



## ARBUTHNOT BANKING GROUP PLC

### Final results for the year to 31 December 2008

12 March 2009

Arbuthnot Banking Group PLC ("Arbuthnot") today announces audited final results for the year ended 31 December 2008. Arbuthnot is the holding company for Arbuthnot Securities Limited, Arbuthnot Latham & Co., Limited and Secure Trust Bank PLC.

	2008	2007
Operating income	£41.9m	£68.8m
(Loss) / Profit before tax	(£2.2)m	£8.6m
Profit attributable to Equity holders of the Company	£0.5m	£3.6m
Basic earnings per share	3.5p	23.8p
Total dividend per share	21.0p	33.0p
Total assets	£359.8m	£414.0m
Regulatory capital	£45.5m	£46.7m

**Commenting on the results, Henry Angest, Chairman and Chief Executive of Arbuthnot, said:**

*"Arbuthnot Banking Group has made a positive return to shareholders which is a creditable performance given the turmoil in the financial services industry. Our balance sheet, capital and liquidity remain strong and I am cautiously optimistic about our prospects for 2009."*

**Arbuthnot Banking Group PLC:**

Henry Angest, Chairman and Chief Executive  
Andrew Salmon, Chief Operating Officer  
James Cobb, Group Finance Director

Tel: 020 7012 2400

**Maitland:**

Emma Burdett  
Richard Farnsworth

Tel: 020 7379 5151

## Operational highlights

### Group

- Positive return to shareholders with attributable profit of £0.5m
- 10.5p final dividend recommended resulting in a total dividend of 21.0p
- Capital, liquidity and balance sheet remain strong

### Private Banking – Arbuthnot Latham

- Profit before tax up 46% to £2.1m (2007: £1.5m)
- Gain on disposals of £2.2m partly offset by restructuring £0.4m and FSCS levy £0.45m
- Customer deposits virtually unchanged £272.6m (2007: £273.6m)
- 1% asset growth and 9% loan book growth
- Loan to deposit ratio 1: 1.7. Committed bank lines undrawn throughout 2008
- Average headcount down to 126 from 160 in 2007

### Retail Banking – Secure Trust Bank

- Profit before tax up 60% to £7.3m (2007: £4.6m)
- Gain on disposal of £2.4m partly offset by restructuring £0.3m
- Unsecured loan book decreased by 21% to £17.0m (2007: £21.2m) - business now cautiously re-entering consumer lending market
- Average headcount down to 257 from 367 in 2007
- Since year end completed purchase of consumer loan portfolio from LV, as announced on 26 February 2009

### Investment Banking - Arbuthnot Securities

- Loss before tax £5.2m (2007: Profit before tax £8.1m), £3.1m attributable to group shareholders
- Repositioned business with £0.7m of restructuring
- Aggregate trading book exposure reduced to £4.6m (2007: £28.2m)
- Average headcount down to 72 from 78 in 2007
- Corporate client list grew 14% to 97 (2007: 85)

The 2008 Annual Report will be posted and available on the Arbuthnot Banking Group website <http://www.arbuthnotgroup.com/Presentations.aspx> on 26 March 2009. Copies may be obtained from the Company Secretary, Arbuthnot Banking Group PLC, Arbuthnot House, 20 Ropemaker Street, London, EC2Y 9AR.

## Consolidated income statement

	Note	Year ended 31 December	
		2008 £000	2007 £000
Interest and similar income		23,799	23,758
Interest expense and similar charges		(12,395)	(12,314)
<b>Net interest income</b>		11,404	11,444
Fee and commission income	5	35,241	54,014
Fee and commission expense		(961)	(1,107)
<b>Net fee and commission income</b>		34,280	52,907
Gains less losses from dealing in securities		(3,818)	4,442
<b>Operating income</b>		41,866	68,793
Impairment losses on loans and advances	15	(977)	(2,237)
Gain on sale of business assets	6	3,077	-
Gain on sale of subsidiary	34	1,528	-
Operating expenses	7	(47,644)	(57,977)
<b>(Loss) / profit before income tax</b>		(2,150)	8,579
Income tax credit / (expense)	9	1,152	(2,792)
<b>(Loss) / profit for the year</b>		(998)	5,787
<b>Attributable to:</b>			
Equity holders of the Company		519	3,555
Minority interest		(1,517)	2,232
		(998)	5,787
<b>Earnings per share for profit attributable to the equity holders of the Company during the year</b>			
(expressed in pence per share):			
- basic and fully diluted	10	3.5p	23.8p

## Consolidated balance sheet

	Note	At 31 December	
		2008 £000	2007 £000
<b>Assets</b>			
Cash	11	3,369	520
Loans and advances to banks	12	15,930	39,708
Trading securities - long positions	13	3,523	23,070
Loans and advances to customers	14	163,350	170,130
Debt securities held-to-maturity	16	137,916	122,306
Current tax asset		1,679	2,198
Financial investments	17	3,434	6,201
Intangible assets	18	2,831	3,138
Property, plant and equipment	19	9,448	11,451
Other assets	20	18,169	35,381
Deferred tax asset	25	106	-
<b>Total assets</b>		<b>359,755</b>	<b>414,103</b>
<b>Liabilities</b>			
Deposits from banks	21	2,898	12,726
Trading securities - short positions	13	1,036	5,105
Deposits from customers	22	291,742	300,920
Other liabilities	23	15,693	41,884
Debt securities in issue	24	13,972	10,708
Deferred tax liabilities	25	-	274
<b>Total liabilities</b>		<b>325,341</b>	<b>371,617</b>
<b>Equity</b>			
Share capital	27	150	150
Share premium account	27	21,085	21,085
Retained earnings	28	10,812	15,419
Other reserves	28	87	1,402
<b>Capital and reserves attributable to equity holders of the parent</b>		<b>32,134</b>	<b>38,056</b>
Minority interest		2,280	4,430
<b>Total equity</b>		<b>34,414</b>	<b>42,486</b>
<b>Total equity and liabilities</b>		<b>359,755</b>	<b>414,103</b>

## **Chairman's statement**

Arbuthnot Banking Group recorded a profit after tax and minorities of £0.5m for the year ended 31 December 2008 (2007: £3.6m). Against the background of the turmoil in the financial services industry we believe returning a profit for shareholders and positioning the Group in order to take advantage of the opportunities now becoming available is a creditable performance for 2008. Furthermore, I am pleased to report that the Group has ended the year in sound financial health, with strong capital ratios, liquidity and balance sheets.

We are disappointed to reduce the final dividend, but we feel in current market circumstances this it is prudent. We intend to increase the dividend as circumstances improve.

During the year I have noted with interest developments within the accounting professions and increasingly I believe that some of the accounting rules could give rise to misunderstanding and distort the comparison between different banks' results. A number of banks have increased their profits by marking their own debt to market and have benefited from the fall in prices of this debt. If Arbuthnot Banking Group had done this, we would have posted a significantly higher profit.

In my speech as Master of the Worshipful Company of International Bankers at the annual Bankers Banquet, I spoke of the need to take a countercyclical view in regards to provisioning and return to the concept of prudent general provisions that should be allowable for taxation as a way to stabilise and re-capitalise banks during the prosperous years.

I also fear that common sense will be overtaken by recent events as the authorities react to the crisis by over regulating the system and bring a burden of administration that will stifle organisations such as this, which have been run with the long-term best interests of both customers and shareholders in mind, sometimes foregoing short-term profits with a view to securing the long term future.

### **Private Banking Division**

Arbuthnot Latham recorded a profit before tax of £2.1m for the year (2007: £1.5m). The bank benefited from focusing on its core private banking business and the gain on sale of its pension administration and commercial finance operations. Costs were reduced by 11% during the year, mainly through head-count reduction and disposals. Customer deposits at the year end were £273m. The Financial Services Compensation Scheme Levy – a charge which penalises conservatively managed businesses and forces them to pay the cost of bailing out those that took excessive risk in pursuit of short-term gain – cost Arbuthnot Latham £0.45m in 2008.

We are finding that we are able to attract an increasing quality of customers to the business, as a result of our decision to protect our depositors by not reducing our base rate on every occasion on which the Bank of England lowered its rates. We remain open to funding good quality lending propositions.

### **Retail Banking Division**

Secure Trust Bank produced a 60% increase in profit before tax to £7.3m (2007: £4.6m). This was achieved in large measure by a 17% reduction in costs and the disposal of the non-core insurance brokerage, which produced a gain of £2.4m. As a result of management action in 2008 the core OneBill product is now operating at a significantly higher level of profitability, despite the gradual decline in customer numbers. Secure Trust Bank took the decision to reduce its exposure to unsecured consumer lending in 2007, and has therefore experienced minimal losses from debts in 2008. Since the onset of the credit crunch there has been a significant withdrawal of capacity from consumer lending and this has created an opportunity for Secure Trust Bank cautiously to re-enter this market in 2009. On 26 February 2009 we announced that we had purchased a portfolio of personal instalment loans from Liverpool Victoria. This was achieved at a discount to the gross value of the loans with no accounts in arrears and significantly increases the number of our personal loan customers. To finance this consumer lending book, Secure Trust Bank refocused its efforts on deposit-taking in January 2009 with a 60 day notice product which has attracted over £13m by the end of February. In addition, in April this year, Secure Trust Bank intends to launch its pre-paid debit card product. This is initially aimed at helping customers of debt management companies and is of real interest to us as it provides bank account facilities without extending credit.

### **Investment Banking Division**

Arbuthnot Securities recorded a pre-tax loss attributable to group shareholders of £3.1m. This was caused largely by the reduced number of corporate finance transactions. 31 deals were completed in 2008, compared with 49 in 2007, whilst IPO's fell from 5 in 2007 to 2 in 2008. In addition, the volatile markets had an adverse impact on the trading book. By the year end, new management had reduced the book size by 84% and cut costs, so that the business enters 2009 in better shape and is taking the opportunity provided by the tough market to enhance the quality of the team by hiring from competitors. On a positive note, our retained corporate client list grew by 14% to close the year at 97, and our largest client has recently been admitted to the FTSE 100 index.

### **Switzerland**

Progress was made in applying for a full Swiss banking licence although due to the market turmoil, this progress has been slowed. We are reviewing whether it is now appropriate to commit the capital required for a full banking licence. A number of options are being considered including introducing a partner.

### **Group**

Overall, Arbuthnot Banking Group has emerged from a year of unprecedented challenge in good shape and with each of its banking businesses well placed for growth in 2009. Furthermore, we have been able to continue our policy of paying good dividends, albeit that the final dividend for 2008 has been reduced to reflect the lower profitability and general market conditions. It demonstrates the benefit of our policy of diversification within the Group, and represents some reward for our emphasis on prudence and conservatism in our banking operations. This result has been achieved despite having to bear the burden of the Financial Services Compensation Scheme, a subsidy from conservative to risky banks, which affected our profits by £0.5m.

## **Board Changes**

There have been a number of changes to the Arbutnot Banking Group PLC Board. Neil Kirton was appointed Chief Executive of Arbutnot Securities and joined the Board in June 2008.

James Cobb was appointed Group Finance Director and joined the Board in November 2008.

I also thanked Mark Brown, John Reed and Paul Sheriff for the contributions they have made to the business as they stepped down from the Board in 2008.

These results once again reflect the continuing hard work and resilience of our employees who have risen to the challenges that the current environment has presented. On behalf of the Board I extend our thanks to all staff for their commitment and contributions made to the Group in 2008.

## **Dividend**

The Board is proposing a final dividend of 10.5p which is in line with the interim dividend, making a total dividend for the year of 21p (2007: 33p).

If approved, the final dividend will be paid at 15 May 2009 to shareholders on the register at 17 April 2009.

## **Outlook**

The prospects for the UK economy, for 2009 at least, appear to be bleak. However, the outlook for the two banking businesses appears more optimistic. Both are well-capitalised and liquid. Secure Trust Bank is cautiously re-entering the consumer lending market and will shortly launch its pre-paid debit card. Both banks are increasing their customer deposits. Despite the economic climate, therefore, the prospects for the banking businesses in 2009 look positive.

Arbutnot Securities continues to face severely challenging market conditions. Nevertheless, we expect that the actions management is taking to address performance will lead to a return to profitability in 2009.

Encouragingly, all three of our businesses are trading ahead of the corresponding period last year.

## Business review

### Private Banking – Arbuthnot Latham

	2008	2007
Operating income	£14.6m	£17.3m
Operating expenses	£13.4m	£15.1m
Profit before tax	£2.1m	£1.5m
Customer loans	£159.9m	£146.6m
Customer deposits	£272.6m	£273.6m
Total assets	£311.4m	£309.2m
Net interest margin	3.3%	3.5%
Loan to deposit ratio	1 : 1.7	1 : 1.9
Cost income ratio	0.85	0.92

In the difficult financial market experienced in 2008, the primary objective for Arbuthnot Latham was to weather the storm. To achieve this, the strategy comprised two main components: to preserve deposits; and to dispose of non-core activities.

We are particularly pleased to report that our deposits remain broadly unchanged during the year. Against the background of dramatic falls in interest rates and depositors' increasing concern about the safety of their deposits, this was a very positive result.

We completed the sale of our pensions administration business and of Arbuthnot Commercial Finance during the year. The effect of the disposals was to contribute £2.2m to the group's profit in 2008. We have reinvested £0.4m of this gain by way of restructuring actions to leave us with a much more focussed business.

We have maintained our prudent policy of funding all loans from customer deposits, and of lending no more than 50% to 60% against our deposit book. During the year, we have been able to add a number of high quality, well secured loans to our book, consequently the loan book increased by 9% to £159.9m.

As a result of these actions, we ended the year with a strong capital position, high liquidity reserves, a robust funding base and a pre-tax profit. This was achieved despite the unbudgeted charge to the income statement of £0.45m being our contribution to the Financial Services Compensation Scheme levy.

Although management's focus was on underpinning the business, a number of marketing initiatives were successfully launched, including new deposit products, our Private Life financial magazine and our specialist offering to the horseracing community.

We have begun 2009 in a strong position and with a positive outlook for the business. Deposits remain strong, and we are seeing a good pipeline of quality lending opportunities at attractive rates.

## Retail Banking – Secure Trust Bank

	2008	2007
Operating income	£19.7m	£22.8m
Operating expenses	£14.0m	£16.8m
Profit before tax	£7.3m	£4.6m
Customer loans - unsecured (Gross)	£16.7m	£21.2m
Customer numbers ('000)	40	44
Net interest margin	18.2%	17.8%
Cost income ratio	0.63	0.68

Despite unprecedented turmoil in the financial markets, the turnaround in the Retail Banking Division continued strongly in 2008. Profits before tax of £7.3m up 60% on the previous year reflecting the positive impact of the strategy put in place by the new management team in 2007. The sale of the loss-making insurance broking business (held in OBC Insurance Consultants), including all the associated people and the bulk of the branch network, to Swinton generated a gain on sale of £2.4m, which coupled with a continued focus on cost management had a significantly positive impact on the cost income ratio which reduced from 68% at the end of 2007 to 63% at the end of 2008. The Moneyway brand is now fully established and will increase in prominence nationally rather than just regionally during 2009.

The decision to outsource part of the unsecured lending activity to Everyday Loans continued to deliver benefit throughout the year with the impairment charge reducing from £1.4m in 2007 to £0.5m in 2008, a reduction of 63%. This outsourcing prevented Secure Trust Bank from suffering losses associated with lending in the run-up to the recession when most lenders rates did not adequately reflect the real risk. This, coupled with the dramatic reduction in competition in the lending market as a result of the credit crunch in the second half of the year, has provided an excellent opportunity to return lending back in house and the business will be cautiously returning to the consumer finance market with appropriate pricing levels.

OneBill customer numbers have continued to decline. However, a number of important efficiencies have been delivered in the OneBill processing environment. The focus on new customer acquisition will now be via customer referral and affinity distribution opportunities.

Mortgage broking was anticipated to make an important contribution to the overall income statement in the year, but the unprecedented decline in the housing and mortgage market meant that the final outcome was below expectations. As stated, this did not prevent a significant uplift in overall profits for the business. Costs in the mortgage broking area will continue to be appropriately managed until the market picks up again.

During the year the division has evolved to be much more efficient and profitable. The focus of 2009 will be on acquiring new customers and diversifying sources of revenue. Secure Trust Bank has become a Principal Member of MasterCard International in the year as well as acquiring an e-Money Licence and this will enable the business to launch a new Prepaid card linked to a current account in 2009. We also launched our motor finance business and completed the purchase of a consumer loan portfolio from LV in February of 2009. The portfolio was purchased at a discount for £16.7m and none of the accounts were in arrears. Given the advantage of the group's funding position, the division will be seeking to exploit opportunities within the consumer finance market, that arise from both reduced competition and a return to appropriate levels of pricing.

## Investment Banking - Arbuthnot Securities

	2008	2007
Gains less losses from dealing in securities	(£3.1)m	£4.3m
Corporate finance fees	£7.2m	£19.2m
Brokerage and retainer fees	£4.7m	£5.8m
Operating expenses	£13.3m	£21.3m
(Loss) / Profit before tax	(£5.2)m	£8.1m
Corporate clients	97	85
Aggregate book	£4.6m	£28.2m
Headcount	72	78

Market conditions in 2008 have been considerably more difficult than in recent years, resulting in income falling by 70% from 2007 levels. However, although the reduction in income has been disappointing, it is encouraging that the business continues to attract corporate clients, with total corporate clients increasing by 14% to 97 during the year. We were also pleased to see our largest client recently admitted to the FTSE 100 index.

Corporate finance fees at £7.2m are £12.0m lower than in the previous year, primarily due to the disruption of the credit markets which affected the mergers and acquisitions volume and the reduction in IPO activity.

The FTSE all share index ended the year down 33% and the FTSE AIM index ended the year down 62%. However, even though market values have dropped by these levels, commission income for the year has held up reasonably well, down just 15% from prior year.

The falling market values throughout the year have contributed to the business making a loss of £3.1m on its trading positions, which was primarily due to large positions in a small number of stocks that have now been reduced or exited. Overall, the trading books have been reduced from an aggregate value of £28.2m at the start of the year to £4.6m at the end.

The 2008 results have suffered from the slowdown in corporate activity and the losses arising from some large trading positions. However, with trading books now reduced, the potential for such losses to recur has now been significantly reduced. In addition to reducing the trading book, the business's overdraft has now been repaid.

Although cost control is a focus, the business is continuing to hire talented individuals, in order to ensure that existing clients receive the highest quality service, whilst at the same time positioning the business for a recovery in the markets.

## Financial review

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

### Highlights

#### *Summarised Income Statement*

£'000	2008	2007
Net interest income	11,404	11,444
Net fee and commission income	34,280	52,907
Gains less losses from dealing in securities (Group and Arbuthnot Securities)	(3,818)	4,442
Operating income	41,866	68,793
Operating expenses	(47,153)	(57,969)
FSCS levy	(491)	(8)
Gain on sale of business assets	3,077	-
Gain on sale of subsidiary	1,528	-
Impairment losses on loans and advances	(977)	(2,237)
(Loss) / profit on continuing activities before tax	(2,150)	8,579
Basic earnings per share (pence)	3.5	23.8

We were pleased to have traded profitably when our interim results were published. It was clear at that time the outlook for Arbuthnot Securities was uncertain and would be contingent, as ever, on the outcome of particular corporate finance transactions. The second half saw a severe downturn in market conditions. This has a major impact on its two major sources of revenues as corporate finance transactions dried up and falling asset valuations had a negative impact on the mark to market levels of our trading book and resulted in us recording a pre-tax loss of £2.15m. However, after taxation and minority interests we were pleased to have achieved positive earnings per share of 3.5p.

The instability in the financial sector also brought the issue of the Financial Services Compensation Scheme into focus as the government was forced to bail out those banks which had a more aggressive approach to their funding strategies. As a result our required levy was £491k across the group.

Throughout the year the group took the opportunity to dispose of a number of non core business assets. Arbuthnot Latham sold its pensions administration and its debt factoring business (Arbuthnot Commercial Finance), the combined gains on sale totalling £2.2m. Secure Trust sold its insurance brokerage business to Swinton and recognised a gain of £2.4m.

The disposals had the impact of reducing the associated operating income and expenses lines but will be earnings enhancing as they were loss making.

However, given the need to reposition the businesses for the future, a total of £1.4m of these gains was reinvested back into the business by way of restructuring costs.

#### *Summarised Balance Sheet*

£'000	2008	2007
<b>Assets</b>		
Loans and advances to customers	163,350	170,130
Liquid assets	157,215	162,534
Other assets	39,190	81,439
Total assets	359,755	414,103
<b>Liabilities</b>		
Customer deposits	291,742	300,920
Other liabilities	33,599	70,697
Total liabilities	325,341	371,617
Equity	34,414	42,486
Total equity and liabilities	359,755	414,103

## Balance Sheet Strength

Total assets of the group decreased by 13% to £359.8 million (2007: £414.1 million) as a result of the sale of businesses during the year. Net assets of the group reduced to £34.4m (2007: £42.5m).

The group continues to adopt a conservative approach to its lending policy remaining entirely funded by customer deposits. The turmoil with the financial markets saw customers seeking protection by diversifying their deposits to the levels guaranteed by the Government Scheme.

Despite this we are pleased to note that the deposit base remained robust and was only down 3% over the year.

The group's total liquid resources (including longer duration certificates of deposit) remain strong at £157.2 million (2007: £162.5 million).

## Segmental Analysis

The segmental analysis in note 33 to the Consolidated Financial Statements to the Annual Report highlights the disclosures required under IAS 14, 'Segmental Reporting'. The primary business segments are Private Banking (Arbuthnot Latham and Arbuthnot Commercial Finance), International Private Banking (Arbuthnot AG), Retail Banking (Secure Trust Bank and OBC Insurance Consultants), Investment Banking (Arbuthnot Securities) and Group costs. 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 (including Arbuthnot Commercial Finance to 31 July 2008)

£'000	2008	2007
Net interest income	8,225	7,921
Net fee and commission income	6,367	9,343
Operating income	14,592	17,264
Gain on sale of business assets	658	-
Gain on sale of Arbuthnot Commercial Finance Limited	1,528	-
Operating expenses	(13,352)	(15,062)
Impairment losses	(444)	(740)
Financial Services Compensation Scheme Levy	(450)	(8)
Restructuring costs	(413)	-
Profit before tax	2,119	1,454

Profit before tax increased to £2.1 million largely due to the gains on sale, however the business reinvested £0.9 million of this into restructuring and to fund the Financial Services Compensation Scheme levy.

Operating income fell by 15% as a result of the sale of Arbuthnot Commercial Finance Limited in July 2008. The net interest income remained broadly unchanged from 2007. The fee and commission decrease is primarily due to the sale of businesses and the non recurrence of fees earned on property transactions in 2007. Operating expenses fell by 11% as a result of the sale of Arbuthnot Commercial Finance and a continued focus on cost cutting. Despite the additional contribution to the Financial Services Compensation Scheme Levy, profit before tax increased to £2.1 million compared to £1.5 million on 2007, an increase of 46%.

£'000	2008	2007
Assets		
Advances (including Group companies)	159,908	146,551
Liquid assets	132,236	140,189
Other assets	19,219	22,486
Total assets	311,363	309,226
Liabilities		
Customer deposits (including Group companies)	272,614	273,580
Other liabilities	15,353	8,488
Total liabilities	287,967	282,068
Capital	23,396	27,158
	311,363	309,226

Total assets increased by 1% to £311.4 million (2007: £309.2 million) with loans increasing by 9%. The customer deposit base of Arbuthnot Latham accounts for 93% of the Group's total customer deposits and these have remained broadly unchanged during the year.

As at 31 December, Arbuthnot Latham had a Core Tier 1 ratio of 9.6%.

Arbuthnot Latham's liquidity remained strong throughout 2008 and committed bank lines remained unutilised throughout the year. The secured loan book at Arbuthnot Latham, representing the majority of the total loan book, had an average loan to collateral value of 44% at the end of 2008.

### International Private Banking - Arbuthnot AG

Costs associated with establishing the Swiss bank were £1.2 million in 2008 (2007: £0.3 million). The increase is due to the fact that the operation was only established in the last quarter of 2007.

## Retail Banking – Secure Trust Bank

£'000	2008	2007
Net interest income	4,214	4,600
Net fee and commission income	15,498	18,236
Operating income	19,712	22,836
Gain on sale of business assets	2,419	-
Operating expenses	(13,960)	(16,839)
Impairment losses	(533)	(1,447)
Financial Services Compensation Scheme Levy	(41)	-
Restructuring costs	(320)	-
Profit before tax	7,277	4,550

Profit before tax increased 60% to £7.3 million. This included £2.4 million of gain on disposals of the insurance brokerage business to Swinton but £0.3 million of this was used to restructure the business for the future. Operating income fell by 14% to £19.7 million and operating expenses (before restructuring and investment costs) falling by 17% as a result of the sale of business assets.

The business also continued to focus on cost control and as a result its cost:income ratio improved from 80% to 63%. Impairment losses fell by 63% to £0.5 million as a result of the reduction in the unsecured loan book.

The unsecured loan book reduced by 21% from £21.2 million to £16.7 million as a result of the continued broking relationship with EveryDay Loans which ceased in the second half of the year. The exposure to unsecured lending, including impairment provisions, reduced by 25% to £12.3 million.

## Investment Banking - Arbuthnot Securities

£'000	2008	2007
Net interest income	(486)	(324)
Net fee and commission income	12,415	25,328
Gains less losses from dealing in securities	(3,116)	4,342
Operating income	8,813	29,346
Operating expenses	(13,347)	(21,270)
Restructuring costs	(691)	-
(Loss) / profit before tax	(5,225)	8,076

Operating income fell 70% to £8.8 million, as a result of a reduced number of corporate finance transactions and the impact of adverse volatility on the trading book, with expenses falling 37% to £13.3 million due to reduction in bonus payments. Loss before tax fell to £5.2 million in 2008 (2007: Profit before tax £8.1 million).

The minority interest remained unchanged at 40.4% and therefore the group's resultant share of this loss is 59.6%.

## Group & Other Costs

£'000	2008	2007
Operating Income	(287)	100
Group costs	(2,921)	(3,022)
Group head office property costs	(989)	(1,560)
Subordinated loan stock	(964)	(753)
Total group & other costs	(4,874)	(5,335)
Loss before tax	(5,161)	(5,235)

Total group and other costs decreased by 9% in 2008 primarily due to decreased property costs and a reduced level of bonuses awarded. Group costs decreased by 3% to £2.9 million in 2008.

## 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 the 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 32.

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 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, minority 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 and the regulatory capital requirements for all entities have subsequently been agreed. All regulated entities have complied with all of the externally imposed capital requirements to which they are subject.

£'000	2008
Core Tier 1 capital	34,473
Tier 1 capital after deductions	31,197
Tier 2	14,338
<b>Total capital</b>	<b>45,535</b>
<b>Core Tier 1 capital</b>	<b>10.5%</b>

## 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 3 to the financial statements. Credit risk is managed through the Credit Committees of Secure Trust Bank and Arbuthnot Latham & Co., with significant exposures also being approved by the Group Risk Committee. Of the total gross loan book of £168.5 million at 31 December 2008, some £16.9 million represents largely unsecured loans to customers of Secure Trust Bank and £151.6 million represents the lending portfolio of Arbuthnot Latham, most of which is well secured against cash, property or other assets. A provision of £5.1 million (3% 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. 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 10.5 pence per share to be paid on 15 May 2009, giving a total dividend for the year of 21 pence (2007: 33 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 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 changes in equity

Consolidated	Attributable to equity holders of the Company					Total £000
	Share capital £000	Share premium account £000	Other reserves £000	Retained earnings £000	Minority interest £000	
	<b>Balance at 1 January 2007</b>	150	21,085	1,402	16,721	
Purchase of minority interest in Arbutnot Commercial Finance Limited	-	-	-	-	(73)	(73)
Sale of minority interest in Arbutnot Securities Limited	-	-	-	-	64	64
Profit for 2007	-	-	-	3,555	2,232	5,787
Final dividend relating to 2006	-	-	-	(3,287)	(591)	(3,878)
Interim dividend relating to 2007	-	-	-	(1,570)	-	(1,570)
<b>At 1 January 2008</b>	150	21,085	1,402	15,419	4,430	42,486
Revaluation of freehold premises - net of deferred tax	-	-	(974)	-	-	(974)
Revaluation reserve realised on disposal of freehold premises	-	-	(42)	42	-	-
Foreign exchange translation reserve	-	-	(299)	-	-	(299)
Sale of Arbutnot Commercial Finance Limited	-	-	-	-	(26)	(26)
Purchase of own shares	-	-	-	(445)	-	(445)
Profit / (loss) for 2008	-	-	-	519	(1,517)	(998)
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)
<b>At 31 December 2008</b>	150	21,085	87	10,812	2,280	34,414

Company	Attributable to equity holders of the Company				Total £000
	Share capital £000	Share premium account £000	Other reserves £000	Retained earnings £000	
	<b>Balance at 1 January 2007</b>	150	21,085	20	
Profit for 2007	-	-	-	782	782
Final dividend relating to 2006	-	-	-	(3,287)	(3,287)
Interim dividend relating to 2007	-	-	-	(1,570)	(1,570)
<b>At 1 January 2008</b>	150	21,085	20	5,000	26,255
Purchase of own shares	-	-	-	(445)	(445)
Profit for 2008	-	-	-	3,650	3,650
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)
<b>At 31 December 2008</b>	150	21,085	20	3,482	24,737

## Company balance sheet

	Note	At 31 December	
		2008 £000	2007 £000
<b>Current assets</b>			
Due from subsidiary undertakings		7,414	1,607
Financial investments	17	364	1,773
Other debtors		2,087	2,145
<b>Non-current assets</b>			
Shares in subsidiary undertakings	32	28,524	29,121
Property, plant and equipment	19	74	102
Due from subsidiary undertakings		6,350	8,350
<b>Total assets</b>		<b>44,813</b>	<b>43,098</b>
<b>Current liabilities</b>			
Borrowings		2,609	1,276
Due to subsidiary undertakings		2,664	3,650
Accruals		831	1,209
<b>Non-current liabilities</b>			
Debt securities in issue	24	13,972	10,708
<b>Total liabilities</b>		<b>20,076</b>	<b>16,843</b>
<b>Net assets</b>		<b>24,737</b>	<b>26,255</b>
<b>Capital and reserves</b>			
Share capital	27	150	150
Share premium account	27	21,085	21,085
Capital redemption reserve	28	20	20
Retained earnings	28	3,482	5,000
<b>Equity shareholders' funds</b>		<b>24,737</b>	<b>26,255</b>

The Company has elected to take the exemption under section 230 of the Companies Act 1985 to not present the parent Company profit and loss account. The profit for the parent Company for the year is presented in note 28 and in the Statement of changes in equity.

## Consolidated cash flow statement

	Note	Year ended 31 December	
		2008 £000	2007 £000
<b>Cash flows from operating activities</b>			
Interest and similar income received		23,663	23,758
Interest and similar charges paid		(12,185)	(12,314)
Fees and commissions received		34,280	52,907
Net trading and other income		(3,818)	4,442
Recoveries on loans previously written off		213	500
Cash payments to employees and suppliers		(45,636)	(58,104)
Taxation received / (paid)		1,280	(6,996)
Cash flows from operating (losses) / profits before changes in operating assets and liabilities		(2,203)	4,193
Changes in operating assets and liabilities:			
- net decrease / (increase) in trading securities		15,478	(11,173)
- net decrease / (increase) in loans and advances to customers		6,826	(18,414)
- net decrease / (increase) in other assets		17,545	(11,149)
- net (decrease) / increase in deposits from other banks		(9,828)	4,997
- net (decrease) / increase in amounts due to customers		(9,178)	30,472
- net (decrease) / increase in other liabilities		(26,598)	11,870
Net cash (outflow) / inflow from operating activities		(7,958)	10,796
<b>Cash flows from investing activities</b>			
Disposal of financial investments		2,767	3,772
Purchase of financial investments		-	(4,429)
Purchase of minority interest		-	(110)
Disposal of minority interest		-	118
Purchase of computer software	18	(255)	(493)
Purchase of property, plant and equipment	19	(1,318)	(2,529)
Proceeds from disposal of businesses		3,565	-
Disposal of subsidiaries, net of cash and cash equivalents disposed	34	2,996	-
Proceeds from sale of property, plant and equipment		659	501
Purchases of debt securities		(274,620)	(301,560)
Proceeds from sale of debt securities		251,305	271,597
Net cash from investing activities		(14,901)	(33,133)
<b>Cash flows from financing activities</b>			
Purchase of treasury shares		(445)	-
Dividends paid		(5,330)	(5,448)
Net cash used in financing activities		(5,775)	(5,448)
<b>Net decrease in cash and cash equivalents</b>		<b>(28,634)</b>	<b>(27,785)</b>
Cash and cash equivalents at beginning of year		55,933	83,718
<b>Cash and cash equivalents at end of year</b>	30	<b>27,299</b>	<b>55,933</b>

## Company cash flow statement

	Note	Year ended 31 December	
		2008 £000	2007 £000
<b>Cash flows from operating activities</b>			
Dividends received from subsidiaries		5,627	4,545
Interest and similar income received		912	622
Interest and similar charges paid		(1,461)	(753)
Net trading and other income		(702)	448
Cash payments to employees and suppliers		(1,332)	(5,505)
Taxation received		1,632	1,584
Cash flows from operating profits before changes in operating assets and liabilities		4,676	941
Changes in operating assets and liabilities:			
- net decrease / (increase) in group company balances		(6,793)	1,706
- net decrease / (increase) in other assets		58	497
- net increase in other liabilities		(378)	(1,648)
Net cash (outflow) / inflow from operating activities		(2,437)	1,496
<b>Cash flows from investing activities</b>			
Loans to subsidiary companies		2,000	(1,000)
Acquisition of subsidiary		-	(42)
Disposal of subsidiaries, net of cash and cash equivalents disposed		2,842	-
Purchase of minority interest		-	(110)
Disposal of minority interest		-	118
Disposal of financial investments		1,409	3,772
Purchase of financial investments		-	(1,955)
Disposal of property, plant and equipment		25	69
Purchase of property, plant and equipment	19	(3)	(43)
Net cash from investing activities		6,273	809
<b>Cash flows from financing activities</b>			
Purchase of treasury shares		(445)	-
Increase in borrowings		-	1,276
Dividends paid		(4,724)	(4,857)
Net cash used in financing activities		(5,169)	(3,581)
<b>Net decrease in cash and cash equivalents</b>		(1,333)	(1,276)
Cash and cash equivalents at beginning of year		(1,276)	-
<b>Cash and cash equivalents at end of year</b>		(2,609)	(1,276)

## Principal accounting policies

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

### 1. Basis of presentation

The group's consolidated financial statements and the Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs as adopted by the EU), IFRIC Interpretations and the Companies Act 1985 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.

#### 1.1a) Interpretations and amendments effective in 2008

- IFRIC 14, 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction', provides guidance on assessing the limit in IAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. This interpretation does not have a material impact on the group's financial statements.
- IFRIC 11, 'IFRS 2 – Group and treasury share transactions', provides guidance on whether share-based transactions involving treasury shares or involving group entities (for example, options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent and group companies. This interpretation does not have a material impact on the group's financial statements.
- IAS 39 (Amendment), 'Financial instruments: Recognition and measurement', permits the reclassification of financial assets classified as held for trading (but not those voluntarily designated as at fair value through profit and loss under the fair value option) in certain situations. This interpretation does not have a material impact on the group's financial statements.

#### 1.1b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the group

The following standards and amendments to existing standards have been published and are mandatory for the group's accounting periods beginning on or after 1 January 2009 or later periods, but the group has not early adopted them:

- IAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009). The amendment requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs will be removed. The group will apply IAS 23 (Amendment) retrospectively from 1 January 2009 but it is currently not applicable to the group as there are no qualifying assets.
- IAS 1 (Revised), 'Presentation of financial statements' (effective from 1 January 2009). The revised standard will prohibit the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, re 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity will be required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning comparative period in addition to the current requirement to present balance sheets at the end of the current period and comparative period. The group will apply IAS 1 (Revised) from 1 January 2009. It is likely that both the income statement and statement of comprehensive income will be presented as performance statements.
- IFRS 2 (Amendment), 'Share-based payment' (effective from 1 January 2009). The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The group will apply IFRS 2 (Amendment) from 1 January 2009. It is not expected to have a material impact on the group's financial statements.
- IFRS 8, 'Operating segments' (effective from 1 January 2009). IFRS 8 replaces IAS 14 and aligns segment reporting with the requirements of the US standard SFAS 131, 'Disclosures about segments of an enterprise and related information'. The new standard requires a 'management approach', under which segment information is presented on the same basis as that used for internal reporting purposes. The group will apply IFRS 8 from 1 January 2009. The expected impact is still being assessed in detail by management, but it appears likely that the reportable segments will remain unchanged. As goodwill is allocated to groups of cash-generating units based on segment level, the change will also require management to reallocate goodwill to the newly identified operating segments. Management does not anticipate that this will result in any material impairment to the goodwill balance.

- IAS 32 (Amendment), 'Financial instruments: Presentation', and IAS 1 (Amendment), 'Presentation of financial statements' – 'Puttable financial instruments and obligations arising on liquidation' (effective from 1 January 2009). 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. The group will apply the IAS 32 and IAS 1 (Amendment) from 1 January 2009. It is not expected to have any impact on the group's financial statements.
- IFRS 1 (Amendment) 'First time adoption of IFRS', and IAS 27 'Consolidated and separate financial statements' (effective from 1 January 2009). The amended standard allows first-time adopters to use a deemed cost of either fair value or the carrying amount under previous accounting practice to measure the initial cost of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements. The amendment also removes the definition of the cost method from IAS 27 and replaces it with a requirement to present dividends as income in the separate financial statements of the investor. The amendment will not have any impact on the group's financial statements.
- IAS 27 (Revised), 'Consolidated and separate financial statements', (effective from 1 July 2009). The revised standard requires the effects of all transactions with noncontrolling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognised in profit or loss. The group will apply IAS 27 (Revised) prospectively to transactions with non-controlling interests from 1 January 2010.
- IFRS 3 (Revised), 'Business combinations' (effective from 1 July 2009). The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, 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 income statement. 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. The group will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010.
- IFRS 5 (Amendment), 'Non-current assets held-for-sale and discontinued operations' (and consequential amendment to IFRS 1, 'First-time adoption') (effective from 1 July 2009). The amendment is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that all of a subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRSs. The group will apply the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.
- IAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. The definition of borrowing costs has been amended so that interest expense is calculated using the effective interest method defined in IAS 39 'Financial instruments: Recognition and measurement'. This eliminates the inconsistency of terms between IAS 39 and IAS 23. The group will apply the IAS 23 (Amendment) prospectively to the capitalisation of borrowing costs on qualifying assets from 1 January 2009.
- IAS 28 (Amendment), 'Investments in associates' (and consequential amendments to IAS 32, 'Financial Instruments: Presentation', and IFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. An investment in associate is treated as a single asset for the purposes of impairment testing. Any impairment loss is not allocated to specific assets included within the investment, for example, goodwill. Reversals of impairment are recorded as an adjustment to the investment balance to the extent that the recoverable amount of the associate increases. The group will apply the IAS 28 (Amendment) to impairment tests related to investments in subsidiaries and any related impairment losses from 1 January 2009.
- IAS 36 (Amendment), 'Impairment of assets' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. Where fair value less costs to sell is calculated on the basis of discounted cash flows, disclosures equivalent to those for value-in-use calculation should be made. The group will apply the IAS 28 (Amendment) and provide the required disclosure where applicable for impairment tests from 1 January 2009.
- IAS 38 (Amendment), 'Intangible assets' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. A prepayment may only be recognised in the event that payment has been made in advance of obtaining right of access to goods or receipt of services. The group will apply the IAS 38 (Amendment) from 1 January 2009.
- IAS 19 (Amendment), 'Employee benefits' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008.
- The amendment clarifies that a plan amendment that results in a change in the extent to which benefit promises are affected by future salary increases is a curtailment, while an amendment that changes benefits attributable to past service gives rise to a negative past service cost if it results in a reduction in the present value of the defined benefit obligation.

- The definition of return on plan assets has been amended to state that plan administration costs are deducted in the calculation of return on plan assets only to the extent that such costs have been excluded from measurement of the defined benefit obligation.
- The distinction between short term and long term employee benefits will be based on whether benefits are due to be settled within or after 12 months of employee service being rendered.
- IAS 37, 'Provisions, contingent liabilities and contingent assets, requires contingent liabilities to be disclosed, not recognised. IAS 19 has been amended to be consistent.

The group will apply the IAS 19 (Amendment) from 1 January 2009.

- IAS 39 (Amendment), 'Financial instruments: Recognition and measurement' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008.
- This amendment clarifies that it is possible for there to be movements into and out of the fair value through profit or loss category where a derivative commences or ceases to qualify as a hedging instrument in cash flow or net investment hedge.
- The definition of financial asset or financial liability at fair value through profit or loss as it relates to items that are held for trading is also amended. This clarifies that a financial asset or liability that is part of a portfolio of financial instruments managed together with evidence of an actual recent pattern of short-term profit-taking is included in such a portfolio on initial recognition.
- The current guidance on designating and documenting hedges states that a hedging instrument needs to involve a party external to the reporting entity and cites a segment as an example of a reporting entity. This means that in order for hedge accounting to be applied at segment level, the requirements for hedge accounting are currently required to be met by the applicable segment. The amendment removes the example of a segment so that the guidance is consistent with IFRS 8, 'Operating segments', which requires disclosure for segments to be based on information reported to the chief operating decision-maker.
- When remeasuring the carrying amount of a debt instrument on cessation of fair value hedge accounting, the amendment clarifies that a revised effective interest rate (calculated at the date fair value hedge accounting ceases) are used.

The group will apply the IAS 39 (Amendment) from 1 January 2009. It is not expected to have an impact on the group's income statement.

- IAS 1 (Amendment), 'Presentation of financial statements' (effective from 1 January 2009). The amendment is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that some rather than all financial assets and liabilities classified as held for trading in accordance with IAS 39, 'Financial instruments: Recognition and measurement' are examples of current assets and liabilities respectively. The group will apply the IAS 39 (Amendment) from 1 January 2009. It is not expected to have an impact on the group's financial statements.
- There are a number of minor amendments to IFRS 7, 'Financial instruments: Disclosures', IAS 8, 'Accounting policies, changes in accounting estimates and errors', IAS 10, 'Events after the reporting period', IAS 18, 'Revenue' and IAS 34, 'Interim financial reporting', which are part of the IASB's annual improvements project published in May 2008 (not addressed above). These amendments are unlikely to have an impact on the group's accounts and have therefore not been analysed in detail.
- IFRIC 16, 'Hedges of a net investment in a foreign operation' (effective from 1 October 2008). IFRIC 16 clarifies the accounting treatment in respect of net investment hedging. This includes the fact that net investment hedging relates to differences in functional currency not presentation currency, and hedging instruments may be held anywhere in the group. The requirements of IAS 21, 'The effects of changes in foreign exchange rates', do apply to the hedged item. The group will apply IFRIC 16 from 1 January 2009. It is not expected to have a material impact on the group's financial statements.
- IFRIC 15, 'Agreements for construction of real estates' (effective from 1 January 2009). The interpretation clarifies whether IAS 18, 'Revenue', or IAS 11, 'Construction contracts', should be applied to particular transactions. It is likely to result in IAS 18 being applied to a wider range of transactions. IFRIC 15 is not relevant to the group or company's operations.

## 1.2. 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 minority interest. The excess of the cost of acquisition over the fair value of the group's shares of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

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

### (b) Transactions and minority interests

The group applies a policy of treating transactions with minority interests as transactions with parties external to the group. Disposals to minority interests results in gains and losses for the group that are recorded in the income statement. Purchases from minority 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.

### 1.3. Segment reporting

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

### 1.4. Foreign currency translation

#### *(a) Functional and presentation 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 presentation currency.

#### *(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions 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 income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

#### *(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 presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement 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.

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 income statement 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.

### 1.5. Interest income and expense

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

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

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

### 1.6. 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.

### 1.7. 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.

## 1.8. Financial assets

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

### *(a) Financial assets at fair value through profit or loss*

This category comprises financial assets held for trading and listed securities. Purchases and sales of financial assets at fair value through profit or loss are recognised on trade-date — the date on which the group commits to purchase or sell the asset. Financial assets 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 and held-to-maturity investments 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.

### *(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 investments and therefore the the group has valued them using appropriate valuation methodologies.

Other financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are de-recognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership.

## 1.9. Offsetting financial instruments

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

## 1.10. 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.

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

### *(b) Assets classified as available for sale*

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as 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 income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

*(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. In subsequent years, the asset is considered to be past due and disclosed only if renegotiated.

### **1.11. Intangible assets**

*(a) Goodwill*

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

*(b) Computer software*

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

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

### **1.12. 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 amount. These are included in the income statement.

### **1.13. Leases**

*(a) As a lessor*

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.

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 income statement on a straight line basis over the term of the lease.

### **1.14. Cash and cash equivalents**

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

### **1.15. 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 balance sheet 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 income statement, 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.

#### **1.16. Deferred tax**

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

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

#### **1.17. Deposits**

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

#### **1.18. 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.

#### **1.19 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.

## 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.

### Impairment losses on loans and advances

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

### Taxation

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

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

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

#### a.) Credit risk

The group takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the balance sheet date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the group's portfolio, could result in losses that are different from those provided for at the balance sheet date. Credit risk is managed through the Credit Committees of the banking subsidiaries, with significant exposures also being approved by the group Risk Committee.

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

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

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 capital from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances. Repossessed collateral, not readily convertible into cash, is made available for sale in an orderly fashion, with the proceeds used to reduce or repay the outstanding indebtedness. Where excess funds are available after the debt has been repaid, they are available either for other secured lenders with lower priority or are returned to the customer.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit.

With respect to credit risk on commitments to extend credit, the group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards.

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Credit risk exposures relating to on-balance sheet assets are as follows:		
Loans and advances to banks	15,930	39,708
Loans and advances to customers – Arbutnot Latham	150,799	135,052
Factoring debtors – Arbutnot Commerical Finance	-	18,455
Loans and advances to customers – Secure Trust Bank	12,551	16,623
Debt securities held-to-maturity	137,916	122,306
Financial investments	3,434	6,201
Other assets	18,169	35,381
Credit risk exposures relating to off-balance sheet assets are as follows:		
Financial guarantees	816	1,131
Loan commitments and other credit related liabilities	15,596	15,570
<b>At 31 December</b>	<b>355,211</b>	<b>390,427</b>

The above table represents the maximum credit risk exposure (net of impairment) to the group at 31 December 2008 and 2007 without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures are based on the net carrying amounts as reported in the balance sheet.

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

- Generally the exposures to banks, including debt securities, have at least an Aa3 credit rating;
- 88% of the loans and advances to customers are considered to be neither past due nor impaired (2007: 76%);
- Only 5% of the loans and advances to customers are considered individually impaired (2007: 3%);
- The average loan to collateral value of the loans and advances to customers is 44% (2007: 37%).

## **b.) Market risk**

### **Price risk**

The group is exposed to equity securities price risk because of investments held by the group and classified on the consolidated balance sheet either as available-for-sale or at fair value through the income statement. 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 13, a stress test scenario of a 10% decline in market prices would result in a £158,100 (2007: £2,020,800) decrease in the group's income and net assets on the equity trading book.

## Currency risk

The group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure for both overnight and intra-day positions, which are monitored daily. The table below summarises the group's exposure to foreign currency exchange rate risk at 31 December 2008. Included in the table overleaf are the group's assets and liabilities at carrying amounts, categorised by currency.

	GBP (£) £000	USD (\$) £000	Euro (€) £000	Other £000	Total £000
<b>At 31 December 2008</b>					
<b>Assets</b>					
Loans and advances to banks	10,372	4,410	1,092	56	15,930
Loans and advances to customers	151,154	3,159	9,037	-	163,350
Debt securities	137,916	-	-	-	137,916
Financial investments	364	57	3,013	-	3,434
Other assets	37,191	826	1,108	-	39,125
<b>Total assets</b>	<b>336,997</b>	<b>8,452</b>	<b>14,250</b>	<b>56</b>	<b>359,755</b>
<b>Liabilities</b>					
Deposits from banks	2,823	11	64	-	2,898
Deposits from customers	278,504	7,905	5,292	41	291,742
Debt securities in issue	-	-	13,972	-	13,972
Other liabilities	16,515	33	181	-	16,729
<b>Total liabilities</b>	<b>297,842</b>	<b>7,949</b>	<b>19,509</b>	<b>41</b>	<b>325,341</b>
<b>Net on-balance sheet position</b>	<b>39,155</b>	<b>503</b>	<b>(5,259)</b>	<b>15</b>	<b>34,414</b>
<b>Credit commitments</b>	<b>15,231</b>	<b>1</b>	<b>364</b>	<b>-</b>	<b>15,596</b>

The table below summarises the group's exposure to foreign currency exchange risk at 31 December 2007:

	GBP (£) £000	USD (\$) £000	Euro (€) £000	Other £000	Total £000
<b>At 31 December 2007</b>					
Total assets	390,256	12,690	11,107	50	414,103
Total liabilities	347,002	11,821	12,759	35	371,617
<b>Net on-balance sheet position</b>	<b>43,254</b>	<b>869</b>	<b>(1,652)</b>	<b>15</b>	<b>42,486</b>
<b>Credit commitments</b>	<b>15,221</b>	<b>27</b>	<b>322</b>	<b>-</b>	<b>15,570</b>

## Interest rate risk

Interest rate risk is the potential adverse impact on the group's future cash flows from changes in interest rates; and arises from the differing interest rate risk characteristics of the group's assets and liabilities. In particular, fixed rate savings and borrowing products expose the group to the risk that a change in interest rates could cause either a reduction in interest income or an increase in interest expense relative to variable rate interest flows. The group seeks to "match" interest rate risk on either side of the balance sheet. 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 both a parallel and worse case scenario of 50 basis points. This typically results in a pre-tax mismatch of £0.1m to £0.2m.

### c.) Liquidity risk

The group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns 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 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 maturity profile of the group's derivative financial instruments:

	31 December 2008			31 December 2007		
	Not more than 3 months	More than 3 months but less than 1 year	Total	Not more than 3 months	More than 3 months but less than 1 year	Total
	£000	£000	£000	£000	£000	£000
Foreign exchange swaps						
- Inflows	7,821	-	7,821	6,274	-	6,274
- Outflows	8,770	-	8,770	6,575	-	6,575
Forward foreign exchange contracts						
- Inflows	1,159	208	1,367	347	6,020	6,367
- Outflows	1,157	203	1,360	347	6,009	6,356

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

The table below analyses the discounted cashflows into relevant maturity groupings at balance sheet date:

	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Total
At 31 December 2008	£000	£000	£000	£000	£000
<b>Assets</b>					
Loans and advances to banks	15,930	-	-	-	15,930
Loans and advances to customers	104,651	36,512	22,121	66	163,350
Debt securities	63,760	74,156	-	-	137,916
Other assets	15,471	10,670	6,690	9,728	42,559
<b>Total assets</b>	<b>199,812</b>	<b>121,338</b>	<b>28,811</b>	<b>9,794</b>	<b>359,755</b>
<b>Liabilities</b>					
Deposits from banks	2,898	-	-	-	2,898
Deposits from customers	219,455	71,451	836	-	291,742
Other liabilities	14,172	1,825	732	13,972	30,701
<b>Total liabilities</b>	<b>236,525</b>	<b>73,276</b>	<b>1,568</b>	<b>13,972</b>	<b>325,341</b>
Net liquidity gap	(36,713)	48,062	27,243	(4,178)	34,414
<b>At 31 December 2007</b>					
Total assets	267,628	102,365	26,481	17,629	414,103
Total liabilities	269,791	63,333	626	37,867	371,617
<b>Net liquidity gap</b>	<b>(2,163)</b>	<b>39,032</b>	<b>25,855</b>	<b>(20,238)</b>	<b>42,486</b>

The table below analyses the contractual undiscounted cashflows into relevant maturity groupings at balance sheet date:

	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Total
At 31 December 2008	£000	£000	£000	£000	£000
<b>Liabilities</b>					
Deposits from banks	2,956	3,067	-	-	6,023
Deposits from customers	220,414	72,881	950	-	294,245
Other liabilities	13,919	1,435	386	13,972	29,712
<b>Total liabilities</b>	<b>237,289</b>	<b>77,383</b>	<b>1,336</b>	<b>13,972</b>	<b>329,980</b>

	Not more than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Total
At 31 December 2007	£000	£000	£000	£000	£000
<b>Liabilities</b>					
Deposits from banks	12,726	-	-	-	12,726
Deposits from customers	238,537	61,762	621	-	300,920
Other liabilities	48,787	1,571	5	10,708	61,071
<b>Total liabilities</b>	<b>300,050</b>	<b>63,333</b>	<b>626</b>	<b>10,708</b>	<b>374,717</b>

#### Fair values of financial assets and liabilities

With the exception of the fair value of debt securities as described in Note 24, the carrying amounts of those financial assets and liabilities not presented on the group's balance sheet at fair value are not materially different from their fair values.

#### Fiduciary activities

The group provides 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 balance sheet date, the group had investment management accounts amounting to approximately £156 million (2007: £193 million). Additionally the group provides investment advisory services.

#### d.) 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. 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 the 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 32.

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, minority 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 last conducted in December 2007 and the regulatory capital requirements for all entities have subsequently been agreed. All regulated entities have complied with all of the externally imposed capital requirements to which they are subject.

## 5. Fee and commission income

Fee and commission income includes loan-related fees of £815,000 (2007: £858,000) which have been recognised under the effective interest method.

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
<b>Fee and commission income</b>		
Trust and other fiduciary fee income	1,997	1,944
Stockbroking fee and commission income	12,818	25,850
Other fee income	20,426	26,220
	<b>35,241</b>	<b>54,014</b>

## 6. 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, had 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, had 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 the year, accruals and deferred income include a provision in respect of various warranties included in the respective Sale and Purchase Agreements, refer to Note 23 for further details.

## 7. Operating profit on ordinary activities before tax

Operating expenses comprise:	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Staff costs, including Directors:		
Wages and salaries	21,761	29,500
Social security costs	2,556	3,540
Pension costs	1,640	2,123
Amortisation of computer software (Note 18)	366	417
Depreciation (Note 19)	1,215	1,248
Profit on disposals of property, plant and equipment	(168)	(33)
Financial Services Compensation Scheme Levy	491	8
Profit on sale of minority interest	-	(54)
Charitable donations	20	35
Operating lease rentals	2,312	2,366
Restructuring costs	1,458	-
Other administrative expenses	15,993	18,827
<b>Total operating expenses</b>	<b>47,644</b>	<b>57,977</b>

The auditors' remuneration for the audit of the Company's accounts was £105,000 (2007: £41,000) and fees payable for the audit of the accounts of subsidiaries of the Company was £254,000 (2007: £316,000). Remuneration of the auditors for non-audit services was: services related to taxation £70,000 (2007: £24,000) and all other services £37,000 (2007: £46,000).

Interest income of £109,000 (2007: £134,000) has been accrued on impaired loans and advances.

## 8. Average number of employees

	2008	2007
Retail banking	257	367
Private banking	126	160
Investment banking	72	78
Group	14	16
	469	621

## 9. Income tax (credit) / expense

	2008	2007
	£000	£000
United Kingdom corporation tax at 28.5% (2007: 30%)		
Current	(916)	2,563
Deferred	52	329
Under/(over) provided in prior years	-	-
Current	(288)	(10)
Deferred	-	(90)
<b>Income tax (credit) / expense</b>	<b>(1,152)</b>	<b>2,792</b>
Tax reconciliation		
(Loss) / profit before tax	(2,150)	8,579
Tax at 28.5% (2007: 30%)	(613)	2,574
Permanent differences	(251)	303
Tax rate change	-	15
Prior period adjustments	(288)	(100)
Corporation tax (credit) / charge for the year	(1,152)	2,792

During the year, as a result of the change in UK Corporation Tax rates which was effective from 1 April 2008, deferred tax balances have been 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.

## 10. 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 £519,000 (2007: £3,555,000) by the weighted average number of ordinary shares 14,976,421 (2007: 14,943,944) in issue during the year. There is no difference between basic and fully diluted earnings per ordinary share.

## 11. Cash

	2008	2007
	£000	£000
Cash in hand included in cash and cash equivalents (Note 30)	3,369	520

## 12. Loans and advances to banks

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Placements with banks included in cash and cash equivalents (Note 30)	15,930	39,708

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:

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Aaa	5,973	3,257
Aa1	4,508	10,853
Aa2	5,381	18,832
Aa3	68	3,762
A1	-	1,004
A2	-	2,000
	15,930	39,708

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

## 13. Trading securities, all held at fair value through profit or loss

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
<i>Unlisted equity securities:</i>		
Long positions	430	1,532
<i>Listed equity securities:</i>		
Long positions	3,093	21,538
Short positions	(1,036)	(5,105)

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

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

The following table shows the group's trading book exposure to market price risk for the year ended 31 December 2007:

	<b>Highest exposure</b>	<b>Lowest exposure</b>	<b>Average exposure</b>	<b>Exposure as at 31 December</b>
Equities:				
Long	26,910	9,049	16,182	23,070
Short	(11,782)	(2,495)	(5,789)	(5,105)

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.

#### 14. Loans and advances to customers

	<b>2008</b>	<b>2007 <sup>(1)</sup></b>
	<b>£000</b>	<b>£000</b>
Gross loans and advances	168,472	175,511
Less: allowances for impairment on loans and advances (Note 15)	(5,122)	(5,381)
	<b>163,350</b>	<b>170,130</b>

(1) Certain comparative balances have been reclassified to other assets to align with current year presentation.

For a maturity profile of loans and advances to customers, refer to Note 3.

Loans and advances to customers include finance lease receivables as follows:

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Gross investment in finance lease receivables:		
- No later than 1 year	1,485	2,239
- Later than 1 year and no later than 5 years	108	154
- Later than 5 years	-	-
	<b>1,593</b>	<b>2,393</b>
Unearned future finance income on finance leases	(96)	(120)
Net investment in finance leases	<b>1,497</b>	<b>2,273</b>

The net investment in finance leases may be analysed as follows:

- No later than 1 year	1,396	2,133
- Later than 1 year and no later than 5 years	101	140
- Later than 5 years	-	-
	<b>1,497</b>	<b>2,273</b>

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Neither past due nor impaired	147,492	132,956
Past due but not impaired	12,044	37,393
Impaired	8,936	5,162
Gross	168,472	175,511
Less: allowance for impairment	(5,122)	(5,381)
Net	<b>163,350</b>	<b>170,130</b>

##### *(a) Loans and advances past due but not impaired*

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Past due up to 30 days	1,907	8,508
Past due 30 – 60 days	559	6,681
Past due 60 – 90 days	3,336	3,541
Over 90 days	6,242	18,663
Total	<b>12,044</b>	<b>37,393</b>

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.

*(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 (2007: £NIL).

*(c) Collateral held*

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Neither past due nor impaired	307,565	294,236
Past due but not impaired	31,657	43,185
Impaired	3,420	1,951
<b>Fair value of collateral held</b>	<b>342,642</b>	<b>339,372</b>

The fair value of the collateral held is £342,642,000 against £150,799,000 secured loans, giving an average loan-to-value of 44% (2007: 37%).

The gross amount of individually impaired loans and advances to customers before taking into account the cash flows from collateral held is £8,936,000 (2007: £5,162,000).

## **15. Allowances for impairment of loans and advances**

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

	<b>2008</b>	<b>2007 (1)</b>
	<b>£000</b>	<b>£000</b>
At 1 January	5,381	6,622
Adjustments for disposals	(1,264)	(2,990)
Impairment losses	977	2,237
Loans written off during the year as uncollectible	(185)	(988)
Amounts recovered during the year	213	500
<b>At 31 December</b>	<b>5,122</b>	<b>5,381</b>

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Loans and advances to customers – Arbuthnot Latham	684	536
Factoring debtors – Arbuthnot Commercial Finance	-	30
Loan and advances to customers – unsecured – Secure Trust Bank	4,438	4,815
<b>At 31 December</b>	<b>5,122</b>	<b>5,381</b>

## 16. Debt securities held-to-maturity

Debt securities represent certificates of deposit. The group's intention is to hold them to maturity and, therefore, they are stated in the balance sheet at amortised cost. Amounts include £8,000,000 (2007: £15,705,000) with a maturity, when placed, of 3 months or less included in cash and cash equivalents (Note 30).

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
At 1 January	122,306	105,961
Exchange difference on monetary assets	61	102
Additions	274,620	301,560
Redemptions	(259,071)	(285,317)
<b>At 31 December</b>	<b>137,916</b>	<b>122,306</b>

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Aaa	-	22,425
Aa1	44,868	26,385
Aa2	80,126	44,275
Aa3	12,922	1,221
A1	-	28,000
	<b>137,916</b>	<b>122,306</b>

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

## 17. Financial investments

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
<b>Group:</b>		
Financial investments comprise:		
- Listed securities (at fair value through profit and loss)	421	3,793
- Unlisted securities (available-for-sale)	3,013	2,408
Total financial investments	<b>3,434</b>	<b>6,201</b>

### 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.

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
<b>Company:</b>		
Financial investments comprise:		
- Listed securities (at fair value through profit and loss)	364	1,773

## 18. Intangible assets

<b>Goodwill</b>	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Opening net book amount	2,042	2,005
On acquisition	-	37
On disposal (Note 34)	(51)	-
<b>Closing net book amount</b>	<b>1,991</b>	<b>2,042</b>

### Computer software

#### At 1 January 2007

Cost	2,694
Accumulated amortisation	(1,674)
<b>Net book amount</b>	<b>1,020</b>

#### Year ended 31 December 2007

Opening net book amount	1,020
Additions	493
Amortisation charge	(417)
<b>Closing net book amount</b>	<b>1,096</b>

#### At 31 December 2007

Cost	3,187
Accumulated amortisation	(2,091)
<b>Net book amount</b>	<b>1,096</b>

#### Year ended 31 December 2008

Opening net book amount	1,096
Additions	255
Disposals	(145)
Amortisation charge	(366)
<b>Closing net book amount</b>	<b>840</b>

#### At 31 December 2008

Cost	3,299
Accumulated amortisation	(2,459)
<b>Net book amount</b>	<b>840</b>

### Total intangible assets:

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Goodwill	1,991	2,042
Computer software	840	1,096
<b>Net book amount at 31 December</b>	<b>2,831</b>	<b>3,138</b>

## 19. Property, plant and equipment

	Freehold land and buildings	Computer and other equipment	Operating leases	Motor vehicles	Total
Group:	£000	£000	£000	£000	£000
<b>At 1 January 2007</b>	6,581	10,614	888	1,637	19,720
Accumulated depreciation	(243)	(7,882)	(51)	(906)	(9,082)
<b>Net book amount</b>	6,338	2,732	837	731	10,638
<b>Year ended 31 December 2007</b>					
Opening net book amount	6,338	2,732	837	731	10,638
Additions	-	1,368	1,046	115	2,529
Disposals	-	-	-	(468)	(468)
Depreciation charge	(122)	(854)	(110)	(162)	(1,248)
<b>Closing net book amount</b>	6,216	3,246	1,773	216	11,451
<b>At 31 December 2007</b>					
Cost or valuation	6,581	12,008	1,934	928	21,451
Accumulated depreciation	(365)	(8,762)	(161)	(712)	(10,000)
Net book amount	6,216	3,246	1,773	216	11,451
<b>Year ended 31 December 2008</b>					
Opening net book amount	6,216	3,246	1,773	216	11,451
Additions	-	875	157	286	1,318
Revaluation	(1,380)	-	-	-	(1,380)
Disposals	(101)	(372)	-	(253)	(726)
Depreciation charge	(118)	(874)	(151)	(72)	(1,215)
<b>Closing net book amount</b>	4,617	2,875	1,779	177	9,448
<b>At 31 December 2008</b>					
Cost or valuation	5,100	12,181	2,091	554	19,926
Accumulated depreciation	(483)	(9,306)	(312)	(377)	(10,478)
Net book amount	4,617	2,875	1,779	177	9,448

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 6<sup>th</sup> 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 (2007: £0.5 million).

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

	2008 £000	2007 £000
Cost	3,980	3,980
Accumulated depreciation	(731)	(641)
<b>Net book amount</b>	3,249	3,339

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

	2008 £000	2007 £000
Cost – capitalised finance leases	206	-
Accumulated depreciation	(29)	-
<b>Net book amount</b>	177	-

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

	<b>Computer and other equipment</b>	<b>Motor vehicles</b>	<b>Total</b>
<b>Company:</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>At 1 January 2007</b>	113	259	372
Accumulated depreciation	(37)	(199)	(236)
<b>Net book amount</b>	<b>76</b>	<b>60</b>	<b>136</b>
<b>Year ended 31 December 2007</b>			
Opening net book amount	76	60	136
Additions	3	40	43
Disposals	-	(36)	(36)
Depreciation charge	(4)	(37)	(41)
<b>Closing net book amount</b>	<b>75</b>	<b>27</b>	<b>102</b>
<b>At 31 December 2007</b>			
Cost or valuation	116	164	280
Accumulated depreciation	(41)	(137)	(178)
<b>Net book amount</b>	<b>75</b>	<b>27</b>	<b>102</b>
<b>Year ended 31 December 2008</b>			
Opening net book amount	75	27	102
Additions	3	-	3
Disposals	-	(17)	(17)
Depreciation charge	(4)	(10)	(14)
<b>Closing net book amount</b>	<b>74</b>	<b>-</b>	<b>74</b>
<b>At 31 December 2008</b>			
Cost or valuation	119	-	119
Accumulated depreciation	(45)	-	(45)
<b>Net book amount</b>	<b>74</b>	<b>-</b>	<b>74</b>

## 20. Other assets

	<b>2008</b>	<b>2007 (1)</b>
	<b>£000</b>	<b>£000</b>
Trade receivables	9,965	27,538
Repossessed collateral - Available-for-sale	1,913	1,823
Prepayments and accrued income	6,291	6,020
	<b>18,169</b>	<b>35,381</b>

(1) Certain comparative balances have been reclassified from loans and advances to customers to align with current year presentation.

Prepayments and accrued income includes interest earned but not yet received on the following financial assets:

- Debt securities held to maturity - £2,723,000 (2007: £2,354,000).
- Loans and advances to banks and building societies - £9,000 (2007: £11,000).
- Loans and advances to customers - £384,000 (2007: £418,000).

## 21. Deposits from banks

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Deposits from other banks	2,898	12,726

For a maturity profile of deposits from banks, refer to Note 3.

## 22. Deposits from customers

	2008	2007
	£000	£000
Retail customers:		
- current/demand accounts	105,662	153,185
- term deposits	186,080	147,735
	291,742	300,920

Included in customer accounts are deposits of £11,185,000 (2007: £11,289,000) 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 3.

## 23. Other liabilities

	2008	2007
	£000	£000
Trade payables	3,944	27,874
Finance lease liabilities	181	-
Accruals and deferred income	11,568	14,010
	15,693	41,884

Accruals and deferred income include £1,148,000 (2007: £741,000) relating to interest payable on time deposits that are disclosed within deposits from customers.

As part of the sale of business assets during the year, accruals and deferred income include a provision of £482,000 (2007: NIL) 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.

Included in other liabilities are balances totalling £942,000 (2007: £320,000) which represent the fair value of outstanding forward foreign exchange contracts with notional principal amounts totalling £7,830,000 (2007: £6,286,000).

The Financial Services Compensation Scheme (FSCS) 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 the year, a number of institutions failed, and 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 named 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 31 December each year. If an institution is a market participant on this date it is obliged to pay a levy. Banking subsidiaries of Arbutnot Banking Group PLC were market participants at 31 December 2007 and 2008. The group has accrued £491,000 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 31 March 2010. 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.

### Finance lease liabilities

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

	2008	2007
	£000	£000
Gross finance lease liabilities - minimum lease payments		
Within 1 year	95	-
Later than 1 year and no later than 5 years	95	-
Later than 5 years	-	-
	190	-
Future finance charges on finance leases	(9)	-
<b>Present value of finance lease liabilities</b>	<b>181</b>	<b>-</b>

The present value of finance lease liabilities is as follows:

Within 1 year	90	-
Later than 1 year and no later than 5 years	91	-
Later than 5 years	-	-
	181	-

## 24. Debt securities in issue

	2008	2007
	£000	£000
Subordinated loan notes 2035	13,972	10,708

The subordinated loan notes 2035 were issued on 7 November 2005 and are denominated in Euros. The principal amount outstanding at 31 December 2008 and 31 December 2007 was €15 million. The notes carry interest at 3% over the interbank rate for three month deposits in euros and are repayable at par in August 2035 unless redeemed or repurchased earlier by the Company.

The contractual undiscounted amount that will be required to be paid at maturity of the above debt securities is €15,000,000.

The Directors note the current dislocation in the credit markets, which has shown itself in widening credit spreads on these types of debt instruments. However 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.

## 25. Deferred taxation

	2008	2007
	£000	£000
The deferred tax liability comprises:		
Unrealised surplus on revaluation of freehold property	(90)	(478)
Accelerated capital allowances and other short-term timing differences	196	204
Deferred tax asset / (liability)	106	(274)
At 1 January	(274)	(35)
Profit and loss account	(50)	(239)
Revaluation reserve	430	-
<b>Deferred tax asset / (liability) at 31 December</b>	<b>106</b>	<b>(274)</b>

## 26. Contingent liabilities and commitments

### Capital commitments

At 31 December 2008, the group had capital commitments of £NIL (2007: £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

	2008	2007
	£000	£000
Guarantees and other contingent liabilities	816	1,131
Commitments to extend credit:		
- Original term to maturity of one year or less	15,596	15,570
	16,412	16,701

### Operating lease commitments

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Expiring:		
Within 1 year	2,040	2,040
Later than 1 year and no later than 5 years	4,016	6,156
Later than 5 years	120	673
	<b>6,176</b>	<b>8,869</b>

### Other commitments

At 31 December 2008 a commitment exists to make further payments with regard to the Financial Compensation Scheme levy for 2010 (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.

### 27. Share capital

	<b>Number of shares</b>	<b>Ordinary shares £000</b>	<b>Share premium £000</b>
<b>At 1 January 2007 and 1 January 2008</b>	14,943,944	150	21,085
New share capital subscribed	55,675	-	213
Transfer to retained earnings in lieu of cash dividends	-	-	(213)
<b>At 31 December 2008</b>	<b>14,999,619</b>	<b>150</b>	<b>21,085</b>

The total authorised number of ordinary shares at 31 December 2008 and 31 December 2007 was 418,439,000 with a par value of 1 pence per share (2007: 1 pence per share). All issued shares are fully paid.

At 31 December 2008 the Company held 141,699 shares (2007: NIL) in treasury.

## 28. Reserves and retained earnings

<b>Group</b>	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Revaluation reserve	366	1,382
Foreign exchange translation reserve	(299)	-
Capital redemption reserve	20	20
Retained earnings	10,812	15,419
<b>Total reserves as 31 December</b>	<b>10,899</b>	<b>16,821</b>

Movements in retained earnings were as follows:

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
At 1 January	15,419	16,721
Profit for the year	519	3,555
Revaluation reserve realised on disposal of freehold premises	42	-
Purchase of own shares	(445)	-
Transfer to retained earnings in lieu of cash dividends	213	-
Interim dividend for the year	(1,575)	(1,570)
Final dividend for prior year	(3,361)	(3,287)
<b>At 31 December</b>	<b>10,812</b>	<b>15,419</b>

<b>Company</b>	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
<b>Capital redemption reserve</b>	<b>20</b>	<b>20</b>

Movements in retained earnings were as follows:

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
At 1 January	5,000	9,075
Profit for the year	3,650	782
Purchase of own shares	(445)	-
Transfer to retained earnings in lieu of cash dividends	213	-
Interim dividend for the year	(1,575)	(1,570)
Final dividend for prior year	(3,361)	(3,287)
<b>At 31 December</b>	<b>3,482</b>	<b>5,000</b>

## 29. Dividends per share

Final dividends are not accounted for until they have been approved at the Annual General Meeting. At the meeting on 13 May 2009, a dividend in respect of 2008 of 10.5 pence per share (2007: actual dividend 22.5 pence per share) amounting to a total of £1,574,960 (2007: actual £3,362,387) is to be proposed. The financial statements for the year ended 31 December 2008 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 2009.

## 30. Cash and cash equivalents

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

	<b>2008</b>	<b>2007</b>
	<b>£000</b>	<b>£000</b>
Cash (Note 11)	3,369	520
Loans and advances to banks (Note 12)	15,930	39,708
Debt securities held to maturity (Note 16)	8,000	15,705
	<b>27,299</b>	<b>55,933</b>

### 31. Related-party transactions

Other than the Directors' remuneration and payment of dividends 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. The volumes of related-party transactions, outstanding balances at the year end, and relating expense and income for the year are as follows:

	Directors and key management personnel	
	2008 £000	2007 £000
<b>Loans</b>		
Loans outstanding at 1 January	1,438	1,399
Loans issued during the year	1,067	424
Loan repayments during the year	(1,046)	(385)
<b>Loans outstanding at 31 December</b>	<b>1,459</b>	<b>1,438</b>
Interest income earned	69	121

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 (2007: £NIL).

The Directors do not believe that any other key management disclosures are required.

	Directors and key management personnel	
	2008 £000	2007 £000
<b>Deposits</b>		
Deposits at 1 January	1,569	1,607
Deposits received during the year	1,307	6,660
Deposits repaid during the year	(2,012)	(6,698)
<b>Deposits at 31 December</b>	<b>864</b>	<b>1,569</b>
Interest expense on deposits	81	48

Arbuthnot Securities Limited received a fee of £15,000 (2007: £15,000) in its capacity as stockbroker to the group. It ceased to be stockbroker to the group on 10 December 2008.

Arbuthnot Latham & Co., Ltd acted as banker for the parent entity and paid net interest of £8,335 in the year (2007: £145,169).

### 32. Shares in subsidiary undertakings

	Shares at cost £000	Impairment provisions £000	Net £000
Arbuthnot Banking Group PLC:			
At 1 January 2008	32,100	(2,979)	29,121
Sale of Arbuthnot Pension Trustees Limited	(4)	-	(4)
Sale of Arbuthnot Commercial Finance Limited	(593)	-	(593)
<b>At 31 December 2008</b>	<b>31,503</b>	<b>(2,979)</b>	<b>28,524</b>
		<b>2008 £000</b>	<b>2007 £000</b>
Subsidiary undertakings:			
Banks		24,486	24,486
Other		4,038	4,635
<b>Total unlisted</b>		<b>28,524</b>	<b>29,121</b>

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 34 for further details.

The principal subsidiary undertakings of Arbuthnot Banking Group PLC at 31 December 2008 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.

### 33. Business segments

The group is organised into four main business segments:

- 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 business segments are on normal commercial terms. Centrally incurred expenses are charged to business segments on an appropriate pro-rata basis. Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet.

	Retail banking	International Private banking	UK Private banking	Investment banking	Group	Subordinated loan stock	Group total
Year ended 31 December 2008	£000	£000	£000	£000	£000	£000	£000
Segment operating income	19,712	-	14,592	8,813	(287)	(964)	41,866
Segment profit / (loss)	7,277	(1,160)	2,119	(5,225)	(4,197)	-	(1,186)
Subordinated loan note interest	-	-	-	-	-	(964)	(964)
Profit / (loss) before income tax	7,277	(1,160)	2,119	(5,225)	(4,197)	(964)	(2,150)
Segment net assets	11,044	(1,453)	23,396	6,789	8,610	(13,972)	34,414
Segment total assets	46,209	-	311,363	16,391	(14,208)	-	359,755
Segment total liabilities	35,165	1,453	287,967	9,602	(22,818)	13,972	325,341
Other segment items:							
Capital expenditure	665	199	652	54	3	-	1,573
Depreciation and amortisation	699	49	724	94	14	-	1,580
Impairment charge – loans	533	-	444	-	-	-	977

	Retail banking	International Private banking	UK Private banking	Investment banking	Group	Subordinated loan stock	Group total
Year ended 31 December 2007	£000	£000	£000	£000	£000	£000	£000
Segment operating income	22,836	-	17,264	29,346	100	(753)	68,793
Segment profit / (loss)	4,550	(266)	1,454	8,076	(4,482)	-	9,332
Subordinated loan note interest	-	-	-	-	-	(753)	(753)
Profit / (loss) before income tax	4,550	(266)	1,454	8,076	(4,482)	(753)	8,579
Segment net assets	7,903	-	28,387	12,049	4,855	(10,708)	42,486
Segment total assets	50,889	-	327,741	44,347	(8,874)	-	414,103
Segment total liabilities	42,986	-	299,354	32,298	(13,729)	10,708	371,617
Other segment items:							
Capital expenditure	1,238	-	1,660	77	47	-	3,022
Depreciation and amortisation	793	-	779	90	4	-	1,666
Impairment charge - loans	1,447	-	740	50	-	-	2,237

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.

### 34. Disposals

On 31 July 2008, the group disposed of 100% of the share capital of 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:

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

### 35. 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 31 of the consolidated financial statements includes related party transactions with Mr Angest.

### 36. Events after the balance sheet date

On 26 February 2009, Arbuthnot Banking Group plc ("Arbuthnot Banking Group") announced that its retail banking subsidiary Secure Trust Bank plc ("Secure Trust"), had reached agreement with Liverpool Victoria Banking Services Ltd, part of the insurance and investment group LV=, to purchase a portfolio of personal instalment loans (the "Loan Portfolio") for a consideration of £16.7 million. The consideration represents a discount to the gross amount receivable under the Loan Portfolio. None of the loans were in arrears as at the effective date of transfer.

The consideration for the transaction was satisfied in cash on completion. The Loan Portfolio is expected to be immediately accretive to earnings.

During the twelve month period to 31 December 2008 the Loan Portfolio earned an average interest margin (before funding, administration and other costs) of 7.9 per cent. The Loan Portfolio will be serviced using Secure Trust's existing platform.

## Five year summary

In the table below, the figures for 2005, 2006, 2007 and 2008 are presented in accordance with IFRS. 2004 has not been restated under IFRS and accordingly are shown on a UK GAAP basis.

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>(i)</b>	<b>(i)</b>			
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Profit / (Loss) before tax and exceptional items*	4,382	7,367	7,551	8,579	(2,150)
Profit / (Loss) before tax	2,996	7,676	14,062	8,579	(2,150)
Earnings per share					
Basic (p)	22.0	45.8	63.0	23.8	3.5
Adjusted* (p)	27.2	32.6	32.0	23.8	3.5
Dividends per share (p)	31.5	32.0	32.5	33.0	21.0

\* The exceptional items and the adjusted earnings per share reflect, in 2004, redundancy and reorganisation costs together with the costs of the consolidation of the London offices into Arbuthnot House, 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 minority 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.