Long Term Incentive Plan at 31 December 2009.

On 21 May 2008 Mr. Salmon was granted an option to subscribe between May 2011 and May 2015 for 100,000 ordinary 1p shares in the Company at 337.5p.

On 5 November 2008 Mr. Cobb was granted an option to subscribe between November 2011 and November 2015 for 50,000 ordinary 1p shares in the Company at 320p.

On 22 December 2009 Dr. Turrell was granted an option to subscribe between December 2012 and December 2016 for 50,000 ordinary 1p shares in the Company at 380p.

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 2009 one director had a loan from Secure Trust Bank PLC amounting to £213,000 and three directors had loans from Arbuthnot Latham & Co., Limited amounting to £2,723,000, all on normal commercial terms as disclosed in note 34 to the financial statements. At 31 December 2009 five directors had deposits with Secure Trust Bank PLC amounting to £497,000 and seven directors had deposits with Arbuthnot Latham & Co., Limited amounting to £1,383,000, all on normal commercial terms as disclosed in note 34 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 22 to 23 will be the subject of an Ordinary Resolution at the Annual General Meeting.

Information on the Audit Committee, Nomination Committee, Risk Committee and Donations Committee is included in the Corporate Governance section of the Annual Report on page 20.

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.

Charitable Donations

The Company made charitable donations of £27,000 during the year (2008: £20,000).

The Company made political donations of £25,472 to the Conservative Party and £3,000 to the Centre of Social Justice during the year (2008: total political donations £10,000).

Status

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

Auditors

Following the resignation of PricewaterhouseCoopers LLP as auditors on 11 August 2009, the directors appointed KPMG Audit Plc in their place.

A resolution to reappoint KPMG Audit Plc 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
10 March 2010

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 four non-executive directors.

The senior independent non-executive director is Robert Wickham, who in addition is Deputy Chairman. Although Mr Wickham has served on the Board for sixteen 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), Ruth Lea, Sir Christopher Meyer and Sir Michael Peat.

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 Ruth Lea. Before a Board appointment is made the skills, knowledge and experience required for a particular appointment are evaluated.

Risk Committee

The Risk Committee is chaired by Henry Angest and its other members are James Cobb, Dean Proctor, John Reed, Andrew Salmon, Atholl Turrell and Robert Wickham. The role of the Risk Committee is to approve specific risk policies for Group subsidiaries and significant individual credit or other exposures.

Donations Committee

The Donations Committee is chaired by Henry Angest and its other members are Robert Wickham and Ruth Lea. The Committee considers any political donation or expenditure as defined within the Political Parties, Elections and Referendums Act 2000.

Shareholder Communications

The Company maintains a regular dialogue with its shareholders and makes full use of the Annual General Meeting and any other 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 which was outsourced to Ernst & Young. The Audit Committee also receives reports from the external auditors, KPMG Audit Plc, which include details of 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

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

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange they are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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

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

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

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Statement of disclosure of information to auditors

The directors confirm that:

- so far as each director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the directors have taken all the steps they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

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 Ruth Lea.

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 payment of bonuses, some transactional and some formulaic but both based on income to the company is common in the banking industry.

Directors' Service Contracts

Henry Angest, Gary Jennison, Neil Kirton and Andrew Salmon each have service contracts terminable at any time on 12 months' notice in writing by either party. James Cobb has a service contract terminable at any time on 6 months' notice in writing by either party. Dean Proctor has a service agreement terminable at any time on 6 months' notice in writing until 10 October 2010 and thereafter on 12 months' notice.

Share Option and Long Term Incentive Schemes

This part of the remuneration report is audited information.

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.

At the date of this remuneration report, the only outstanding options to directors under the Unapproved Executive Share Option Scheme are those in relation to 100,000 shares for Andrew Salmon and 50,000 shares each for James Cobb and Atholl Turrell. 150,000 shares are held in the Arbuthnot ESOP Trust.

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, Atholl Turrell acquired 10,000 shares in Arbuthnot Securities Limited under the plan at a price of £2.35 per share. On 31 May 2006 Neil Kirton acquired 40,000 shares at a price of £2.35 and on 20 July 2007 20,000 shares at a price of £8.45.

Directors' Emoluments

This part of the remuneration report is audited information.

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Fees (including benefits in kind) | 195 | 193 |
| Salary payments (including benefits in kind) | 1,728 | 2,204 |
| Pension contributions | 155 | 172 |
| | 2,078 | 2,569 |

| | Salary £000 | Bonus £000 | Benefits £000 | Pension £000 | Fees £000 | Total 2009 £000 | Total 2008 £000 |
|----------------------------------|----------------|---------------|------------------|-----------------|--------------|-----------------------|-----------------------|
| H Angest | 318 | – | 76 | – | – | 394 | 386 |
| MF Brown (to 01/06/08) | – | – | – | – | – | – | 110 |
| MA Bussey (to 03/11/09) | 208 | – | 1 | – | – | 209 | 351 |
| JR Cobb (from 20/10/08) | 175 | 25 | 16 | 35 | – | 251 | 106 |
| GA Jennison | 200 | – | 7 | 50 | – | 257 | 558 |
| NW Kirton (from 01/06/08) | 225 | – | 12 | 35 | – | 272 | 167 |
| DM Proctor (from 03/11/09) | 33 | 27 | – | – | – | 60 | – |
| J Reed (to 01/06/08) | – | – | – | – | – | – | 99 |
| AA Salmon | 200 | 25 | 27 | 35 | – | 287 | 258 |
| PN Sheriff (to 31/10/08) | – | – | – | – | – | – | 188 |
| AD Turrell | 153 | – | – | – | – | 153 | 153 |
| Non-executive | | | | | | | |
| Ms RJ Lea | – | – | – | – | 70 | 70 | 70 |
| Sir Christopher Meyer | – | – | – | – | 40 | 40 | 40 |
| Sir Michael Peat (from 15/01/08) | – | – | – | – | 40 | 40 | 38 |
| RJJW Wickham | – | – | – | – | 45 | 45 | 45 |
| | 1,512 | 77 | 139 | 155 | 195 | 2,078 | 2,569 |

Details of any shares or options held by directors are presented on pages 18 and 19.

The emoluments of the Chairman were £394,000 (2008: £386,000). The emoluments of the highest paid director were £394,000 (2008: £558,000) including pension contributions of £nil (2008: £nil).

Mr R J J Wickham is a director of Calando Finance Limited which received an annual fee of £45,000 (2008: £45,000) in respect of his services to the Group.

These amounts are included in the above figures.

Retirement benefits are accruing under money purchase schemes for five directors who served during 2009 (2008: seven directors).

Henry Angest

Chairman of the Remuneration Committee
10 March 2010

Independent auditors' report

to the members of Arbutnot Banking Group PLC

We have audited the financial statements of Arbutnot Banking Group PLC for the year ended 31 December 2009 set out on pages 26 to 77. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 21, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2009 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

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

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

Ian A Dewar (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants

One Canada Square
London
E14 5AG
10 March 2010

Consolidated statement of comprehensive income

| | Note | Year ended 31 December 2009 £000 | Year ended 31 December 2008 £000 |
|---|------|---|---|
| Interest and similar income | | 22,464 | 23,799 |
| Interest expense and similar charges | | (5,548) | (12,395) |
| Net interest income | | 16,916 | 11,404 |
| Fee and commission income | 6 | 31,816 | 35,241 |
| Fee and commission expense | | (795) | (961) |
| Net fee and commission income | | 31,021 | 34,280 |
| Gains less losses from dealing in securities | | 3,763 | (3,818) |
| Operating income | | 51,700 | 41,866 |
| Impairment losses on loans and advances | 17 | (2,368) | (977) |
| Other income | 7 | 2,118 | – |
| Gain on sale of business assets | 8 | – | 3,077 |
| Gain on sale of subsidiary | 37 | – | 1,528 |
| Operating expenses | 9 | (46,400) | (47,644) |
| Profit/(loss) before income tax | | 5,050 | (2,150) |
| Income tax (expense)/credit | 11 | (1,679) | 1,152 |
| Profit/(loss) for the year | | 3,371 | (998) |
| Foreign currency translation reserve | | 41 | (299) |
| Revaluation reserve | | | |
| – Revaluation of freehold premises | | – | (974) |
| – Amount transferred to profit or loss on sale | | (108) | – |
| Other comprehensive income for the period, net of income tax | | (67) | (1,273) |
| Total comprehensive income for the period | | 3,304 | (2,271) |
| Profit attributable to: | | | |
| Equity holders of the Company | | 3,507 | 519 |
| Non-controlling interests | | (136) | (1,517) |
| | | 3,371 | (998) |
| Total comprehensive income attributable to: | | | |
| Equity holders of the Company | | 3,440 | (754) |
| Non-controlling interests | | (136) | (1,517) |
| | | 3,304 | (2,271) |
| 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 | 12 | 23.4p | 3.5p |

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Consolidated statement of financial position

| | Note | At 31 December | |
|--|------|----------------|-----------------------------|
| | | 2009 £000 | 2008 ⁽¹⁾ £000 |
| ASSETS | | | |
| Cash | 13 | 230 | 3,369 |
| Derivative financial instruments | 24 | 236 | – |
| Loans and advances to banks | 14 | 54,614 | 15,939 |
| Loans and advances to customers | 16 | 229,722 | 163,734 |
| Trading securities – long positions | 15 | 2,659 | 3,523 |
| Debt securities held-to-maturity | 18 | 127,597 | 140,639 |
| Current tax asset | | 1,805 | 1,679 |
| Other assets | 22 | 18,754 | 15,053 |
| Financial investments | 19 | 5,057 | 3,434 |
| Intangible assets | 20 | 2,906 | 2,831 |
| Property, plant and equipment | 21 | 8,552 | 9,448 |
| Deferred tax asset | 28 | 383 | 106 |
| Total assets | | 452,515 | 359,755 |
| EQUITY AND LIABILITIES | | | |
| Equity attributable to owners of the parent | | | |
| Share capital | 30 | 150 | 150 |
| Share premium account | 30 | 21,085 | 21,085 |
| Retained earnings | 31 | 11,684 | 11,257 |
| Other reserves | 31 | (920) | (358) |
| Non-controlling interests | | 2,144 | 2,280 |
| Total equity | | 34,143 | 34,414 |
| LIABILITIES | | | |
| Deposits from banks | 23 | 2,886 | 2,898 |
| Trading securities – short positions | 15 | 959 | 1,036 |
| Derivative financial instruments | 24 | – | 942 |
| Deposits from customers | | 385,999 | 292,890 |
| Current tax liability | | 2,208 | – |
| Other liabilities | 26 | 13,217 | 13,603 |
| Deferred tax liability | 28 | 81 | – |
| Debt securities in issue | 27 | 13,022 | 13,972 |
| Total liabilities | | 418,372 | 325,341 |
| Total equity and liabilities | | 452,515 | 359,755 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

The financial statements on pages 26 to 77 were approved by the Board of directors on 10 March 2010 and were signed on behalf by:

H Angest Director
JR Cobb Director

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Company statement of financial position

| | Note | At 31 December | |
|-------------------------------------|------|----------------|---------------|
| | | 2009 £000 | 2008 £000 |
| ASSETS | | | |
| Current assets | | | |
| Due from subsidiary undertakings | | 6,781 | 7,414 |
| Financial investments | 19 | 465 | 364 |
| Other debtors | | 1,703 | 2,087 |
| Non-current assets | | | |
| Shares in subsidiary undertakings | 35 | 28,624 | 28,524 |
| Property, plant and equipment | 21 | 78 | 74 |
| Due from subsidiary undertakings | | 7,750 | 6,350 |
| Total assets | | 45,401 | 44,813 |
| EQUITY AND LIABILITIES | | | |
| Equity | | | |
| Share capital | 30 | 150 | 150 |
| Share premium account | 30 | 21,085 | 21,085 |
| Other reserves | 31 | (920) | (425) |
| Retained earnings | 31 | 1,862 | 3,927 |
| Total equity | | 22,177 | 24,737 |
| LIABILITIES | | | |
| Current liabilities | | | |
| Deposits from banks | | 2,618 | 2,609 |
| Due to subsidiary undertakings | | 6,954 | 2,664 |
| Accruals | | 630 | 831 |
| Non-current liabilities | | | |
| Debt securities in issue | 27 | 13,022 | 13,972 |
| Total liabilities | | 23,224 | 20,076 |
| Total equity and liabilities | | 45,401 | 44,813 |

The Company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the Parent Company profit and loss account. The profit for the Parent Company for the year is presented in the Statement of changes in equity.

The financial statements on pages 26 to 77 were approved by the Board of directors on 10 March 2010 and were signed on behalf by:

H Angest Director
JR Cobb Director

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Consolidated statement of changes in equity

| | Attributable to equity holders of the Company | | | | | | | | Total £000 |
|--|---|-------------------------------------|---|--------------------------------|--|----------------------------|------------------------------|--|---------------|
| | Share capital £000 | Share premium account £000 | Foreign currency translation reserve £000 | Revaluation reserve £000 | Capital redemption reserve £000 | Treasury shares £000 | Retained earnings £000 | Non- controlling interests £000 | |
| Balance at 1 January 2009 | 150 | 21,085 | (299) | 366 | 20 | (445) | 11,257 | 2,280 | 34,414 |
| Total comprehensive income for the period | | | | | | | | | |
| Profit/(loss) for 2009 | – | – | – | – | – | – | 3,507 | (136) | 3,371 |
| Other comprehensive income, net of income tax | | | | | | | | | |
| Foreign currency translation reserve | – | – | 41 | – | – | – | – | – | 41 |
| Revaluation reserve | | | | | | | | | |
| – Amount transferred to profit and loss on sale | – | – | – | (108) | – | – | – | – | (108) |
| Total other comprehensive income | – | – | 41 | (108) | – | – | – | – | (67) |
| Total comprehensive income for the period | – | – | 41 | (108) | – | – | 3,507 | (136) | 3,304 |
| Transactions with owners, recorded directly in equity | | | | | | | | | |
| Contributions by and distributions to owners | | | | | | | | | |
| Purchase of own shares | – | – | – | – | – | (495) | – | – | (495) |
| Final dividend relating to 2008 | – | – | – | – | – | – | (1,541) | – | (1,541) |
| Interim dividend relating to 2009 | – | – | – | – | – | – | (1,539) | – | (1,539) |
| Total contributions by and distributions to owners | – | – | – | – | – | (495) | (3,080) | – | (3,575) |
| Balance at 31 December 2009 | 150 | 21,085 | (258) | 258 | 20 | (940) | 11,684 | 2,144 | 34,143 |

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Consolidated statement of changes in equity continued

| | Attributable to equity holders of the Company | | | | | | | | |
|--|---|----------------------------------|---|--------------------------------|--|----------------------------|------------------------------|--|---------------|
| | Share capital £000 | Share premium account £000 | Foreign currency translation reserve £000 | Revaluation reserve £000 | Capital redemption reserve £000 | Treasury shares £000 | Retained earnings £000 | Non- controlling interests £000 | Total £000 |
| Balance at 1 January 2008 | 150 | 21,085 | – | 1,382 | 20 | – | 15,419 | 4,430 | 42,486 |
| Total comprehensive income for the period | | | | | | | | | |
| Profit/(loss) for 2008 | – | – | – | – | – | – | 519 | (1,517) | (998) |
| Other comprehensive income, net of income tax | | | | | | | | | |
| Foreign currency translation reserve | – | – | (299) | – | – | – | – | – | (299) |
| Revaluation reserve | | | | | | | | | |
| – Revaluation of freehold premises | – | – | – | (974) | – | – | – | – | (974) |
| – Amount transferred to profit or loss on sale | – | – | – | (42) | – | – | 42 | – | – |
| Total other comprehensive income | – | – | (299) | (1,016) | – | – | 42 | – | (1,273) |
| Total comprehensive income for the period | – | – | (299) | (1,016) | – | – | 561 | (1,517) | (2,271) |
| Transactions with owners, recorded directly in equity | | | | | | | | | |
| Contributions by and distributions to owners | | | | | | | | | |
| Sale of Arbuthnot Commercial Finance Limited | – | – | – | – | – | – | – | (26) | (26) |
| Purchase of own shares | – | – | – | – | – | (445) | – | – | (445) |
| Final dividend relating to 2007 | – | – | – | – | – | – | (3,361) | (607) | (3,968) |
| New share capital subscribed | – | 213 | – | – | – | – | – | – | 213 |
| Transfer to retained earnings in lieu of cash dividends | – | (213) | – | – | – | – | 213 | – | – |
| Interim dividend relating to 2008 | – | – | – | – | – | – | (1,575) | – | (1,575) |
| Total contributions by and distributions to owners | – | – | – | – | – | (445) | (4,723) | (633) | (5,801) |
| Balance at 31 December 2008 | 150 | 21,085 | (299) | 366 | 20 | (445) | 11,257 | 2,280 | 34,414 |

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Company statement of changes in equity

| | Attributable to equity holders of the Company | | | | | Total £000 |
|--|---|-------------------------------------|--|----------------------------|------------------------------|---------------|
| | Share capital £000 | Share premium account £000 | Capital redemption reserve £000 | Treasury shares £000 | Retained earnings £000 | |
| Balance at 1 January 2008 | 150 | 21,085 | 20 | – | 5,000 | 26,255 |
| Total comprehensive income for the period | – | – | – | – | 3,650 | 3,650 |
| Transactions with owners, recorded directly in equity | | | | | | |
| Contributions by and distributions to owners | | | | | | |
| Purchase of own shares | – | – | – | (445) | – | (445) |
| Final dividend relating to 2007 | – | – | – | – | (3,361) | (3,361) |
| New share capital subscribed | – | 213 | – | – | – | 213 |
| Transfer to retained earnings in lieu of cash dividends | – | (213) | – | – | 213 | – |
| Interim dividend relating to 2008 | – | – | – | – | (1,575) | (1,575) |
| Total contributions by and distributions to owners | – | – | – | (445) | (4,723) | (5,168) |
| Balance at 1 January 2009 | 150 | 21,085 | 20 | (445) | 3,927 | 24,737 |
| Total comprehensive income for the period | – | – | – | – | 1,015 | 1,015 |
| Transactions with owners, recorded directly in equity | | | | | | |
| Contributions by and distributions to owners | | | | | | |
| Purchase of own shares | – | – | – | (495) | – | (495) |
| Final dividend relating to 2008 | – | – | – | – | (1,541) | (1,541) |
| Interim dividend relating to 2009 | – | – | – | – | (1,539) | (1,539) |
| Total contributions by and distributions to owners | – | – | – | (495) | (3,080) | (3,575) |
| Balance at 31 December 2009 | 150 | 21,085 | 20 | (940) | 1,862 | 22,177 |

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Consolidated statement of cash flows

| | Note | Year ended 31 December 2009 £000 | Year ended 31 December 2008 ⁽¹⁾ £000 |
|---|------|---|--|
| Cash flows from operating activities | | | |
| Interest and similar income received | | 22,464 | 23,663 |
| Interest and similar charges paid | | (5,548) | (12,185) |
| Fees and commissions received | | 31,021 | 34,280 |
| Net trading and other income | | 5,881 | (3,818) |
| Recoveries on loans previously written off | | 202 | 213 |
| Cash payments to employees and suppliers | | (46,183) | (45,636) |
| Taxation received | | 207 | 1,280 |
| Cash flows from operating profits/(losses) before changes in operating assets and liabilities | | 8,044 | (2,203) |
| Changes in operating assets and liabilities: | | | |
| – net decrease in trading securities | | 787 | 15,478 |
| – net increase in derivative financial instruments | | (1,178) | – |
| – net (increase)/decrease in loans and advances to customers | | (68,369) | 6,442 |
| – net (increase)/decrease in other assets | | (3,701) | 20,661 |
| – net decrease in deposits from other banks | | (12) | (9,828) |
| – net increase/(decrease) in amounts due to customers | | 93,109 | (8,030) |
| – net decrease in other liabilities | | (494) | (27,746) |
| Net cash inflow/(outflow) from operating activities | | 28,294 | (5,226) |
| Cash flows from investing activities | | | |
| (Acquisition)/disposal of financial investments | | (1,623) | 2,767 |
| Purchase of computer software | 20 | (426) | (255) |
| Purchase of property, plant and equipment | 21 | (543) | (1,318) |
| Proceeds from disposal of businesses | | – | 3,565 |
| Disposal of subsidiaries, net of cash and cash equivalents disposed | 37 | – | 2,996 |
| Proceeds from sale of property, plant and equipment | | 367 | 659 |
| Purchases of debt securities | | (248,688) | (277,343) |
| Proceeds from sale of debt securities | | 253,730 | 251,305 |
| Net cash from investing activities | | 2,817 | (17,624) |
| Cash flows from financing activities | | | |
| Purchase of treasury shares | | (495) | (445) |
| Dividends paid | | (3,080) | (5,330) |
| Net cash used in financing activities | | (3,575) | (5,775) |
| Net increase/(decrease) in cash and cash equivalents | | 27,536 | (28,625) |
| Cash and cash equivalents at 1 January | | 27,308 | 55,933 |
| Cash and cash equivalents at 31 December | 33 | 54,844 | 27,308 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

Company statement of cash flows

| | Year ended 31 December 2009 £000 | Year ended 31 December 2008 £000 |
|--|---|---|
| | Note | |
| Cash flows from operating activities | | |
| Dividends received from subsidiaries | 4,126 | 5,627 |
| Interest and similar income received | 359 | 912 |
| Interest and similar charges paid | (747) | (1,461) |
| Net trading and other income | 741 | (702) |
| Cash payments to employees and suppliers | (5,549) | (1,332) |
| Taxation received | 1,121 | 1,632 |
| Cash flows from operating profits before changes in operating assets and liabilities | 51 | 4,676 |
| Changes in operating assets and liabilities: | | |
| – net decrease/(increase) in group company balances | 4,923 | (6,793) |
| – net decrease in other assets | 384 | 58 |
| – net increase in other liabilities | (201) | (378) |
| Net cash inflow/(outflow) from operating activities | 5,157 | (2,437) |
| Cash flows from investing activities | | |
| Loans to subsidiary companies | (1,400) | 2,000 |
| Increase investment in subsidiary | (100) | – |
| Disposal of subsidiaries, net of cash and cash equivalents disposed | – | 2,842 |
| (Acquisition)/disposal of financial investments | (101) | 1,409 |
| Disposal of property, plant and equipment | 17 | 25 |
| Purchase of property, plant and equipment | 21 (7) | (3) |
| Net cash from investing activities | (1,591) | 6,273 |
| Cash flows from financing activities | | |
| Purchase of treasury shares | (495) | (445) |
| Dividends paid | (3,080) | (4,724) |
| Net cash used in financing activities | 3,575 | 5,169 |
| Net decrease in cash and cash equivalents | (9) | (1,333) |
| Cash and cash equivalents at 1 January | (2,609) | (1,276) |
| Cash and cash equivalents at 31 December | 33 (2,618) | (2,609) |

The notes on pages 34 to 77 are an integral part of these consolidated financial statements

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.

1.1. Reporting entity

Arbuthnot Banking Group PLC is a company domiciled in the United Kingdom. The registered address of the Arbuthnot Banking Group PLC is One Arlestone Way, Solihull B90 4LH. The consolidated financial statements of the Arbuthnot Banking Group PLC as at and for the year ended 31 December 2009 comprise the Arbuthnot Banking Group PLC and its subsidiaries (together referred to as the “Group” and individually as “subsidiaries”). The Company is primarily involved in banking and financial services.

1.2. 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 (IFRSs as adopted and endorsed by the EU), IFRIC Interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. They have been prepared under the historical cost convention, as modified by the revaluation of land and buildings, available-for-sale financial assets, and financial assets and financial liabilities at fair value through profit or loss.

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 Group’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 2.

The Group’s business activities and financial position, the factors likely to affect its future development and performance, and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Financial Review. The Directors have assessed, in the light of current and anticipated economic conditions, the Group’s ability to continue as a going concern. The Directors confirm they are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the ‘going concern’ basis for preparing accounts.

(a) Standards, interpretations and amendments effective in 2009 – relevant to the Group

- IAS 1 (Revised), ‘Presentation of financial statements’. Revises the overall requirements for the presentation of financial statements, guidance for their structure and minimum content requirements. The revised standard requires the presentation of all non-owner changes in equity within a statement of comprehensive income.
- IFRS 2 (Amendment), ‘Share-based payment’. The amendment restricts the definition of vesting conditions to include only service conditions and performance conditions and deals with the accounting consequences of a failure to meet a condition other than a vesting condition including how to deal with cancellations by the counterparty and circumstances where neither the entity nor the counterparty is in a position to choose whether or not to meet a vesting condition.
- IAS 32 (Amendment), ‘Financial instruments: Presentation’, and IAS 1 (Amendment), ‘Presentation of financial statements’ – ‘Puttable financial instruments and obligations arising on liquidation’. The amended standards require entities to classify puttable financial instruments and instruments, or components of instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation as equity, provided the financial instruments have particular features and meet specific conditions.
- IFRS 7 (Amendment), ‘Financial instruments: Disclosure’. The amendment requires enhanced disclosures about fair value measurements and liquidity risk in respect of financial instruments. The main change relates to fair value measurements which should now be disclosed in a 3 level hierarchy that reflects the significance of the inputs. Specific disclosures are required for Level 3 (significant unobservable inputs), movements between level 1 and 2, and around changes in valuation techniques between different periods.
- IFRS 8, ‘Operating segments’. IFRS 8 replaces IAS 14 Segment Reporting and requires a ‘management approach’, under which segment information is presented on the same basis as that used for internal reporting purposes.
- Improvements to IFRSs. Sets out minor amendments to IFRS standards as part of annual improvements process.

1.2. Basis of presentation continued

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

The following standards, interpretations and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2010 or later periods, but the Group has not early adopted them:

- IFRS 3 (Revised), 'Business combinations' (effective from 1 July 2009). The revised standard continues to apply the acquisition method to business combinations, however, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the statement of comprehensive income. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed.
- IAS 27 (Revised), 'Consolidated and separate financial statements' (effective from 1 July 2009). The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control. Any remaining interest in an investee is re-measured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.
- IAS 24 (Revised), 'Related party disclosures' (effective from 1 January 2011). The revised standard includes an exemption from the disclosure requirements for related party transactions between "state-controlled" entities and includes a revised definition for related parties. The revised standard will not have a material impact on the Group's financial accounts.*
- IFRS 9, 'Financial instruments' (effective from 1 January 2013). This standard deals with the classification and measurement of financial assets and will replace IAS 39. The requirements of this standard represent a significant change from the existing requirements in IAS 39. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. The standard eliminates the existing IAS 39 categories of 'held to maturity', 'available for sale' and 'loans and receivables'. The potential effect of this standard is currently being evaluated but it is expected to have a pervasive impact on the Group's financial statements, due to the nature of the Group's operations.*

* The revised IAS 24 and IFRS 9 have not yet been endorsed by the EU.

1.3. Consolidation

(a) Subsidiaries

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 non-controlling 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 statement of comprehensive income.

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

(b) Special purpose entities

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or lending transaction. SPEs are consolidated when the substance of the relationship between the Group and the entity and the evaluation of the Group's exposure to the risks and rewards of the SPE indicates control. The following circumstances may indicate control by the Group and would therefore require consolidation of the SPE:

- in substance, the activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE's operation;
- in substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the entity has delegated these decision-making powers;

Principal accounting policies

1.3. Consolidation continued

(b) *Special purpose entities continued*

- in substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
- in substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The assessment of whether the Group has control over an SPE is carried out at inception and the initial assessment is only reconsidered at a later date if there were any changes to the structure or terms of the SPE, or there were additional transactions between the Group and the SPE.

(c) *Transactions and non-controlling interests*

The Group applies a policy of treating transactions with non-controlling interests as transactions with parties external to the Group. Disposals to non-controlling interests result in gains and losses for the Group that are recorded in the statement of comprehensive income. Purchases from non-controlling interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

1.4. Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Group Board. The Group Board, which is responsible for allocating resources and assessing performance of the operating segments, has been identified as the chief operating decision maker. All transactions between segments are conducted on an arm's length basis. Income and expenses directly associated with each segment are included in determining segment performance. There are four main operating segments:

- Retail Banking
- International Private Banking
- UK Private Banking
- Investment Banking

1.5. Foreign currency translation

(a) *Functional and presentational currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in pounds sterling, which is the Company's functional and the Group's presentational 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 or valuation where items are remeasured. 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 statement of comprehensive income.

(c) *Group companies*

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentational currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
- all resulting exchange differences are recognised as a separate component of equity.

1.5. Foreign currency translation continued

c) Group companies continued

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the statement of comprehensive income as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

1.6. Interest income and expense

Interest income and expense are recognised in the statement of comprehensive income 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.

1.7. Fee and commission income

Fees and commissions which are not considered integral to the effective interest rate 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 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.

1.8. Gains less losses arising from dealing in securities

This includes the net gains arising from both buying and selling securities and from positions held in securities, including related interest income and dividends, recognised on trade-date – the date on which the Group commits to purchase or sell the asset.

1.9. Financial assets and financial liabilities

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

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

This category comprises financial assets and financial liabilities held for trading and listed securities. All listed securities are held for trading. Financial assets and liabilities at fair value through profit or loss are initially recognised on trade-date – the date on which the Group becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities at fair value through profit or loss are subsequently carried at fair value.

(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. Loans are recognised when cash is advanced to the borrowers. Loans and receivables are carried at amortised cost using the effective interest method.

(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. Held-to-maturity investments are carried at amortised cost using the effective interest method.

Principal accounting policies

1.9. Financial assets and financial liabilities continued

(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. Included in available-for-sale are equity investments, in special purpose vehicles set up to acquire and enhance the value of commercial properties and equity investments in unquoted vehicles. These investments are of a medium term nature. There is no open market for these assets and there are no available-for-sale debt securities. Unquoted equity securities whose fair value cannot reliably be measured are carried at cost. All other available-for-sale investments are carried at fair value. Fair value changes on the equity securities are recognised in other comprehensive income (fair value reserve) until the investment is sold or impaired. Once sold or impaired the cumulative gains or losses previously recognised in other comprehensive income is reclassified to profit or loss.

(e) Other financial liabilities

Other financial liabilities are non-derivative financial liabilities with fixed or determinable payments. Other financial liabilities are recognised when cash is received from the depositors. Other financial liabilities are carried at amortised cost using the effective interest method.

Derecognition

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

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Amortised cost measurement

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

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date. The fair value of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using appropriate valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis.

1.10. Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent arm's length transactions. Derivatives are shown in the statement of financial position as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are recognised immediately in the statement of comprehensive income.

1.11. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position 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.

1.12. Impairment of financial assets

(a) Assets carried at amortised cost

On an ongoing basis the Group assesses 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.

1.12. Impairment of financial assets continued

(a) Assets carried at amortised cost continued

The criteria that the Group uses to determine that 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. 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.

(b) Assets classified as available-for-sale

The Group assesses at each statement of financial position date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the statement of comprehensive income. Impairment losses recognised in the statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income.

(c) Renegotiated loans

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans.

1.13. 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'. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place and carry goodwill at cost less accumulated impairment losses. Assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). For impairment testing purposes goodwill cannot be allocated to a CGU that is greater than a reported operating segment. CGUs to which goodwill has been allocated are aggregated so that the level at which impairment is tested reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

Principal accounting policies

1.13. Intangible assets continued

(a) Goodwill continued

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. Management considers the value in use for the core Arbuthnot Latham CGU (currently the only CGU with goodwill attached to it) to be the discounted cash flow over 5 years with a terminal value (2008: 5 years with a terminal value). The 5 year plan with a terminal value is considered to be appropriate as the goodwill relates to an ongoing well established business and not underlying assets with finite lives. A growth rate of 7% (2008: 7%) was used for income and 4% (2008: 4%) for expenditure from 2010 to 2012 (these rates were the best estimate of future forecasted performance), while a 4% (2008: 4%) percent growth rate for income and expenditure (a more conservative approach was taken for latter years as these were not budgeted for in detail as per the three year plan approved by the Board of Directors) was used for cash flows after the approved three year plan. Cash flows were discounted at a pre-tax rate of 12% (2008: 12%) to their net present value. The discount rate of 12% is considered to be appropriate after evaluating current market assessments of the time value of money and the risks specific to the assets or CGUs.

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

(b) Computer software

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

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

1.14. Property, plant and equipment

Land and buildings comprise mainly branches and offices and are stated at the 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, which are subject to regular review:

| | |
|--------------------|------------|
| 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 amounts. These are included in the statement of comprehensive income. Depreciation on revalued freehold buildings is calculated using the straight-line method over the remaining useful life.

1.15. Leases

(a) As a lessor

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

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

(b) As a lessee

Rentals made under operating leases are recognised in the statement of comprehensive income on a straight line basis over the term of the lease.

1.16. Cash and cash equivalents

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

1.17. Employee benefits

(a) Post-retirement obligations

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.

(b) Share-based compensation

The Group operates a number of equity-settled, share-based compensation plans. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. At each statement of financial position date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision to original estimates, if any, in the statement of comprehensive income, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

The grant by the Company of options over its equity instruments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the investing period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity.

1.18. Taxation

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

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

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

1.19. Issued debt and equity securities

Issued financial instruments or their components are classified as liabilities where the contractual arrangement results in the Group having a present obligation to either deliver cash or another financial asset to the holder; to exchange financial instruments on terms that are potentially unfavourable. Issued financial instruments, or their components, are classified as equity where they meet the definition of equity and confer on the holder a residual interest in the assets of the Company. The components of issued financial instruments that contain both liability and equity elements are accounted for separately with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component.

Principal accounting policies

1.19. Issued debt and equity securities continued

Financial liabilities, other than trading liabilities and financial liabilities designated at fair value, are carried at amortised cost using the effective interest method as set out in policy 1.6. Equity instruments, including share capital, are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Dividend and other payments to equity holders are deducted from equity, net of any related tax.

1.20. 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.

(c) Share buybacks

Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued.

1.21. 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

2. 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.

2.1. Estimation uncertainty

Credit losses

The Group reviews its loan portfolios and held-to-maturity investments to assess impairment at least on a half-yearly basis. The basis for evaluating impairment losses is described in accounting policy 1.12. Where financial assets are individually evaluated for impairment, management uses their best estimates in calculating the net present value of future cash flows. Management has to make judgements on the financial position of the counterparty and the net realisable value of collateral, in determining the expected future cash flows.

In determining whether an impairment loss should be recorded in the statement of comprehensive income, 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 or held-to-maturity investments with similar credit characteristics, 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.

Goodwill impairment

The accounting policy for goodwill is described in note 1.13 (a). The Company reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. Significant management judgements are made in estimations, to evaluate whether an impairment of goodwill is necessary. Impairment testing is done at CGU level and the following two items, with judgements surrounding them, have a significant impact on the estimations used in determining the necessity of an impairment charge:

- Future cash flows – Cash flow forecasts reflect managements view of future business forecasts at the time of the assessment. A detailed three year budget is done every year and management also uses judgement in applying a growth rate. The accuracy of future cash flows is subject to a high degree of uncertainty in volatile market conditions. During such conditions, management would do impairment testing more frequently than annually to ensure that the assumptions applied are still valid in the current market conditions.
- Discount rate – Management also apply judgement in determining the discount rate used to discount future expected cash flows. The discount rate is derived from the cost of capital for each CGU.

At the time of the impairment testing, if the future expected cash flows decline and/or the cost of capital has increased, then the recoverable amount will reduce.

2.2. Judgements

Impairment of equity securities

A significant or prolonged decline in the fair value of an equity security is objective evidence of impairment. The Group regards a decline of more than 20 percent in fair value as “significant” and a decline in the quoted market price that persists for nine months or longer as “prolonged”.

Valuation of financial instruments

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices. If the market is not active the Group establishes a fair value by using appropriate valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis. The objective of valuation techniques is to determine the fair value of the financial instrument at the reporting date as the price that would have been agreed between active market participants in an arm's length transaction.

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

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Notes to the consolidated financial statements

2.2. Judgements continued

Valuation of financial instruments continued

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

| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
|--------------------------------------|-----------------|-----------------|-----------------|---------------|
| At 31 December 2009 | | | | |
| Trading securities – long positions | 2,633 | 26 | – | 2,659 |
| Derivative financial instruments | – | 236 | – | 236 |
| | 2,633 | 162 | – | 2,895 |
| Trading securities – short positions | 959 | – | – | 959 |
| | 959 | – | – | 959 |
| At 31 December 2008 | | | | |
| Trading securities – long positions | 3,093 | 158 | 272 | 3,523 |
| | 3,093 | 158 | 272 | 3,523 |
| Trading securities – short positions | 1,036 | – | – | 1,036 |
| Derivative financial instruments | – | 942 | – | 942 |
| | 1,036 | 942 | – | 1,978 |

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

The following table reconciles the movement in level 3 financial instruments during the year:

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Movement in level 3 | | |
| At 1 January | 272 | 272 |
| Losses recognised in the profit and loss | (272) | – |
| At 31 December | – | 272 |

3. Maturity analysis of assets and liabilities

The table below shows the maturity analysis of assets and liabilities as at 31 December 2009:

| At 31 December 2009 | Due within one year £000 | Due after more than one year £000 | Total £000 |
|--------------------------------------|--------------------------------|--|----------------|
| ASSETS | | | |
| Cash | 230 | – | 230 |
| Derivative financial instruments | 236 | – | 236 |
| Loans and advances to banks | 54,614 | – | 54,614 |
| Loans and advances to customers | 203,751 | 25,971 | 229,722 |
| Trading securities – long positions | 2,659 | – | 2,659 |
| Debt securities held-to-maturity | 119,559 | 8,038 | 127,597 |
| Current tax asset | 1,805 | – | 1,805 |
| Other assets | 16,674 | 2,080 | 18,754 |
| Financial investments | 1,533 | 3,524 | 5,057 |
| Intangible assets | – | 2,906 | 2,906 |
| Property, plant and equipment | – | 8,552 | 8,552 |
| Deferred tax asset | – | 383 | 383 |
| Total assets | 401,061 | 51,454 | 452,515 |
| LIABILITIES | | | |
| Deposits from banks | 2,886 | – | 2,886 |
| Trading securities – short positions | 959 | – | 959 |
| Deposits from customers | 384,583 | 1,416 | 385,999 |
| Current tax liability | 2,208 | – | 2,208 |
| Other liabilities | 13,214 | 3 | 13,217 |
| Debt securities in issue | – | 13,022 | 13,022 |
| Deferred tax liabilities | 81 | – | 81 |
| Total liabilities | 403,931 | 14,441 | 418,372 |

Notes to the consolidated financial statements

3. Maturity analysis of assets and liabilities (continued)

The table below shows the maturity analysis of assets and liabilities as at 31 December 2009:

| At 31 December 2008 | Due within one year £000 | Due after more than one year £000 | Total £000 |
|--------------------------------------|--------------------------------|--|----------------|
| ASSETS | | | |
| Cash | 3,369 | – | 3,369 |
| Loans and advances to banks | 15,939 | – | 15,939 |
| Loans and advances to customers | 141,547 | 22,187 | 163,734 |
| Trading securities – long positions | 3,523 | – | 3,523 |
| Debt securities held-to-maturity | 140,639 | – | 140,639 |
| Current tax asset | 1,679 | – | 1,679 |
| Other assets | 14,348 | 705 | 15,053 |
| Financial investments | – | 3,434 | 3,434 |
| Intangible assets | – | 2,831 | 2,831 |
| Property, plant and equipment | – | 9,448 | 9,448 |
| Deferred tax asset | – | 106 | 106 |
| Total assets | 321,044 | 38,711 | 359,755 |
| LIABILITIES | | | |
| Deposits from banks | 2,898 | – | 2,898 |
| Trading securities – short positions | 1,036 | – | 1,036 |
| Derivative financial instruments | 942 | – | 942 |
| Deposits from customers | 292,054 | 836 | 292,890 |
| Other liabilities | 9,771 | 3,832 | 13,603 |
| Debt securities in issue | – | 13,972 | 13,972 |
| Total liabilities | 306,701 | 18,640 | 325,341 |

The comparatives have been reclassified to align with current year presentation (see note 39).

4. Financial risk management

Strategy

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

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

(a) Credit risk

The Company and 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 statement of financial position date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Company and Group's portfolio, could result in losses that are different from those provided for at the statement of financial position date. Credit risk is managed through the Credit Committees of the banking subsidiaries, with significant exposures also being approved by the Group Risk Committee.

4. Financial risk management continued

(a) Credit risk continued

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

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral 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 premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities;
- Personal guarantees; and
- Charges over other chattels.

Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In order to minimise any potential credit loss the 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.

Notes to the consolidated financial statements

4. Financial risk management continued

(a) Credit risk continued

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

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|--|----------------|-----------------------------|
| Credit risk exposures relating to on-balance sheet assets are as follows: | | |
| Cash | 230 | 3,369 |
| Derivative financial instruments | 236 | – |
| Loans and advances to banks | 54,614 | 15,939 |
| Loans and advances to customers – Arbuthnot Latham | 177,744 | 151,183 |
| Loan and advances to customers – Secure Trust Bank | 51,425 | 12,551 |
| Trading securities – long positions | 2,659 | 3,523 |
| Debt securities held-to-maturity | 127,597 | 140,639 |
| Financial investments | 5,057 | 3,434 |
| Other assets | 15,657 | 8,762 |
| Credit risk exposures relating to off-balance sheet assets are as follows: | | |
| Guarantees | 1,135 | 816 |
| Loan commitments and other credit related liabilities | 14,163 | 15,596 |
| At 31 December | 450,517 | 355,812 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

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

| | 2009 £000 | 2008 £000 |
|--|---------------|---------------|
| Credit risk exposures relating to on-balance sheet assets are as follows: | | |
| Due from subsidiary undertakings | 23,198 | 20,960 |
| Financial investments | 465 | 364 |
| Other debtors | 1,703 | 2,087 |
| Credit risk exposures relating to off-balance sheet assets are as follows: | | |
| Guarantees | 2,500 | 2,500 |
| At 31 December | 27,866 | 25,911 |

The above tables represents the maximum credit risk exposure (net of impairment) to the Group and Company at 31 December 2009 and 2008 without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures are based on the net carrying amounts as reported in the statement of financial position.

Concentration risk

The Group is well diversified in the UK, being exposed to retail banking, private banking and investment banking. Management assesses the potential concentration risk from a number of areas including:

- geographical concentration;
- product concentration; and
- high value residential properties.

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

4. Financial risk management continued

(b) Operational risk

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost effectiveness and to avoid control procedures that restrict initiatives and creativity. Operational risk arises from all of the Group's operations.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to the senior management within each subsidiary.

Compliance with Group standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of the Internal Audit reviews are discussed with the Company's senior management, with summaries submitted to the Arbuthnot Banking Group Audit Committee.

(c) Market risk

Price risk

The Company and Group is exposed to equity securities price risk because of investments held by the Group and classified on the consolidated statement of financial position either as available-for-sale or at fair value through the statement of comprehensive income. The Group is not exposed to commodity price risk. To manage its price risk arising from investments in equity securities, the Group diversifies its portfolio. Diversification of the portfolio is done in accordance with the limits set by the Group.

Based upon the trading book exposure given in note 15 and the financial investment exposure (in note 19), a stress test scenario of a 10% (2008: 10%) decline in market prices, with all other things being equal, would result in a £250,000(2008: £158,000) decrease in the Group's income and equity.

Based upon the financial investment exposure given in note 19, a stress test scenario of a 10% (2008: 10%) decline in market prices, with all other things being equal, would result in a £46,500 (2008: £42,100) decrease in the Company's income and equity.

Currency risk

The Company and 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 2009. Included in the table overleaf are the Group's assets and liabilities at carrying amounts, categorised by currency.

Notes to the consolidated financial statements

4. Financial risk management continued

(c) Market risk continued

Currency risk continued

| At 31 December 2009 | GBP (£) £000 | USD (\$) £000 | Euro (€) £000 | Other £000 | Total £000 |
|--------------------------------------|-----------------|------------------|------------------|---------------|----------------|
| ASSETS | | | | | |
| Cash | 230 | – | – | – | 230 |
| Derivative financial instruments | 236 | – | – | – | 236 |
| Loans and advances to banks | 48,002 | 4,587 | 816 | 1,209 | 54,614 |
| Loans and advances to customers | 192,681 | 3,579 | 31,430 | 2,032 | 229,722 |
| Trading securities – long positions | 2,199 | 460 | – | – | 2,659 |
| Debt securities held-to-maturity | 127,597 | – | – | – | 127,597 |
| Financial investments | 18,577 | 41 | 136 | – | 18,754 |
| Other assets | 8,552 | – | – | – | 8,552 |
| Total assets | 398,074 | 8,667 | 32,382 | 3,241 | 442,364 |
| LIABILITIES | | | | | |
| Deposits from banks | 1,241 | 7 | 21 | 1,617 | 2,886 |
| Trading securities – short positions | 959 | – | – | – | 959 |
| Deposits from customers | 370,600 | 8,720 | 5,475 | 1,204 | 385,999 |
| Other liabilities | 13,107 | 1 | 1 | – | 13,109 |
| Debt securities in issue | – | – | 13,022 | – | 13,022 |
| Total liabilities | 386,015 | 8,728 | 18,519 | 2,821 | 416,083 |
| Net on-balance sheet position | 12,059 | (61) | 13,863 | 420 | 26,281 |
| Credit commitments | 13,865 | 3 | 295 | – | 14,163 |

4. Financial risk management continued

(c) Market risk continued

Currency risk continued

The table below summarises the Group's exposure to foreign currency exchange risk at 31 December 2008:

| At 31 December 2008 | GBP (£) £000 | USD (\$) £000 | Euro (€) £000 | Other £000 | Total £000 |
|--------------------------------------|-----------------|------------------|------------------|---------------|----------------|
| ASSETS | | | | | |
| Cash | 3,369 | – | – | – | 3,369 |
| Loans and advances to banks | 10,381 | 4,410 | 1,092 | 56 | 15,939 |
| Loans and advances to customers | 136,940 | 3,159 | 23,635 | – | 163,734 |
| Trading securities – long positions | 3,067 | 456 | – | – | 3,523 |
| Debt securities held-to-maturity | 140,639 | – | – | – | 140,639 |
| Financial investments | 364 | 57 | 3,013 | – | 3,434 |
| Other assets | 13,575 | 370 | 1,108 | – | 15,053 |
| Total assets | 308,335 | 8,452 | 28,848 | 56 | 345,691 |
| LIABILITIES | | | | | |
| Deposits from banks | 2,823 | 11 | 64 | – | 2,898 |
| Trading securities – short positions | 1,036 | – | – | – | 1,036 |
| Deposits from customers | 279,652 | 7,905 | 5,292 | 41 | 292,890 |
| Derivative financial instruments | 942 | – | – | – | 942 |
| Other liabilities | 13,389 | 33 | 181 | – | 13,603 |
| Debt securities in issue | – | – | 13,972 | – | 13,972 |
| Total liabilities | 297,842 | 7,949 | 19,509 | 41 | 325,341 |
| Net on-balance sheet position | 10,493 | 503 | 9,339 | 15 | 20,350 |
| Credit commitments | 15,231 | 1 | 364 | – | 15,596 |

* The 2008 Group comparative schedule has been expanded to include the categories as per the statement of financial position, previously Cash, Trading securities – long positions, Current tax asset, Intangible assets, Property, plant and equipment and Deferred tax asset was shown as part of Other assets and Trading securities – short positions and Derivative financial instruments were shown as part of Other liabilities. The 2008 comparatives have also been reclassified to align with the current year presentation (see note 39) and there was also a reclassification of £14,598,000 from GBP to Euro under Loans and advances to customers.

A 10% strengthening of the pound against the US dollar would lead to a negligible (2008: £50,000) decrease in Group profits and equity, while a 10% weakening of the pound against the US dollar would lead to the same increase in Group profits and equity. Similarly a 10% strengthening of the pound against the Euro would lead to £42,000 (2008: £52,000) decrease in Group profits and equity, while a 10% weakening of the pound against the Euro would lead to the same increase in Group profits and equity. The above results are after taking into account the effect of derivative financial instruments (see note 24), which covers most of the net exposure in each currency.

Notes to the consolidated financial statements

4. Financial risk management continued

(c) Market risk continued

Currency risk continued

The table below summarises the Company's exposure to foreign currency exchange rate risk at 31 December 2009:

| At 31 December 2009 | GBP (£) £000 | USD (\$) £000 | Euro (€) £000 | Other £000 | Total £000 |
|--------------------------------------|-----------------|------------------|------------------|---------------|---------------|
| ASSETS | | | | | |
| Due from subsidiary undertakings | 7,814 | – | 13,352 | 2,032 | 23,198 |
| Financial investments | 465 | – | – | – | 465 |
| Other debtors | 1,703 | – | – | – | 1,703 |
| Shares in subsidiary undertakings | 28,624 | – | – | – | 28,624 |
| Total assets | 38,606 | – | 13,352 | 2,032 | 53,990 |
| LIABILITIES | | | | | |
| Deposits from banks | 1,001 | – | – | 1,617 | 2,618 |
| Due to subsidiary undertakings | 15,621 | – | – | – | 15,621 |
| Debt securities in issue | (297) | – | 13,319 | – | 13,022 |
| Total liabilities | 16,325 | – | 13,319 | 1,617 | 31,261 |
| Net on-balance sheet position | 22,281 | – | 33 | 415 | 22,729 |

The table below summarises the Company's exposure to foreign currency exchange risk at 31 December 2008:

| At 31 December 2008 | GBP (£) £000 | USD (\$) £000 | Euro (€) £000 | Other £000 | Total £000 |
|--------------------------------------|-----------------|------------------|------------------|---------------|---------------|
| ASSETS | | | | | |
| Due from subsidiary undertakings | 4,727 | – | 14,598 | 1,635 | 20,960 |
| Financial investments | 364 | – | – | – | 364 |
| Other debtors | 2,087 | – | – | – | 2,087 |
| Shares in subsidiary undertakings | 28,524 | – | – | – | 28,524 |
| Total assets | 35,702 | – | 14,598 | 1,635 | 51,935 |
| LIABILITIES | | | | | |
| Deposits from banks | 1,004 | – | – | 1,605 | 2,609 |
| Due to subsidiary undertakings | 9,860 | – | – | – | 9,860 |
| Debt securities in issue | (310) | – | 14,282 | – | 13,972 |
| Total liabilities | 10,554 | – | 14,282 | 1,605 | 26,441 |
| Net on-balance sheet position | 25,148 | – | 316 | 30 | 25,494 |

A 10% strengthening of the pound against the Euro would lead to £3,000 (2008: £32,000) decrease in the Company profits and equity, conversely a 10% weakening of the pound against the Euro would lead to the same increase in the Company profits and equity. A 10% strengthening of the pound against the Swiss Franc would lead to £43,000 (2008: £3,000) decrease in the Company profits and equity, conversely a 10% weakening of the pound against the Swiss Franc would lead to the same increase in the Company profits and equity.

4. Financial risk management continued

(c) *Market risk continued*

Interest rate risk

Interest rate risk is the potential adverse impact on the Company and Group's future cash flows from adverse changes in interest rates; and arises from the differing interest rate risk characteristics of the Company and 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. The principal interest rate mismatch is in Arbuthnot Latham and 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 scenario for both 50 and 100 basis points movement. This typically results in a pre-tax mismatch of £0.1m (2008: £0.1m to £0.2m) for the Group, with the same impact to equity pre-tax. The Company has no fixed rate exposures, but a change of 50 basis points on variable rates would impact pre-tax profits and equity by £7,000 (2008: £7,000).

(d) *Liquidity risk*

The Company and 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. The Company and Group maintains long-term committed bank facilities and use is made of 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 normal practice for banks to operate liquidity on a mismatch basis.

The table below analyses the contractual undiscounted cash flows for the Group into relevant maturity groupings at 31 December 2009:

| At 31 December 2009 | Carrying amount £000 | Gross nominal inflow/ (outflow) £000 | Not more than 3 months £000 | More than 3 months but less than 1 year £000 | More than 1 year but less than 5 years £000 | More than 5 years £000 |
|--------------------------------------|----------------------------|--|-----------------------------------|--|--|------------------------------|
| Non-derivative liabilities | | | | | | |
| Deposits from banks | 2,886 | (2,886) | (2,886) | – | – | – |
| Trading securities – short positions | 959 | (959) | (959) | – | – | – |
| Deposits from customers | 385,999 | (386,177) | (317,736) | (66,931) | (1,510) | – |
| Other liabilities | 13,217 | (13,475) | (4,672) | (8,303) | (500) | – |
| Debt securities in issue | 13,022 | (13,022) | – | – | – | (13,022) |
| Issued financial guarantee contracts | | (1,135) | (1,135) | – | – | – |
| Unrecognised loan commitments | | (14,163) | (14,163) | – | – | – |
| | 416,083 | (431,817) | (341,551) | (75,234) | (2,010) | (13,022) |
| Derivative liabilities | | | | | | |
| Risk management: | – | – | – | – | – | – |
| - Inflows | – | – | – | – | – | – |
| - Outflows | – | – | – | – | – | – |
| | – | – | – | – | – | – |

Notes to the consolidated financial statements

4. Financial risk management continued

The table below analyses the contractual undiscounted cash flows for the Group into relevant maturity groupings at 31 December 2008:

(d) *Liquidity risk continued*

| | Carrying amount £000 | Gross nominal inflow/ (outflow) £000 | Not more than 3 months £000 | More than 3 months but less than 1 year £000 | More than 1 year but less than 5 years £000 | More than 5 years £000 |
|--------------------------------------|-------------------------|--|-----------------------------------|--|--|------------------------------|
| At 31 December 2008 | | | | | | |
| Non-derivative liabilities | | | | | | |
| Deposits from banks | 2,898 | (6,023) | (2,956) | (3,067) | – | – |
| Trading securities – short positions | 1,036 | (1,036) | (1,036) | – | – | – |
| Deposits from customers | 292,890 | (293,097) | (219,266) | (72,881) | (950) | – |
| Other liabilities | 13,603 | (14,592) | (12,771) | (1,435) | (386) | – |
| Debt securities in issue | 13,972 | (13,972) | – | – | – | (13,972) |
| Issued guarantee contracts | – | (816) | (816) | – | – | – |
| Unrecognised loan commitments | – | (15,596) | (15,596) | – | – | – |
| | 324,399 | (345,132) | (252,441) | (77,383) | (1,336) | (13,972) |
| Derivative liabilities | | | | | | |
| Risk management: | 942 | – | – | – | – | – |
| – Inflows | – | 9,188 | 8,980 | 208 | – | – |
| – Outflows | – | (10,130) | (9,927) | (203) | – | – |
| | 942 | (942) | (947) | 5 | – | – |

The comparatives have been reclassified to align with current year presentation (see note 39).

The table below analyses the contractual undiscounted cash flows for the Company into relevant maturity groupings at 31 December 2009:

| | Carrying amount £000 | Gross nominal inflow/ (outflow) £000 | Not more than 3 months £000 | More than 3 months but less than 1 year £000 | More than 1 year but less than 5 years £000 | More than 5 years £000 |
|-----------------------------------|-------------------------|--|-----------------------------------|--|--|------------------------------|
| At 31 December 2009 | | | | | | |
| Non-derivative liabilities | | | | | | |
| Deposits from banks | 2,618 | (2,618) | (2,618) | – | – | – |
| Due to subsidiary undertakings | 15,621 | (15,621) | (15,621) | – | – | – |
| Accruals | 630 | (630) | – | (630) | – | – |
| Debt securities in issue | 13,022 | (13,022) | – | – | – | (13,022) |
| Issued guarantee contracts | – | (2,500) | (2,500) | – | – | – |
| | 31,891 | (34,391) | (20,739) | (630) | – | (13,022) |

4. Financial risk management continued

(d) Liquidity risk continued

The table below analyses the contractual undiscounted cash flows for the Company into relevant maturity groupings at 31 December 2008:

| At 31 December 2008 | Carrying amount £000 | Gross nominal inflow/ (outflow) £000 | Not more than 3 months £000 | More than 3 months but less than 1 year £000 | More than 1 year but less than 5 years £000 | More than 5 years £000 |
|--------------------------------------|----------------------------|--|-----------------------------------|--|--|------------------------------|
| Non-derivative liabilities | | | | | | |
| Deposits from banks | 2,609 | (2,609) | (2,609) | – | – | – |
| Due to subsidiary undertakings | 9,860 | (9,860) | (9,860) | – | – | – |
| Accruals | 831 | (831) | – | (831) | – | – |
| Debt securities in issue | 13,972 | (13,972) | – | – | – | (13,972) |
| Issued financial guarantee contracts | – | (2,500) | (2,500) | – | – | – |
| | 27,272 | (29,772) | (14,969) | (831) | – | (13,972) |

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.

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 underperformance. At the statement of financial position date, the Group had investment management accounts amounting to approximately £179 million (2008: £156 million). Additionally the Group provides investment advisory services.

Notes to the consolidated financial statements

4. Financial risk management continued

(e) Financial assets and liabilities

The tables below set out the Group's financial assets and financial liabilities into the respective classifications:

| | Note | Trading £000 | Held-to- maturity £000 | Loans and advances £000 | Available- for-sale £000 | Other amortised cost £000 | Total carrying amount £000 | Fair value £000 |
|--------------------------------------|------|-----------------|------------------------------|-------------------------------|--------------------------------|------------------------------------|----------------------------------|--------------------|
| At 31 December 2009 | | | | | | | | |
| Cash | 13 | – | – | 230 | – | – | 230 | 230 |
| Derivative financial instruments | 24 | 236 | – | – | – | – | 236 | 236 |
| Loans and advances to banks | 14 | – | – | 54,614 | – | – | 54,614 | 54,614 |
| Loans and advances to customers | 16 | – | – | 229,722 | – | – | 229,722 | 229,722 |
| Trading securities – long positions | 15 | 2,659 | – | – | – | – | 2,659 | 2,659 |
| Debt securities held-to-maturity | 18 | – | 127,597 | – | – | – | 127,597 | 127,597 |
| Financial investments | 19 | 465 | – | – | 4,592 | – | 5,057 | 5,057 |
| | | 3,360 | 127,597 | 284,566 | 4,592 | – | 420,115 | 420,115 |
| Deposits from banks | 23 | – | – | – | – | 2,886 | 2,886 | 2,886 |
| Trading securities – short positions | 15 | 959 | – | – | – | – | 959 | 959 |
| Deposits from customers | 25 | – | – | – | – | 385,999 | 385,999 | 385,999 |
| Debt securities in issue | 27 | – | – | – | – | 13,022 | 13,022 | 13,022 |
| | | 959 | – | – | – | 401,907 | 402,866 | 402,866 |

| | Note | Trading £000 | Held-to- maturity £000 | Loans and advances £000 | Available- for-sale £000 | Other amortised cost £000 | Total carrying amount £000 | Fair value £000 |
|--------------------------------------|------|-----------------|------------------------------|-------------------------------|--------------------------------|------------------------------------|----------------------------------|--------------------|
| At 31 December 2008 | | | | | | | | |
| Cash | 13 | – | – | 3,369 | – | – | 3,369 | 3,369 |
| Loans and advances to banks | 14 | – | – | 15,939 | – | – | 15,939 | 15,939 |
| Loans and advances to customers | 16 | – | – | 163,734 | – | – | 163,734 | 163,734 |
| Trading securities – long positions | 15 | 3,523 | – | – | – | – | 3,523 | 3,523 |
| Debt securities held-to-maturity | 18 | – | 140,639 | – | – | – | 140,639 | 140,639 |
| Financial investments | 19 | 421 | – | – | 3,013 | – | 3,434 | 3,434 |
| | | 3,944 | 140,639 | 183,042 | 3,013 | – | 330,638 | 330,638 |
| Deposits from banks | 23 | – | – | – | – | 2,898 | 2,898 | 2,898 |
| Trading securities – short positions | 15 | 1,036 | – | – | – | – | 1,036 | 1,036 |
| Derivative financial instruments | 24 | 942 | – | – | – | – | 942 | 942 |
| Deposits from customers | 25 | – | – | – | – | 292,890 | 292,890 | 292,890 |
| Debt securities in issue | 27 | – | – | – | – | 13,972 | 13,972 | 13,972 |
| | | 1,978 | – | – | – | 309,760 | 311,738 | 311,738 |

5. Capital management

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

In accordance with the EU's Capital Requirements Directive (CRD) and the required parameters set out in the FSA Handbook (BIPRU 2.2), the Individual Capital Assessment Process (ICAAP) is embedded in the risk management framework of the Group and is subject to ongoing updates and revisions when necessary. However, at a minimum, the ICAAP is updated annually as part of the business planning process. The ICAAP is a process that brings together management framework (i.e. the policies, procedures, strategies, and systems that the Group has implemented to identify, manage and mitigate its risks) and the financial disciplines of business planning and capital management. The Group's regulated entities are also the principal trading subsidiaries as detailed in Note 35.

Not all material risks can be mitigated by capital, but where capital is appropriate the Board has adopted a "Pillar I plus" approach to determine the level of capital the Group needs to hold. This method takes the Pillar I capital formula calculations (standardised approach for credit, market and operational risk) as a starting point, and then considers whether each of the calculations deliver a sufficient capital sum adequately to cover managements' anticipated risks. Where the Board considered that the Pillar I calculations did not reflect the risk, an additional capital add-on in Pillar II is applied, as per the Individual Capital Guidance (ICG) issued by the FSA.

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

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

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

| | 2009 £000 | 2008 £000 |
|--|---------------|---------------|
| Tier 1 | | |
| Share capital | 150 | 150 |
| Share premium account | 21,085 | 21,085 |
| Retained earnings | 11,684 | 11,257 |
| Other reserves | (1,178) | (724) |
| Non-controlling | 2,144 | 2,280 |
| Goodwill | (1,991) | (1,991) |
| Other deductions | (915) | (840) |
| Total tier 1 capital | 30,979 | 31,217 |
| Tier 2 | | |
| Revaluation reserve | 258 | 366 |
| Debt securities in issue | 13,022 | 13,972 |
| Total tier 2 capital | 13,280 | 14,338 |
| Total tier 1 & tier 2 capital | 44,259 | 45,555 |

Notes to the consolidated financial statements

5. Capital management continued

The ICAAP includes a summary of the capital required to mitigate the identified risks in its regulated entities and the amount of capital that the Group has available. The FSA's last review of the Group's ICAAP was last conducted in December 2007 and the regulatory capital requirements for all entities have subsequently been agreed, as part of the ICG issued by the FSA. The FSA sets ICG for each UK bank calibrated by references to its Capital Resources Requirement, broadly equivalent to 8 percent of risk weighted assets and thus representing the capital required under Pillar I of the Basel II framework. The ICAAP is a key input into the FSA's ICG setting process, which addresses the requirements of Pillar II of the Basel II framework. The FSA's approach is to monitor the available capital resources in relation to the ICG requirement. Each entity maintains an extra internal buffer and capital ratios are reviewed on a monthly basis to ensure that external requirements are adhered to. All regulated entities have complied with all of the externally imposed capital requirements to which they are subject.

6. Fee and commission income

| | 2009 £000 | 2008 £000 |
|--|---------------|---------------|
| Fee and commission income | | |
| Trust and other fiduciary fee income | 1,922 | 1,997 |
| Stockbroking fee and commission income | 13,580 | 12,818 |
| Other fee income | 16,314 | 20,426 |
| | 31,816 | 35,241 |

7. Other income

Other income mainly consist of a contribution of £0.5m towards the cost of the Swiss entity received from a possible investor, and provisions released relating to business assets sold in the prior year of £1.1m (see note 8).

8. Gain on sale of business assets

In June 2008, the Group announced that its subsidiary, Secure Trust Bank PLC, as part of its restructuring process, sold its insurance branch network to the UK's leading high street insurance retailer, Swinton. At a Group level, this generated a gain on disposal of business assets of £2,419,100.

Also in June 2008, the Group announced that its subsidiary, Arbuthnot Latham & Co., Ltd, sold its pension administration business to Premier Pension Services. At a Group level, this generated a gain on disposal of business assets of £658,300.

As part of the sale of business assets during 2008, accruals and deferred income included a provision in respect of various warranties included in the respective Sale and Purchase Agreements, refer to Note 26 for further details. During 2009 these warranties (£482,000) were written back to the profit and loss account as they expired and £688,000 of trade payables were written off.

9. Operating profit on ordinary activities before tax

| | 2009 £000 | 2008 £000 |
|--|---------------|---------------|
| Operating expenses comprise: | | |
| Staff costs, including Directors: | | |
| Wages and salaries | 23,255 | 21,761 |
| Social security costs | 2,458 | 2,556 |
| Pension costs | 1,448 | 1,640 |
| Amortisation of computer software (Note 20) | 351 | 366 |
| Depreciation (Note 21) | 1,171 | 1,215 |
| Profit on disposals of property, plant and equipment | (99) | (168) |
| Financial Services Compensation Scheme Levy | 258 | 491 |
| Charitable donations | 27 | 20 |
| Operating lease rentals | 2,249 | 2,312 |
| Restructuring costs | 127 | 1,458 |
| Other administrative expenses | 15,155 | 15,993 |
| Total operating expenses | 46,400 | 47,644 |

The auditors' remuneration for the audit of the Company's accounts was £70,000 (2008: £41,000) and fees payable for the audit of the accounts of subsidiaries of the Company was £205,000 (2008: £316,000). Remuneration of the auditors for non-audit services was: services related to taxation £15,000 (2008: £24,000) and all other services £25,000 (2008: £46,000).

10. Average number of employees

| | 2009 | 2008 |
|--------------------|------------|------------|
| Retail banking | 208 | 257 |
| Private banking | 121 | 126 |
| Investment banking | 72 | 72 |
| Group | 14 | 14 |
| | 415 | 469 |

Notes to the consolidated financial statements

11. Income tax expense/(credit)

| | 2009 £000 | 2008 £000 |
|--|--------------|----------------|
| United Kingdom corporation tax at 28% (2008: 28.5%) | | |
| Current taxation | | |
| Corporation tax charge – current year | 1,691 | (916) |
| Corporation tax charge – adjustments in respect of prior years | 95 | (288) |
| | 1,786 | (1,204) |
| Deferred taxation | | |
| Origination and reversal of temporary differences | (212) | 52 |
| Adjustments in respect of prior years | 105 | – |
| | (107) | 52 |
| Income tax expense/(credit) | 1,679 | (1,152) |
| Tax reconciliation | | |
| Profit/(loss) before tax | 5,050 | (2,150) |
| Tax at 28% (2008: 28.5%) | 1,414 | (613) |
| Permanent differences | 65 | (251) |
| Tax rate change | – | – |
| Prior period adjustments | 200 | (288) |
| Corporation tax charge/(credit) for the year | 1,679 | (1,152) |

During 2008, as a result of the change in UK Corporation Tax rates which was effective from 1 April 2008, deferred tax balances were remeasured. Deferred tax relating to temporary differences which were expected to reverse prior to 1 April 2008 were measured at 30% and deferred tax relating to temporary differences expected to reverse after 1 April 2008 are measured at the tax rate of 28% as these are the tax rates that apply on reversal.

12. 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 £3,507,000 (2008: £519,000) by the weighted average number of ordinary shares 14,999,619 (2008: 14,976,421) in issue during the year. There is no difference between basic and fully diluted earnings per ordinary share.

13. Cash

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Cash in hand included in cash and cash equivalents (Note 33) | 230 | 3,369 |

14. Loans and advances to banks

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|---|--------------|-----------------------------|
| Placements with banks included in cash and cash equivalents (Note 33) | 54,614 | 15,939 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

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:

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|-----|--------------|-----------------------------|
| Aaa | – | 5,973 |
| Aa1 | – | 4,517 |
| Aa2 | 31 | 5,381 |
| Aa3 | 54,583 | 68 |
| A1 | – | – |
| A2 | – | – |
| | 54,614 | 15,939 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

None of the loans and advances to banks is either past due or impaired.

15. Trading securities, all held at fair value through profit and loss

| | 2009 £000 | 2008 £000 |
|------------------------------------|--------------|--------------|
| <i>Unlisted equity securities:</i> | | |
| Long positions | 80 | 430 |
| <i>Listed equity securities:</i> | | |
| Long positions | 2,579 | 3,093 |
| Short positions | (959) | (1,036) |

The following table shows the Group's trading book exposure to market price risk for the year ended 31 December 2009:

| | Highest exposure £000 | Lowest exposure £000 | Average exposure £000 | Exposure as at 31 December £000 |
|-----------|-----------------------------|----------------------------|-----------------------------|--|
| Equities: | | | | |
| Long | 4,298 | 1,575 | 2,824 | 2,659 |
| Short | (1,976) | (516) | (1,131) | (959) |

The following table shows the Group's trading book exposure to market price risk for the year ended 31 December 2008:

| | Highest exposure £000 | Lowest exposure £000 | Average exposure £000 | Exposure as at 31 December £000 |
|-----------|-----------------------------|----------------------------|-----------------------------|--|
| Equities: | | | | |
| Long | 23,070 | 2,921 | 11,767 | 3,523 |
| Short | (7,505) | (669) | (4,628) | (1,036) |

The average exposure has been calculated on a daily basis. The highest and lowest exposures occurred on different dates and therefore a net position of these exposures does not reflect a spread of the trading book. The basis on which the trading book is valued each day is given in the accounting policies in note 1.9.

Notes to the consolidated financial statements

16. Loans and advances to customers

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|---|----------------|-----------------------------|
| Gross loans and advances | 237,023 | 168,856 |
| Less: allowances for impairment on loans and advances (Note 17) | (7,301) | (5,122) |
| | 229,722 | 163,734 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

For a maturity profile of loans and advances to customers, refer to Note 4.

| | 2009 £000 | 2008 £000 |
|---|--------------|--------------|
| Loans and advances to customers include finance lease receivables as follows: | | |
| Gross investment in finance lease receivables: | | |
| – No later than 1 year | 158 | 1,485 |
| – Later than 1 year and no later than 5 years | 111 | 108 |
| – Later than 5 years | 2 | – |
| | 271 | 1,593 |
| Unearned future finance income on finance leases | (14) | (96) |
| Net investment in finance leases | 257 | 1,497 |
| The net investment in finance leases may be analysed as follows: | | |
| – No later than 1 year | 150 | 1,396 |
| – Later than 1 year and no later than 5 years | 105 | 101 |
| – Later than 5 years | 2 | – |
| | 257 | 1,497 |

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|---|----------------|-----------------------------|
| Loans and advances to customers can be further summarised as follows: | | |
| Neither past due nor impaired | 212,455 | 147,876 |
| Past due but not impaired | 15,748 | 12,044 |
| Impaired | 8,820 | 8,936 |
| Gross | 237,023 | 168,856 |
| Less: allowance for impairment | (7,301) | (5,122) |
| Net | 229,722 | 163,734 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

(a) Loans and advances past due but not impaired

| | 2009 £000 | 2008 £000 |
|---|---------------|---------------|
| Gross amounts of loans and advances to customers that were past due but not impaired were as follows: | | |
| Past due up to 30 days | 3,460 | 1,907 |
| Past due 30 - 60 days | 1,587 | 559 |
| Past due 60 - 90 days | 2,295 | 3,336 |
| Over 90 days | 8,406 | 6,242 |
| Total | 15,748 | 12,044 |

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

16. Loans and advances to customers continued

(b) Loans and advances renegotiated

Restructuring activities include external payment arrangements, modification and deferral of payments. Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Renegotiated loans that would otherwise be past due or impaired totalled £nil (2008: £nil).

(c) Collateral held

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

| | 2009 £000 | 2008 £000 |
|--------------------------------------|---------------|---------------|
| Past due but not impaired | 20,215 | 31,657 |
| Impaired | 1,275 | 3,420 |
| Fair value of collateral held | 21,490 | 35,077 |

The fair value of the collateral held is £21,490,000 against £13,312,000 secured loans, giving an average loan-to-value of 62% (2008: 41%).

The gross amount of individually impaired loans and advances to customers before taking into account the cash flows from collateral held is £8,820,000 (2008: £8,936,000).

Interest income on loans classified as impaired totalled £644,000 (2008: £338,000).

17. Allowances for impairment of loans and advances

A reconciliation of the allowance account for losses on loans and advances by class is as follows:

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| At 1 January | 5,122 | 5,381 |
| Adjustments for disposals | – | (1,264) |
| Impairment losses | 2,368 | 977 |
| Loans written off during the year as uncollectible | (391) | (185) |
| Amounts recovered during the year | 202 | 213 |
| At 31 December | 7,301 | 5,122 |

A further analysis of allowances for impairment of loans and advances is as follows:

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Loans and advances to customers – Arbuthnot Latham | 1,472 | 684 |
| Loan and advances to customers – unsecured – Secure Trust Bank | 5,829 | 4,438 |
| At 31 December | 7,301 | 5,122 |

18. 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 statement of financial position at amortised cost. Amounts include £nil (2008: £8,000,000) with a maturity, when placed, of 3 months or less included in cash and cash equivalents (Note 33).

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

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|--|----------------|-----------------------------|
| At 1 January | 140,639 | 122,306 |
| Exchange difference on monetary assets | – | 61 |
| Additions | 248,688 | 277,343 |
| Redemptions | (261,730) | (259,071) |
| At 31 December | 127,597 | 140,639 |

(1) The comparatives have been reclassified to align with current year presentation (see note 39).

Notes to the consolidated financial statements

18. Debt securities held-to-maturity continued

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

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|-----|----------------|-----------------------------|
| Aaa | – | – |
| Aa1 | – | 44,868 |
| Aa2 | 20,132 | 82,849 |
| Aa3 | 107,465 | 12,922 |
| A1 | – | – |
| | 127,597 | 140,639 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

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

19. Financial investments

| Group | 2009 £000 | 2008 £000 |
|---|--------------|--------------|
| Financial investments comprise: | | |
| – Listed securities (at fair value through profit and loss) | 465 | 421 |
| – Unlisted securities (available-for-sale) | 4,592 | 3,013 |
| Total financial investments | 5,057 | 3,434 |

(a) Unlisted securities

The Group has made equity investments in unlisted special purpose vehicles set up to acquire and enhance the value of commercial properties. These investments are of a medium term nature. There is no open market for these investments therefore the Group has valued them using appropriate valuation methodologies.

The Directors intend to dispose of these assets when a suitable buyer has been identified and when the Directors believe that the underlying assets have reached their maximum value.

| Company | 2009 £000 | 2008 £000 |
|---|--------------|--------------|
| Financial investments comprise: | | |
| – Listed securities (at fair value through profit and loss) | 465 | 364 |

20. Intangible assets

| | | |
|--------------------------------|--------------|--------------|
| Goodwill | | |
| Group | 2009 £000 | 2008 £000 |
| Opening net book amount | 1,991 | 2,042 |
| On disposal (Note 37) | – | (51) |
| Closing net book amount | 1,991 | 1,991 |
| Computer software | | |
| Group | | £000 |
| Cost | | |
| At 1 January 2008 | | 3,187 |
| Additions | | 255 |
| Disposals | | (143) |
| At 31 December 2008 | | 3,299 |
| Additions | | 426 |
| At 31 December 2009 | | 3,725 |
| Accumulated amortisation | | |
| At 1 January 2008 | | (2,091) |
| Amortisation charge | | (366) |
| Disposals | | (2) |
| At 31 December 2008 | | (2,459) |
| Amortisation charge | | (351) |
| At 31 December 2009 | | (2,810) |
| Net book amount | | |
| At 31 December 2008 | | 840 |
| At 31 December 2009 | | 915 |
| Total intangible assets | 2009 £000 | 2008 £000 |
| Goodwill | 1,991 | 1,991 |
| Computer software | 915 | 840 |
| Net book amount at 31 December | 2,906 | 2,831 |

Notes to the consolidated financial statements

21. Property, plant and equipment

| Group | Freehold land and buildings £000 | Computer and other equipment £000 | Operating leases £000 | Motor vehicles £000 | Total £000 |
|---------------------------------|-------------------------------------|---|-----------------------------|---------------------------|-----------------|
| Cost or valuation | | | | | |
| At 1 January 2008 | 6,581 | 12,008 | 1,934 | 928 | 21,451 |
| Additions | – | 875 | 157 | 286 | 1,318 |
| Revaluation | (1,380) | – | – | – | (1,380) |
| Disposals | (101) | (702) | – | (660) | (1,463) |
| At 31 December 2008 | 5,100 | 12,181 | 2,091 | 554 | 19,926 |
| Additions | – | 500 | 4 | 39 | 543 |
| Revaluation | – | – | – | – | – |
| Disposals | (250) | (1,187) | – | (265) | (1,702) |
| At 31 December 2009 | 4,850 | 11,494 | 2,095 | 328 | 18,767 |
| Accumulated depreciation | | | | | |
| At 1 January 2008 | (365) | (8,762) | (161) | (712) | (10,000) |
| Depreciation charge | (118) | (874) | (151) | (72) | (1,215) |
| Disposals | – | 330 | – | 407 | 737 |
| At 31 December 2008 | (483) | (9,306) | (312) | (377) | (10,478) |
| Depreciation charge | (80) | (879) | (156) | (56) | (1,171) |
| Disposals | 34 | 1,188 | – | 212 | 1,434 |
| At 31 December 2009 | (529) | (8,997) | (468) | (221) | (10,215) |
| Net book amount | | | | | |
| At 31 December 2008 | 4,617 | 2,875 | 1,779 | 177 | 9,448 |
| At 31 December 2009 | 4,321 | 2,497 | 1,627 | 107 | 8,552 |

The Group's freehold property at 1 Arleston Way, Solihull, 890 4LH, was valued on 17 December 2008 by an External Valuer, Graham Piercy, FRICS, of DWD2 Limited, Property Consultants.

The Valuation was in accordance with the requirements of the RICS Valuation Standards 6th Edition and the International Valuation Standards. The Valuation of the property was on the basis and assumption it is an Owner/Occupied property, valued to Market Value assuming that the property will be sold as part of the continuing business.

The Valuer's opinion of Market Value was primarily derived using comparable recent market transactions on arms-length terms.

As a Regulated Purpose Valuation, the Valuer, Graham Piercy FRICS, confirms this was the first occasion on which he had provided a Valuation of the Property. DWD2 Limited had had no previous relationship with the Company and accordingly received no fees in DWD2 Limited's preceding financial year.

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 £0.5 million (2008: £0.5 million).

21. Property, plant and equipment continued

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

| | 2009 £000 | 2008 £000 |
|--------------------------|--------------|--------------|
| Cost | 3,778 | 3,980 |
| Accumulated depreciation | (753) | (731) |
| Net book amount | 3,025 | 3,249 |

Motor vehicles include the following amounts where the Group is a lessee under a finance lease:

| | 2009 £000 | 2008 £000 |
|-----------------------------------|--------------|--------------|
| Cost – capitalised finance leases | 160 | 206 |
| Accumulated depreciation | (53) | (29) |
| Net book amount | 107 | 177 |

The Group leases various vehicles under non-cancellable finance lease agreements with original lease terms of three years.

| Company | Computer and other equipment £000 | Motor vehicles £000 | Total £000 |
|---------------------------------|--|---------------------------|---------------|
| Cost or valuation | | | |
| At 1 January 2008 | 116 | 164 | 280 |
| Additions | 3 | – | 3 |
| Disposals | – | (164) | (164) |
| At 31 December 2008 | 119 | – | 119 |
| Additions | 7 | – | 7 |
| At 31 December 2009 | 126 | – | 126 |
| Accumulated depreciation | | | |
| At 1 January 2008 | (41) | (137) | (178) |
| Depreciation charge | (4) | (10) | (14) |
| Disposals | – | 147 | 147 |
| At 31 December 2008 | (45) | – | (45) |
| Depreciation charge | (3) | – | (3) |
| At 31 December 2009 | (48) | – | (48) |
| Net book amount | | | |
| At 31 December 2008 | 74 | – | 74 |
| At 31 December 2009 | 78 | – | 78 |

Notes to the consolidated financial statements

22. Other assets

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|--|---------------|-----------------------------|
| Trade receivables | 15,090 | 9,965 |
| Repossessed collateral – Held-for-sale | 1,950 | 1,913 |
| Prepayments and accrued income | 1,714 | 3,175 |
| | 18,754 | 15,053 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

23. Deposits from banks

| | 2009 £000 | 2008 £000 |
|---------------------------|--------------|--------------|
| Deposits from other banks | 2,886 | 2,898 |

For a maturity profile of deposits from banks, refer to Note 4.

24. Derivative financial instruments

| | 2009 | | | 2008 | | |
|----------------|---|------------------------------|-----------------------------------|---|------------------------------|-----------------------------------|
| | Contract/ notional amount £000 | Fair value assets £000 | Fair value liabilities £000 | Contract/ notional amount £000 | Fair value assets £000 | Fair value liabilities £000 |
| Currency swaps | 16,516 | 236 | – | 8,817 | – | 942 |
| | 16,516 | 236 | – | 8,817 | – | 942 |

The principal derivatives used by the Group are exchange rate contracts. Exchange rate related contracts include forward foreign exchange contracts and currency swaps. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; exchange of principal can be notional or actual.

The table below presents an analysis of derivative financial instruments contract/notional amounts by rating agency designation at 31 December, based on Moody's long term ratings:

| | 2009 £000 | 2008 £000 |
|-----|---------------|--------------|
| Aaa | – | – |
| Aa1 | – | 8,817 |
| Aa2 | – | – |
| Aa3 | 16,516 | – |
| A1 | – | – |
| | 16,516 | 8,817 |

25. Deposits from customers

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|---------------------------|----------------|-----------------------------|
| Retail customers: | | |
| – current/demand accounts | 131,649 | 105,662 |
| – term deposits | 254,350 | 187,228 |
| | 385,999 | 292,890 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

Included in customer accounts are deposits of £10,035,000 (2008: £11,185,000) held as collateral for loans and advances. The fair value of these deposits approximates the carrying value.

For a maturity profile of deposits from customers, refer to Note 4.

26. Other liabilities

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|------------------------------|---------------|-----------------------------|
| Trade payables | 4,449 | 3,002 |
| Finance lease liabilities | 112 | 181 |
| Accruals and deferred income | 8,656 | 10,420 |
| | 13,217 | 13,603 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

As part of the sale of business assets during the prior year, accruals and deferred income include a provision of £nil (2008: £482,000) in respect of various warranties included in the respective Sale and Purchase Agreements, as of the year end no claims have been made against this provision.

The Financial Services Compensation Scheme provides compensation to customers of financial institutions in the event that an institution is unable, or is likely to be unable, to pay claims against it. During 2008, a number of institutions failed. In order to meet its obligations to the depositors of these institutions, the FSCS has borrowed £19.7 billion from HM Treasury, which is on an interest only basis until September 2011. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the above institutions. The FSCS raises annual levies from the banking industry to meet its management expenses and compensation costs. Individual institutions make payments based on their level of market participation (in the case of deposits, the proportion that their protected deposits represent of total market protected deposits) at 31st December each year. If an institution is a market participant on this date it is obligated to pay a levy. Banking subsidiaries of Arbutnot Banking Group PLC were market participants at 31st December 2008 and 2009. The Group has accrued £443,000 for its share of levies that will be raised by the FSCS including the interest on the loan from HM Treasury in respect of the levy years to 31st March 2011. The accrual includes the directors' estimates for the interest FSCS will pay on the loan and estimates of the Group's market participation in the relevant periods. Interest will continue to accrue on the HM Treasury loan to the FSCS until September 2011 and will form part of future FSCS management expenses levies. If the assets of the failed institutions are insufficient to repay the HM Treasury loan in 2011, the FSCS will agree a schedule of repayments with HM Treasury, which will be recouped from the industry in the form of additional levies. At the date of these financial statements, it is not possible to estimate the quantum and timing of additional levies on the industry, the level of Group's market participation or other factors that may affect the amounts or timing of amounts that may ultimately become payable, nor the effect that such levies may have upon operating results in any particular financial period.

Notes to the consolidated financial statements

26. Other liabilities continued

(a) Finance lease liabilities

Lease liabilities are effectively secured as the rights to the leased asset revert to the lessor in the event of default.

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Gross finance lease liabilities – minimum lease payments | | |
| Within 1 year | 61 | 95 |
| Later than 1 year and no later than 5 years | 58 | 95 |
| | 119 | 190 |
| Future finance charges on finance leases | (7) | (9) |
| Present value of finance lease liabilities | 112 | 181 |

The present value of finance lease liabilities is as follows:

| | | |
|---|------------|------------|
| Within 1 year | 58 | 90 |
| Later than 1 year and no later than 5 years | 54 | 91 |
| | 112 | 181 |

27. Debt securities in issue

| | 2009 £000 | 2008 £000 |
|------------------------------|--------------|--------------|
| Subordinated loan notes 2035 | 13,022 | 13,972 |

The subordinated loan notes 2035 were issued on 7 November 2005 and are denominated in Euros. The principal amount outstanding at 31 December 2009 was €5,000,000 (2008: €5,000,000). 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 contractual undiscounted amount that will be required to be paid at maturity of the above debt securities is €15,000,000.

Given the fact that the Group has never been subject to a published credit rating by any of the relevant agencies and the notes in issue are not quoted, it is not considered possible to approximate a fair value for these notes. The Directors do not believe the users of the accounts would be able to draw any meaningful conclusions from the information if it were practical to derive it.

28. Deferred taxation

The deferred tax asset comprises:

| | 2009 £000 | 2008 £000 |
|--|--------------|--------------|
| Unrealised surplus on revaluation of freehold property | (56) | (90) |
| Accelerated capital allowances and other short-term timing differences | 259 | 196 |
| Tax losses | 99 | – |
| Deferred tax asset | 302 | 106 |
| At 1 January | 106 | (274) |
| Revaluation reserve | (20) | 430 |
| Profit and loss account – accelerated capital allowances and other short-term timing differences | 117 | (50) |
| Profit and loss account – tax losses | 99 | – |
| Deferred tax asset | 302 | 106 |

The above balance is made up as follows:

| | 2009 £000 | 2008 £000 |
|---|--------------|--------------|
| Deferred tax assets within the Group | 383 | 106 |
| Deferred tax liabilities within the Group | (81) | – |
| | 302 | 106 |

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

29. Contingent liabilities and commitments

Capital commitments

At 31 December 2009, the Group had capital commitments of £nil (2008: £nil) 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:

| | 2009 £000 | 2008 £000 |
|---|---------------|---------------|
| Guarantees and other contingent liabilities | 1,135 | 816 |
| Commitments to extend credit: | | |
| – Original term to maturity of one year or less | 14,163 | 15,596 |
| | 15,298 | 16,412 |

Notes to the consolidated financial statements

29. Contingent liabilities and commitments continued

Operating lease commitments

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

| | 2009 £000 | 2008 £000 |
|---|--------------|--------------|
| Expiring: | | |
| Within 1 year | 1,862 | 2,040 |
| Later than 1 year and no later than 5 years | 2,168 | 4,016 |
| Later than 5 years | 89 | 120 |
| | 4,119 | 6,176 |

Other commitments

At 31 December 2009 a commitment exists to make further payments with regard to the Financial Compensation Scheme Levy for 2011 and thereafter. Due to uncertainties regarding the calculation of the levy and the Group's share thereof, the directors consider this cost to be unquantifiable.

30. Share capital

| | Number of shares | Ordinary shares £000 | Share premium £000 |
|---|---------------------|----------------------------|--------------------------|
| At 1 January 2008 | 14,943,944 | 150 | 21,085 |
| New share capital subscribed | 55,675 | – | 213 |
| Transfer to retained earnings in lieu of cash dividends | – | – | (213) |
| At 31 December 2008 and 31 December 2009 | 14,999,619 | 150 | 21,085 |

The total authorised number of ordinary shares at 31 December 2009 and 31 December 2008 was 418,439,000 with a par value of 1 pence per share (2008: 1 pence per share). All issued shares are fully paid.

At 31 December 2009 the Company held 340,274 shares (2008: 141,699) in treasury.

31. Reserves and retained earnings

| | 2009 £000 | 2008 £000 |
|--------------------------------------|---------------|---------------|
| Group | | |
| Revaluation reserve | 258 | 366 |
| Foreign exchange translation reserve | (258) | (299) |
| Capital redemption reserve | 20 | 20 |
| Treasury shares | (940) | (445) |
| Retained earnings | 11,684 | 11,257 |
| Total reserves at 31 December | 10,764 | 10,899 |

The revaluation reserve represents the unrealised change in the fair value of properties.

The foreign exchange translation reserve represents the cumulative gains and losses on the retranslation of the Group's and the Company's net investment in foreign operations, net of the effects of hedging.

The capital redemption reserve represents a reserve created after the Company purchased its own shares which resulted in a reduction of share capital.

There is currently no available-for-sale reserve as the recognition criteria set out in note 2.2 (impairment of equity securities) has not been met.

| | 2009 £000 | 2008 £000 |
|--------------------------------------|--------------|--------------|
| Company | | |
| Capital redemption reserve | 20 | 20 |
| Treasury shares | (940) | (445) |
| Retained earnings | 1,862 | 3,927 |
| Total reserves at 31 December | 942 | 3,502 |

32. Dividends per share

Final dividends are not accounted for until they have been approved at the Annual General Meeting. At the meeting on 12 May 2010, a dividend in respect of 2009 of 11.5 pence per share (2008: 10.5 pence per share) amounting to a total of £1,685,825 (2008: £1,560,082) is to be proposed. The financial statements for the year ended 31 December 2009 do not reflect the final dividend which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2010.

33. Cash and cash equivalents

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

| | 2009 £000 | 2008 ⁽¹⁾ £000 |
|--|---------------|-----------------------------|
| Cash (Note 13) | 230 | 3,369 |
| Loans and advances to banks (Note 14) | 54,614 | 15,939 |
| Debt securities held to maturity (Note 18) | – | 8,000 |
| | 54,844 | 27,308 |

⁽¹⁾ The comparatives have been reclassified to align with current year presentation (see note 39).

34. Related-party transactions

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

Other than the Directors' remuneration, payment of dividends and transactions with subsidiaries, there were no related party transactions within the Parent Company. 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. Except for the directors' disclosures, there were no other Key Management Personnel disclosures; therefore the tables below relate to directors.

| | Directors | |
|---|--------------|--------------|
| | 2009 £000 | 2008 £000 |
| Loans | | |
| Loans outstanding at 1 January | 1,459 | 1,438 |
| Loans issued during the year | 1,754 | 1,067 |
| Loan repayments during the year | (277) | (1,046) |
| Loans outstanding at 31 December | 2,936 | 1,459 |
| Interest income earned | 117 | 69 |

The loans to directors are secured on property or shares and bear interest at rates linked to base rate. No provisions have been recognised in respect of loans given to related parties (2008: £nil). Details of directors' remuneration are given in the Remuneration Report. The directors do not believe that any other key management disclosures are required.

| | Directors | |
|-----------------------------------|--------------|--------------|
| | 2009 £000 | 2008 £000 |
| Deposits | | |
| Deposits at 1 January | 864 | 1,569 |
| Deposits received during the year | 4,790 | 1,307 |
| Deposits repaid during the year | (3,774) | (2,012) |
| Deposits at 31 December | 1,880 | 864 |
| Interest expense on deposits | 40 | 81 |

Notes to the consolidated financial statements

34. Related-party transactions continued

Details of principal subsidiaries are given in note 35. Transactions and balances with subsidiaries are shown below:

| | 2009 | | Subsidiaries | | 2008 | |
|-----------------------------------|--------------------------------------|-----------------------------|--------------------------------------|-----------------------------|--------------------------------------|-----------------------------|
| | Highest balance during the year £000 | Balance at 31 December £000 | Highest balance during the year £000 | Balance at 31 December £000 | Highest balance during the year £000 | Balance at 31 December £000 |
| ASSETS | | | | | | |
| Due from subsidiary undertakings | 23,645 | 23,198 | 22,605 | 20,960 | | |
| Shares in subsidiary undertakings | 28,624 | 28,624 | 28,524 | 28,524 | | |
| Total assets | 52,269 | 51,822 | 51,129 | 49,484 | | |
| LIABILITIES | | | | | | |
| Due to subsidiary undertakings | 15,621 | 15,621 | 15,302 | 9,860 | | |
| Total liabilities | 15,621 | 15,621 | 15,302 | 9,860 | | |
| Issued guarantee contracts | 2,500 | 2,500 | 2,500 | 2,500 | | |

The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent the transactions during the year. The above transactions arose during the normal course of business and are on substantially the same terms as for comparable transactions with third-parties. Arbuthnot Securities Limited received a fee of £15,000 in 2008 in its capacity as stockbroker for the Group, it ceased to be stockbroker to the Group on 10th December 2008.

Share-based payment options

At 31 December 2009, the Company had the following equity settled share-based payment awards outstanding:

On 21 May 2008 Mr. Salmon was granted an option to subscribe between May 2011 and May 2015 for 100,000 ordinary 1p shares in the Company at 337.5p. The fair value of the option at grant date was £nil.

On 5 November 2008 Mr. Cobb was granted an option to subscribe between November 2011 and November 2015 for 50,000 ordinary 1p shares in the Company at 320p. The fair value of the option at grant date was £nil.

On 22 December 2009 Dr. Turrell was granted an option to subscribe between December 2012 and December 2016 for 50,000 ordinary 1p shares in the Company at 380p. The fair value of the option at grant date was £nil.

35. Shares in subsidiary undertakings

| | Shares at cost £000 | Impairment provisions £000 | Net £000 |
|---|------------------------|-------------------------------|---------------|
| At 1 January 2009 | 31,503 | (2,979) | 28,524 |
| Purchase of shares in Arbuthnot Unit Trust Management Limited | 100 | – | 100 |
| At 31 December 2009 | 31,603 | (2,979) | 28,624 |
| | | 2009 £000 | 2008 £000 |
| Subsidiary undertakings: | | | |
| Banks | | 24,486 | 24,486 |
| Other | | 4,138 | 4,038 |
| Total unlisted | | 28,624 | 28,524 |

On 31 July 2008, the Group sold 100% of its investment in Arbuthnot Commercial Finance Limited for a total consideration of £2,996,314. These shares represent 98% of the issued ordinary share capital of Arbuthnot Commercial Finance Limited, refer to Note 37 for further details.

35. Shares in subsidiary undertakings continued

The principal subsidiary undertakings of Arbuthnot Banking group PLC at 31 December 2009 were:

| | Country of incorporation | Interest % | Principal activity |
|---------------------------------|--------------------------|------------|--------------------|
| Secure Trust Bank PLC | UK | 100 | Retail banking |
| Arbuthnot Latham & Co., Limited | UK | 100 | Private banking |
| Arbuthnot AG | Switzerland | 100 | Private banking |
| Arbuthnot Securities Limited | UK | 59.6 | Investment banking |

- (i) All the above subsidiary undertakings are included in the consolidated financial statements and have an accounting reference date of 31 December.
(ii) All the above interests relate wholly to ordinary shares.

36. Operating segments

The Group is organised into four main operating segments, arranged over four separate companies with each having its own specialised banking service, as disclosed below:

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

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

| Year ended 31 December 2009 | Retail banking £000 | International Private banking £000 | UK Private banking £000 | Investment banking £000 | Group (reconciling items) £000 | Group Total £000 |
|--|------------------------|---|-------------------------------|-------------------------------|---|---------------------|
| Interest revenue | 9,932 | — | 13,061 | 82 | 359 | 23,434 |
| Inter-segment revenue | — | — | (611) | — | (359) | (970) |
| Interest revenue from external customers | 9,932 | — | 12,450 | 82 | — | 22,464 |
| Fee and commission income | 13,505 | — | 4,731 | 13,580 | — | 31,816 |
| Revenue from external customers | 23,437 | — | 17,181 | 13,662 | — | 54,280 |
| Interest expense | (1,345) | — | (4,163) | (234) | 812 | (4,930) |
| Subordinated loan note interest | — | — | — | — | (618) | (618) |
| Segment operating income | 22,092 | — | 13,064 | 16,860 | (316) | 51,700 |
| Impairment losses | (1,189) | — | (1,179) | — | — | (2,368) |
| Segment profit/(loss) before exceptional items | 10,219 | (506) | 206 | (147) | (4,722) | 5,050 |
| Exceptional items | — | — | — | — | — | — |
| Segment profit/(loss) before tax | 10,219 | (506) | 206 | (147) | (4,722) | 5,050 |
| Income tax (expense)/income | (2,903) | — | (33) | 132 | 1,125 | (1,679) |
| Segment profit/(loss) after tax | 7,316 | (506) | 173 | (15) | (3,597) | 3,371 |
| Segment total assets | 114,067 | 162 | 370,068 | 17,710 | (49,492) | 452,515 |
| Segment total liabilities | 99,527 | 2,081 | 347,023 | 11,258 | (41,517) | 418,372 |
| Other segment items: | | | | | | |
| Capital expenditure | (485) | — | (357) | (119) | (8) | (969) |
| Depreciation and amortisation | (727) | (71) | (662) | (59) | (3) | (1,522) |

The “Group” segment above includes the parent entity and all intercompany eliminations and fulfils the requirement of IFRS8.28.

Notes to the consolidated financial statements

36. Operating segments continued

| Year ended 31 December 2008 | Retail banking £000 | International Private banking £000 | UK Private banking £000 | Investment banking £000 | Group (reconciling items) £000 | Group Total £000 |
|--|------------------------|---|-------------------------------|-------------------------------|---|---------------------|
| Interest revenue | 4,981 | – | 19,204 | 190 | 912 | 25,287 |
| Inter-segment revenue | – | – | (576) | – | (912) | (1,488) |
| Interest revenue from external customers | 4,981 | – | 18,628 | 190 | – | 23,799 |
| Fee and commission income | 15,498 | – | 6,925 | 12,818 | – | 35,241 |
| Revenue from external customers | 20,479 | – | 25,553 | 13,008 | – | 59,040 |
| Interest expense | (767) | – | (10,455) | (676) | 467 | (11,431) |
| Subordinated loan note interest | – | – | – | – | (964) | (964) |
| Segment operating income | 19,712 | – | 14,592 | 8,813 | (287) | 42,830 |
| Impairment losses | (533) | – | (444) | – | – | (977) |
| Segment profit/(loss) before exceptional items | 4,858 | (1,160) | 1,461 | (5,225) | (6,689) | (6,755) |
| Exceptional items | 2,419 | – | 658 | – | 1,528 | 4,605 |
| Segment profit/(loss) before tax | 7,277 | (1,160) | 2,119 | (5,225) | (5,161) | (2,150) |
| Income tax (expense)/income | (1,898) | – | (11) | 1,465 | 1,596 | 1,152 |
| Segment profit/(loss) after tax | 5,379 | (1,160) | 2,108 | (3,760) | (3,565) | (998) |
| Segment total assets | 46,209 | – | 311,363 | 16,391 | (14,208) | 359,755 |
| Segment total liabilities | 35,165 | 1,453 | 287,967 | 9,602 | (8,846) | 325,341 |
| Other segment items: | | | | | | |
| Capital expenditure | (665) | (199) | (652) | (54) | (3) | (1,573) |
| Depreciation and amortisation | (699) | (49) | (724) | (94) | (14) | (1,580) |

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

Other than the International private banking operations which are in Switzerland, all the Group's other operations are conducted wholly within the United Kingdom and geographical information is therefore not presented.

37. Disposals

On 31 July 2008, the Group disposed of 100% of its interest in its subsidiary, Arbuthnot Commercial Finance Limited.

The net asset position of Arbuthnot Commercial Finance Limited at 31 July 2008, together with the resulting profit on disposal of shares and related net cash inflow, is shown below:

| | £000 |
|---------------------------------|--------------|
| Loans and advances to customers | 26,277 |
| Property, plant and equipment | 106 |
| Other assets | 63 |
| Deposits from banks | (10,466) |
| Other liabilities | (14,695) |
| Net assets | 1,285 |
| Add: Goodwill | 51 |
| Less: Non-controlling interests | (26) |
| Net assets disposed | 1,310 |
| Net gain on disposal | 1,528 |
| Costs accrued | 158 |
| Net cash inflow on sale | 2,996 |

38. Ultimate controlling party

The Company regards Henry Angest, the group Chairman and Chief Executive Officer, who has a beneficial interest in 52.8% of the issued share capital of the Company, as the ultimate controlling party. Details of his remuneration are given in the Remuneration Report and Note 34 of the consolidated financial statements includes related party transactions with Mr Angest.

39. Reclassification of 2008 numbers

The following reclassifications took place on the consolidated statement of financial position for 2008:

| | Balance as per 2008 financial statements | Interest reclassification | Comparative balance 2009 financial statements |
|----------------------------------|---|------------------------------|--|
| ASSETS | | | |
| Loans and advances to banks | 15,930 | 9 | 15,939 |
| Loans and advances to customers | 163,350 | 384 | 163,734 |
| Debt securities held-to-maturity | 137,916 | 2,723 | 140,639 |
| Other assets | 18,169 | (3,116) | 15,053 |
| | 335,365 | – | 335,365 |
| LIABILITIES | | | |
| Deposits from customers | 291,742 | 1,148 | 292,890 |
| Other liabilities | 15,693 | (1,148) | 14,545 |
| | 307,435 | – | 307,435 |

The following reclassifications took place on the consolidated statement of cash flows for 2008:

| | Balance as per 2008 financial statements | Interest reclassification | Comparative balance 2009 financial statements |
|--|---|------------------------------|--|
| Changes in operating assets and liabilities: | | | |
| – net decrease/(increase) in loans and advances to customers | 6,826 | (384) | 6,442 |
| – net decrease in other assets | 17,545 | 3,116 | 20,661 |
| – net (decrease)/increase in amounts due to customers | (9,178) | 1,148 | (8,030) |
| – net decrease in other liabilities | (26,598) | (1,148) | (27,746) |
| Net cash (outflow)/inflow from operating activities | (7,958) | 2,732 | (5,226) |
| Cash flows from investing activities | | | |
| Purchase of debt securities | (274,620) | (2,723) | (277,343) |
| Net cash from investing activities | (14,901) | (2,723) | (17,624) |
| Net decrease in cash and cash equivalents | (28,634) | 9 | (28,625) |
| Cash and cash equivalents at end of year | 27,299 | 9 | 27,308 |

The above reclassifications took place to align with the current year presentation. Interest receivable was reclassified from other assets to loans and advances to banks, loans and advances to customers and debt securities held-to-maturity. Interest payable was reclassified from other liabilities to deposits from customers. Interest receivable and payable is now reflected with the principal amount outstanding.

40. Events after the balance sheet date

There were no material post balance sheet events.

Five year summary

In the table below, all the figures are presented in accordance with IFRS.

| | 2005 £000 ⁽ⁱ⁾ | 2006 £000 | 2007 £000 | 2008 £000 | 2009 £000 |
|---|-----------------------------|--------------|--------------|--------------|--------------|
| Profit/(Loss) before tax and exceptional items* | 7,367 | 7,551 | 8,579 | (2,150) | 5,050 |
| Profit/(Loss) before tax | 7,676 | 14,062 | 8,579 | (2,150) | 5,050 |
| Earnings per share | | | | | |
| Basic (p) | 45.8 | 63.0 | 23.8 | 3.5 | 23.4 |
| Adjusted* (p) | 32.6 | 32.0 | 23.8 | 3.5 | 23.4 |
| Dividends per share (p) | 32.0 | 32.5 | 33.0 | 21.0 | 22.0 |

* In 2005 exceptional items included reorganisation and redundancy costs of £486,000, the costs of moving to AIM of £55,000 and a profit on the sale to non-controlling interests of £850,000 and in 2006 exceptional items include the profit on disposal of Arbuthnot House of £12,623,000, long term bonuses of £1,900,000, restructuring costs of £1,312,000 and affinity bad debt of £2,900,000.

(i) The prior year adjustments, referred to in Note 9 of the 2007 Annual Report, of £1,028,000 relating to years earlier than 2006 have not been included in the pre 2006 figures disclosed in the table above.

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the twenty-fourth Annual General Meeting of the Company will be held at Arbutnot House, 20 Ropemaker Street, London EC2Y 9AR on 12 May 2010 at 3pm for the following purposes:

ORDINARY BUSINESS

To consider and, if thought fit, pass the following resolutions which will be proposed as ordinary resolutions:

1. To receive and adopt the report of the directors and the financial statements for the year ended 31 December 2009.
2. To receive the report of the Remuneration Committee.
3. To declare a final dividend in respect of the year ended 31 December 2009 which the directors propose should be 11.5p per ordinary share, payable on 14 May 2010 to shareholders on the register of members at the close of business on 16 April 2010.
4. To re-elect Mr. D.M. Proctor as a director who, having been appointed as a director since the last annual general meeting, offers himself for re-election in accordance with Article 77 of the Articles of Association.
5. To re-elect Mr. H. Angest as a director who retires by rotation in accordance with Article 80 of the Articles of Association and offers himself for re-election.
6. To re-elect Sir Christopher Meyer as a director who retires by rotation in accordance with Article 80 of the Articles of Association and offers himself for re-election.
7. To re-elect Mr. A.A. Salmon as a director who retires by rotation in accordance with Article 80 of the Articles of Association and offers himself for re-election.
8. To re-appoint KPMG Audit Plc as Auditors and to authorise the directors to fix their remuneration.

SPECIAL BUSINESS

To consider and, if thought fit, pass the following resolutions which will be proposed as special resolutions:

9. That, in substitution for all subsisting authorities to the extent unused, the directors be and they are hereby empowered to allot or make offers or agreements to allot equity securities (as defined in Section 560 of the Companies Act 2006 (the "Act") for cash either pursuant to the authority conferred by the resolution of the Company passed at the Annual General Meeting held on 13 May 2009 or by way of a sale of treasury shares as if Section 561(1) of the Act did not apply to any such allotment provided that this power shall be limited to:
 - (a) the allotment or sale of equity securities in connection with any issue of shares to holders of relevant shares or relevant employee shares, or in connection with any other form of issue of such securities in which such holders are offered the right to participate, in proportion (as nearly as may be) to their respective holdings, but subject to such exclusions or other arrangements as the directors consider necessary or expedient to deal with any fractional entitlements or any legal or practical problems under the laws of any territory or the requirements of any stock exchange or regulatory authority; and
 - (b) the allotment or sale (otherwise than pursuant to sub-paragraph (a) above) of equity securities up to an aggregate nominal amount of £7,350 (being approximately 5% of the issued share capital of the Company as at 10 March 2010)

and this authority shall expire on 31 May 2011, or, if earlier, on the conclusion of 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 and the directors may allot equity securities in pursuance of such an offer or agreement as if the authority conferred hereby had not expired.

Notice of Annual General Meeting

10. That the Company be generally and unconditionally authorised to make market purchases (as defined in section 693(4) of the Companies Act 2006) of ordinary shares of 1p each in the capital of the Company (“ordinary shares”) provided that:
- (a) the maximum number of ordinary shares hereby authorised to be purchased shall be 1,460,000 (being approximately 10% of the issued share capital of the Company as at 10 March 2010);
 - (b) the minimum price which may be paid for an ordinary share shall be 1p;
 - (c) The maximum price which may be paid for an ordinary share shall be 5% above the average of the closing middle market price of the ordinary shares (as derived from the London Stock Exchange Daily Official List) for the 10 business days prior to the day the purchase is made;
 - (d) the authority hereby conferred shall expire on 31 May 2011 or, if earlier, on the conclusion of the next Annual General Meeting of the Company unless such authority is renewed prior to such time; and
 - (e) the Company may enter into contracts to purchase ordinary shares under the authority hereby conferred prior to the expiry of such authority, which contracts will or may be executed wholly or partly after the expiry of such authority, and may make purchases of ordinary shares pursuant to any such contracts.

By order of the Board

J.R. Kaye
Company Secretary

Registered Office

One Arleston Way
Solihull B90 4LH

31 March 2010

Notes:

1. In accordance with Regulation 41 of the Uncertificated Securities Regulations 2001, the Company gives notice that only those shareholders entered on the relevant register of members (the ‘Register’) for certificated or uncertificated shares of the Company (as the case may be) at 6.00 p.m. on 10 May 2010 (the ‘Specified Time’) will be entitled to attend or vote at the Annual General Meeting in respect of the number of shares registered in their name at that time. Changes to entries on the Register after the Specified Time will be disregarded in determining the rights of any person to attend or vote at the Annual General Meeting. Should the Annual General Meeting be adjourned to a time not more than 48 hours after the Specified Time, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned Annual General Meeting. Should the Annual General Meeting be adjourned for a longer period, then to be so entitled, members must be entered on the Register at the time which is 48 hours before the time fixed for the adjourned Annual General Meeting or, if the Company gives notice of the adjourned Annual General Meeting, at the time specified in the notice.
2. Any member may appoint a proxy to attend, speak and vote on his/her behalf. A member may appoint more than one proxy in relation to the Annual General Meeting provided that each proxy is appointed to exercise the rights attached to a different share or shares of the member, but must attend the meeting in person. A proxy need not be a member. Proxy Forms should be lodged with the Company’s Registrar or submitted not later than 48 hours before the time for which the Annual General Meeting is convened. Completion of the appropriate Proxy Form does not prevent a member from attending and voting in person if he/she is entitled to do so and so wishes.
3. There are no service contracts of directors other than ones which may be terminated on 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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Principal Bankers:
Barclays Bank PLC
Lloyds TSB plc

Stockbrokers:
Numis Securities Limited

Nominated Advisor:
Hawkpoint Partners Limited

Registrars:
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