

ANNUAL FINANCIAL REPORT

YEAR ENDED 31 DECEMBER 2016 (AUDITED)

This is the Annual Financial Report of The Law Debenture Corporation p.l.c. as required to be published under DTR 4 of the UKLA Listing Rules.

The directors recommend a final dividend of 11.50p per share making a total for the year of 16.70p. Subject to the approval of shareholders, the final dividend will be paid on 20 April 2017 to holders on the register on the record date of 17 March 2017. The annual financial report has been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial information set out in this Annual Financial Report does not constitute the Corporation's statutory accounts for 2015 or 2016. Statutory accounts for the years ended 31 December 2015 and 31 December 2016 have been reported on by the Independent Auditor. The Independent Auditor's Reports on the Annual Report and Financial Statements for 2015 and 2016 were unqualified, did not draw attention to any matters by way of emphasis, and did not contain a statement under 498(2) or 498(3) of the Companies Act 2006.

Statutory accounts for the year ended 31 December 2015 have been filed with the Registrar of Companies. The statutory accounts for the year ended 31 December 2016 will be delivered to the Registrar in due course.

The financial information in this Annual Financial Report has been prepared using the recognition and measurement principles of International Accounting Standards, International Financial Reporting Standards and Interpretations adopted for use in the European Union (collectively Adopted IFRSs). The accounting policies adopted in this Annual Financial Report have been consistently applied to all the years presented and are consistent with the policies used in the preparation of the statutory accounts for the year ended 31 December 2016. The principal accounting policies adopted are unchanged from those used in the preparation of the statutory accounts for the year ended 31 December 2015.

Group income statement

for the year ended 31 December

	2016			2015		
	<u>Revenue £000</u>	<u>Capital £000</u>	<u>Total £000</u>	<u>Revenue £000</u>	<u>Capital £000</u>	<u>Total £000</u>
UK dividends	16,468	-	16,468	14,813	-	14,813
UK special dividends	831	-	831	1,643	-	1,643
Overseas dividends	3,021	-	3,021	2,355	-	2,355
Overseas special dividends	157	-	157	194	-	194
	20,477	-	20,477	19,005	-	19,005
Interest income	303	-	303	125	-	125
Independent fiduciary services fees	30,735	-	30,735	30,384	-	30,384
Other income	225	-	225	196	-	196
Total income	51,740	-	51,740	49,710	-	49,710
Net gain/(loss) on investments held at fair value through profit or loss	-	105,437	105,437	-	(20,210)	(20,210)
Total income and capital gains/(losses)	51,740	105,437	157,177	49,710	(20,210)	29,500
Cost of sales	(3,565)	-	(3,565)	(3,461)	-	(3,461)
Administrative expenses	(20,776)	(9)	(20,785)	(20,411)	(410)	(20,821)
Provision for onerous contracts	(3,031)	-	(3,031)	-	-	-
Operating profit	24,368	105,428	129,796	25,838	(20,620)	5,218
Finance costs						
Interest payable	(5,542)	-	(5,542)	(3,632)	-	(3,632)
Profit before taxation	18,826	105,428	124,254	22,206	(20,620)	1,586
Taxation	17	-	17	(847)	-	(847)
Profit for the year	18,843	105,428	124,271	21,359	(20,620)	739
Return per ordinary share (pence)	15.96	89.30	105.26	18.10	(17.47)	0.63
Diluted return per ordinary share (pence)	15.96	89.30	105.26	18.10	(17.47)	0.63

Statement of comprehensive income

for the year ended 31 December

	Revenue 2016 £000	Capital 2016 £000	Total 2016 £000	Revenue 2015 £000	Capital 2015 £000	Total 2015 £000
Profit for the year	18,843	105,428	124,271	21,359	(20,620)	739
Foreign exchange on translation of foreign operations	-	1,247	1,247	-	290	290
Pension actuarial gains/(losses)	(2,200)	-	(2,200)	1,200	-	1,200
Taxation on pension	417	-	417	(240)	-	(240)
Other comprehensive income for the year	(1,783)	1,247	(536)	960	290	1,250
Total comprehensive income for the year	17,060	106,675	123,735	22,319	(20,330)	1,989

Financial summary

Financial summary

	31 December 2016 Pence	31 December 2015 Pence
Share price	530.00	498.00
NAV per share at fair value ¹	598.48	524.54
Revenue return per share		
- Investment trust	10.88	11.01
- Independent fiduciary services	7.68	7.09
- Group charges ²	(2.60)	-
Group revenue return per share	15.96	18.10
Capital return/(loss) per share	89.30	(17.47)
Dividends per share	16.70	16.20

	2016 %	2015 %
Ongoing charges ³	0.45	0.46
Gearing ³	8	12

1 Calculated in accordance with AIC methodology based on NAV including fair value of IFS businesses and long term borrowings.

2 See segmental analysis

3 Source AIC.

Ongoing charges are based on the costs of the investment trust and include the Henderson management fee of 0.30% of the NAV of the investment trust. There is no performance related element to the fee.

Performance

	1 year %	3 years %	5 years %	10 years %
NAV total return ¹	16.9	19.8	79.2	125.7
FTSE Actuaries All-Share Index total return ¹	16.8	19.3	61.8	71.8
Share price total return ¹	10.1	10.2	86.5	117.8
Change in Retail Price index ¹	1.9	4.8	10.9	31.0
Investment trusts (Global) ¹ NAV total return	21.0	41.4	98.9	119.3
Investment trusts (All conventional companies) ¹ (NAV total return)	18.6	34.3	85.4	111.1

By year	2016 %	2015 %	2014 %	2013 %	2012 %
Share price total return ¹	10.1	(3.0)	3.1	28.3	32.0
NAV total return ²	16.9	(0.3)	2.8	29.4	15.6
FTSE Actuaries All-Share Index total return	16.8	1.0	1.2	20.8	12.3

¹ Source AIC.

² Calculated in accordance with AIC methodology based on NAV including fair value of IFS businesses and long term borrowings.

NAV- Fair value of independent fiduciary services businesses and long term borrowings

NAV per share

	31 December 2016 pence	31 December 2015 pence
NAV per share per financial statements	560.73	472.14
Fair value adjustment for independent fiduciary services	62.37	61.27
Debt fair value adjustment	(24.62)	(8.87)
NAV per share at fair value	598.48	524.54

Background

Our consolidated financial statements are presented, in order to comply with International Financial Reporting Standards ('IFRS'), with the value of the investment portfolio expressed at fair value which is broadly a rational and unbiased estimate of the potential market value, taking into account acquisition/replacement/disposal costs.

Since 31 December 2015, we have published a fair value NAV that includes the fair value of the IFS businesses and long term borrowings.

The calculation of the IFS valuation and methodology used to derive it are included in the annual report. However, in accordance with financial reporting standards, the valuation itself is not reflected in the financial statements.

In determining a basis for the fair valuation of the IFS businesses the directors have taken external professional advice. However, it should be noted that fair valuation guidelines require that the IFS businesses are fair valued on a stand-alone basis and this does not reflect the full value to the group and its shareholders. In particular, the value of group tax relief from the investment trust to the IFS businesses, which significantly reduces the tax charge, is

excluded from the fair value of IFS businesses. In 2016 this reduced the tax charge by £1,446,000, although this will not continue at this level in the future.

In order to assist investors, The Law Debenture Corporation p.l.c. (the 'Corporation') restated its historic NAV last year to include the fair value of the IFS businesses for the last ten years. This information is provided in the annual report within the 10 year record, performance and 10 year performance .

The IFS is represented by the wholly owned subsidiaries of the Corporation, with the exception of Law Debenture Finance p.l.c. The fair valuation is used in preparing performance data for the group. The fair value is determined using unobservable inputs (including the group's own data), which represent Level 3 inputs. The directors' estimate of fair value uses the guidelines and methodologies on valuation published by the International Private Equity and Venture Capital Association.

The fair valuation of IFS is based upon the historic earnings before interest, taxation, depreciation and amortisation ('EBITDA'), an appropriate multiple and the surplus net assets of the business at their underlying fair value. The multiple applied in valuing the IFS is from comparable companies sourced from market data, with appropriate adjustments to reflect the difference between the comparable companies and the IFS in respect of growth, margin, size and liquidity .

	2016	2015
	£000	£000
Fair valuation of IFS		
EBITDA at a multiple of 8.1 (2015:8.4)	80,028	78,397
Surplus net assets	9,908	12,082
	89,936	90,479

An increase or decrease of 1 in the multiple would give rise to a £9.9 million change in the fair valuation of the IFS. The adjustment to NAV to reflect the IFS fair value is an increase of 62.37p per share (2015: 61.27p).

Long term borrowings

The methodology of fair valuing all long term borrowings is to benchmark the group debt against A rated UK corporate bond yields.

Chairman's statement and review of 2016

Performance

Our net asset value total return for the year to 31 December 2016 was up 16.9%, compared to a total return of 16.8% for the FTSE Actuaries All-Share Index. Revenue return per share was 18.56p (excluding group charges of 2.60p), an increase of 2.5% over the previous year, as a result of a 1.2% decrease in the investment trust and a 8.3% increase in independent fiduciary services.

Dividend

The board is recommending a final dividend of 11.5p per ordinary share (2015: 11.0p), which together with the interim dividend of 5.2p (2015: 5.2p) gives a total dividend of 16.7p (2015: 16.2p).

The Corporation's policy continues to be to seek growth in both capital and income. We attach considerable importance to the dividend, which we aim to increase steadily and which does not inhibit the flexibility of our investment strategy. Our basis for reporting earnings is more conservative than that of many investment trusts, in that all of our expenses, including interest costs, are charged fully to the revenue account. Notwithstanding this prudent approach to reporting, our dividend has been increased annually for at least 25 years save for three occasions (the ending of the dot.com boom and the aftermath of the 2007/2008 financial crisis) when it was maintained. We are proud of that record.

Investment trust

2016 was an extraordinary year in the markets. There was a sell-off in January and February, largely driven by concerns about events in China, but also reflecting some concerns about prospects for global growth generally and political uncertainty. Long term gilt yields declined to all-time lows creating conditions that many market observers had never seen before. Central bank interventions, including in China, stabilised markets so that, at the mid-year point, despite all the turbulence, our share price was more or less back to where it had been at the start of the year.

The second half of the year was heavily influenced by the UK electorate's decision on Brexit and the consequent (and significant) depreciation in sterling. Markets climbed towards record highs, led by a dramatic surge in share price performance from companies with large overseas earnings denominated in dollars. Performance was more sluggish from UK companies that are reliant on domestic, sterling denominated revenues.

James Henderson describes these matters in more detail in his report. Our performance relative to other global investment trusts has been relatively subdued, largely because of our comparative underweighting in dollar denominated companies.

The investment manager continues to focus on companies that are growing businesses over the long-term and he remains optimistic about the prospects for some sectors, such as manufacturing, that have been out of fashion recently. He intends to continue holding a relatively long list of stocks to provide diversification both by geography and sector and as a means of cushioning the negative effects of poor performance of any individual stock.

Looking forward, with the prospect for some inflation in the UK, it remains an extremely difficult market to call. The recent highs experienced by the FTSE indices suggest general confidence in equities, which mirrors Law Debenture's long-term belief. However, the highly changeable political landscape within Europe and the US will do nothing to lessen uncertainty.

Independent fiduciary services

The performance of the IFS businesses in 2016 was broadly unchanged.

Our new chief executive, Michael Adams, joined in August 2016, replacing Caroline Banzsky who retired having successfully led the businesses since 2002. He has formulated a strategy to grow the IFS businesses and has made encouraging progress, including the opening of a Law Debenture office in Dublin in early 2017. Not only should this provide opportunities for growth, but in the medium to long-term, it will ensure that Law Debenture has an established capability in the EU post-Brexit.

Towards the end of the year, we completed the sale of substantially all of our US corporate trust business. While our US trust activities have always generated reasonable revenues, the associated regulatory cost of business in the US – where since 2013 we have had to maintain regulatory capital of US\$50m – has been unwelcome and the decision was reached that this capital could more usefully be employed elsewhere. Subject to wind-down and termination of a small number of trusts that we have retained, it is anticipated that the regulatory capital requirement will be removed within two years. Meanwhile, our corporate services offering in the US has been retained and should continue to grow.

Pension arrangements

In 2016, the employer of the London based staff took the difficult decision, following appropriate consultation, to close the defined benefit pension scheme to future accruals, effective 31 December 2016. Affected employees will instead have contributions paid to a defined contribution scheme, which has been in place for some years, running parallel to the final salary scheme.

Over the last decade, the costs to employers of final salary schemes have grown significantly and most schemes, including Law Debenture's, have a funding deficit. A robust deficit reduction plan has been, and will continue to be, in place but the closure of the scheme to future accruals will at least cap the deficit and enable more certain financial planning going forward. This will bring some benefit for shareholders, although the board acknowledges that affected staff have lost a benefit that was highly valued.

Tax deductibility of corporate interest expense

A final decision was announced in January 2017 that, with effect from 1 April 2017, HMRC will cap the amount of UK tax relief that is available for distribution within a group to the higher of 30% of taxable earnings before interest and depreciation and £2 million net UK interest expense per year.

Law Debenture generates tax relief at the investment trust level arising from the long term debt interest and excess costs. The unutilised reliefs can be transferred to the IFS businesses, thus reducing their tax liabilities. The new rules limiting the amount of unutilised relief that can be passed down in this way will have an effect on the IFS businesses, increasing their tax charge in aggregate by c.£600,000 per annum (£450,000 in 2017), which reduces the profits available for distribution to the investment trust by that amount.

While this is unwelcome, it is not material to the success of the group as a whole and we will continue to obtain the benefit available from being able to pass down at least £2m of interest relief, together with the administration costs of running the investment trust.

Outlook

The investment manager's review and management review refer to the year ahead. We seem to be entering a period where political developments, most notably those associated with the UK's decision to leave the EU, are likely to be more important to the economic environment than has been the case for some years. We expect that Law Debenture will adapt quickly to changes as they arise and, as we have done throughout the group's long history, to find ways to capitalise on opportunities that will enhance shareholder value.

Annual general meeting

The annual general meeting will be held at the Brewers Hall, Aldermanbury Square, London, EC2V 7HR on 11 April 2017 and I look forward to seeing as many as possible of you there.

Christopher Smith

Investment manager's review

Review

Despite some large market swings, overall 2016 was a strong year for equity returns, particularly if those equities were held in a currency other than sterling or if the underlying business derives significant dollar denominated revenues. The fall in the pound came about as the result of the referendum in the UK. The decision to leave the EU led to a cut in interest rates and increased investor uncertainty over the outlook for the UK economy. This resulted in global investors selling sterling. Therefore, although the UK market made a good advance, it lagged other major markets in sterling terms.

The strength of equities was driven by the continued growth of the global economy. A notable feature was the recovery in raw material prices, with oil doubling from its low.

Biggest rises by value

		Value appreciation
1.	Royal Dutch Shell	£8.6m
2.	Anglo American	£7.1m
3.	Rio Tinto	£6.2m
4.	Applied Materials	£6.0m
5.	Glencore	£5.9m

Biggest falls by value

		Value depreciation
1.	Cape	£2.2m
2.	Senior	£2.0m
3.	International Consolidated Airlines	£2.0m
4.	Interserve	£1.9m
5.	St Modwen Properties	£1.5m

Portfolio activity and investment background

Overall, the performance of the portfolio was good and we outperformed the benchmark index and were in line with the average performance in the AIC Global sector. Nevertheless, relative to other funds in the Global sector, we were in the lower quartile for performance over the year. The main reason for that was our weighting in the UK, which we describe in more detail below.

In the latter part of 2015, we built up a position in the large miners Anglo American, Glencore and Rio Tinto. These shares were trading substantially below their asset values but we believed they had been oversold and that the strong management in the companies would quickly deal with the issues facing the sector to deliver a recovery. This proved to be an accurate call and 2016 saw a strong upturn in the fortunes of these companies. They took action including selling their poorer assets, closing underperforming mines, having capital raisings and initiating modest production cuts. As a result of these actions, coupled with continued global growth and economic stimulation measures taken by the Chinese authorities, raw material prices recovered from very low levels and share prices rose quite steeply. We benefited from this and during the summer months, decided to reduce the exposure, selling entirely the holdings in Glencore and Anglo American. Our purchases were well timed but the sales were not as the prices of raw material kept going up – for instance, coking coal prices doubled in a six week period – thus propelling the share prices substantially higher still in the fourth quarter of the year. The holdings in the sector were further reduced into this strength. The stimulus that contributed to rises in raw material prices may however be stirring inflationary pressures, so the authorities may have to intervene again in the future and weakening raw material prices may return. Therefore, we will continue reducing further into share price strength.

The US was the best performing region in 2016, delivering a total return in excess of 50%. Energy and manufacturing stocks performed well, particularly towards the end of the year when markets began to anticipate the upside that might materialise from Trump initiatives to reduce regulation and stimulate economic growth. This has led to some very high valuations and as a result, we have reduced Applied Materials and Cummins while building up a holding in General Motors.

During the year, we re-configured our exposures in Japan and the Far East. Exposures to Henderson Japanese and Far Eastern OEICs were sold and replaced with a new holding in Schroder Japan Growth Investment Trust, which was bought on a reasonable discount, and increases in our holdings in Scottish Oriental Smaller Companies and Templeton Emerging Markets, the latter having performed particularly strongly since being added to the portfolio in 2015. However, Better Capital, the investment company that is involved with corporate turnarounds, severely disappointed as some of the underlying holdings experienced continued poor operational results. The company responded to pressure and is now returning capital to its shareholders.

The rise of populism, illustrated by the Brexit vote in the UK and Donald Trump winning the US Presidential race, has suddenly thrust politics into the forefront of investors' thinking. After the Brexit vote, we reduced equity exposure in the UK, as uncertainty about the economic outlook became a greater concern. Share prices have recovered from the initial falls after the vote, but sterling's weakness has increased the prospect for inflation to rise during 2017. It is possible that inflation will rise faster than wages, which will put downward pressure on consumption – the consumer having been a significant factor in better than expected growth figures in the second half of 2016 – with the UK retail sector possibly suffering as a result. The portfolio has very little exposure to this sector. On the other hand, if wages rise faster than inflation, this might suggest that inflation is becoming more embedded in the economy. It may become necessary for interest rates to rise from current historic lows. While this would help savers, the adjustment to higher rates will be painful for consumers and consequently for some parts of the economy.

Although there are concerns about the UK, the case for equity investment remains strong. The board and the managers continue to believe in the long term benefit of investing in equities and of the investment trust structure. The UK market has a higher dividend yield than other major markets and around 70% of the profits of UK companies are derived from overseas. These profits in sterling terms have received a large boost from the fall in the pound, as have the dividends received from UK stocks that pay their dividends in Euros or US dollars. Higher dividend yield and higher dividend growth than other markets drives our belief that the portfolio should hold a substantial weighting in UK stocks, despite the concerns described above.

Corporate governance

As an active manager, our preference is to engage with management and boards to resolve issues of concern rather than to vote against shareholder meeting proposals. In our experience this approach is more likely to be effective in influencing company behaviour. However, where we believe proposals are not in shareholder interests or where engagement proves unsuccessful, we will vote against. Proposals we voted against during 2016 included remuneration related proposals at BP, Weir Group and Babcock International. All three companies received very significant levels of shareholder opposition, and have subsequently made changes to their remuneration policies.

We also engaged with management and non-executives of companies on a wide range of other issues. Meetings of note (and key issues covered) included GlaxoSmithKline (management succession, remuneration and business ethics), Carnival (health & safety, reporting), BHP Billiton (health & safety, climate change), HSBC (succession planning, corporate culture, business conduct) and Royal Dutch Shell (remuneration, climate change).

Outlook

The portfolio is made up of companies that have management teams that will adapt their businesses to prevailing economic circumstances. Macroeconomic factors are not the fundamental determinant for stocks that we choose to hold but rather management quality and excellence of product. That said, increasing inflationary pressures, as well as concerns over real GDP growth, means that the equity valuations need to be reasonable. When they are relatively high, profits need to be taken and the money recycled into better value opportunities. The focus will remain on stocks and valuations. During periods of political and economic volatility, investment opportunities will emerge to buy stocks on long term attractive valuations.

James Henderson

Henderson Global Investors Limited

Management review – independent fiduciary services

Introduction

This is my first management review since I joined Law Debenture, following the retirement of Caroline Banszky in August 2016.

Prior to joining, I spent much of my career in professional services. I was generally aware of the attributes and reputation of Law Debenture, but in the short time that I have been here, I have found out exactly how excellent our services – and our people - actually are, and also in what high regard they are held by our clients.

My mission is to ensure that we become more proactive as an organisation in promoting and capitalising on our capabilities. I recognise that there is fierce competition in most of the markets where we operate and that there is downward pressure on pricing, but we have a good story to tell and I want us to be more vocal in telling it than we have been historically.

I have begun to implement a strategy in conjunction with the business heads that will initially focus on growing each of our existing businesses organically. This will involve some level of refreshment and investment and inevitably, there will be a lead time before the new investments translate to bottom line growth. However, beyond the short term, I expect to deliver growth and improved profitability across all of our businesses.

As you will read below, already in 2017 we have extended our operations into Dublin and set up a brand new office, to both take advantage of the opportunities in Ireland and help mitigate any difficulties that may be encountered as the UK negotiates its exit from the European Union.

As well as organic growth, if an appropriate acquisition opportunity comes along – one that could significantly enhance shareholder value and expand the range or extent of our service offering to clients in a controlled way – it will be given very careful consideration in conjunction with the board.

Results

Independent fiduciary services profit before tax increased by 2.8% from £9.2 million to £9.5 million. Revenue return per share increased by 8.3% from 7.09p to 7.68p.

Independent fiduciary services businesses (“IFS”)

Law Debenture is a leading provider of independent third party professional services, including corporate trusts (including trustee and escrow banking), pension trusts, corporate services, agent for service of process, whistleblowing services and governance services to client boards and pension funds. The businesses are monitored and overseen by a board comprising the heads of the relevant business areas and two non-executive, independent directors.

Review of 2016

I was honoured and proud to be appointed Law Debenture’s chief executive and am grateful to my predecessor, Caroline Banszky, both for the briefings she gave me during our handover and the care that she took of the business over her many years at the helm. Law Debenture enjoys an unparalleled reputation for quality, longevity, consistency and innovation in the markets where we operate and I aim to enhance that reputation and increase profitability, in turn enhancing shareholder value.

IFS profits in 2016 continued the trend of the three previous years in being broadly flat. While the turbulence in equity markets at the beginning of the year made little difference to our new business flow, the Brexit vote certainly did, at least for a short while. A number of projects and financings went on hold while counterparties paused as the vote approached, then took stock immediately afterwards to work out what Brexit might actually mean. Markets returned to normal activity levels quite quickly and although a small number of transactions were abandoned, most were reactivated shortly after the vote and went on to complete successfully. The last few months of the year were thus quite positive. Market share remained satisfactory across all business areas.

Corporate trusts, including trustee and escrow banking

Corporate trusts had a solid year overall in terms of revenues and new transaction volumes, continuing to operate successfully across a broad spectrum of activities. Some of the appointments we secured during the year are set out below.

We were appointed trustee of a new MTN Programme for National Grid Gas, as well as on further large debt issues by the Bank of England, BP and BT. Repeat issuance by existing clients including Affordable Housing (guaranteed by the UK Government), Northumbrian Water and Ladbrokes whilst, as a new development in funding, we were appointed on two large convertible bonds by Vodafone.

In the high yield bond market, levels of activity reflected the continuing retrenchment of bank credit for medium sized companies, with a number of such issues being placed with a single investor. The private placement market continues to grow in other areas also, with many UK companies now raising finance direct from one or just a few investors.

Islamic finance remained an active area for us and included appointments as delegate on further sukuk bonds by Islamic Development Bank, a sukuk programme for its affiliate ICD and a sukuk financing on behalf of the Government of Pakistan.

Security trustee appointments reflected a variety of underlying commercial objectives ranging from bank funding – including an acquisition by Italian chemicals group IGM RFE and a mix of long term bank, EIB and institutional funding for the development for a port in the UK – to project financings. We continue to work in this arena with International Finance Corporation (part of the World Bank) around the world and in 2016, acted as security trustee and facility agent on an African copper mine project, with IFC as a lender. We were also appointed as bond and security trustee for the proposed Hinkley Point nuclear power project in the UK.

Our recognised independence as an impartial third party continues to enable us also to secure many escrow agent appointments thereby serving to diversify our income base further.

In the last twelve months, our experienced trust management team has continued to deal with a steady stream of post-issuance work, including a number of debt restructurings, modification requests, corporate reorganisations and defaults. This work is a material source of income for the business.

Pension trusts and governance services

Our pension trusteeship service had a good year, benefitting from the greater focus in government and the media on the quality of governance for pension schemes in the UK. The requirement to understand the increasingly complex issues that confront lay trustees has resulted in a growing demand for our services, especially as chair of trustees.

We continued to grow and develop our team with four new directors joining the department – bringing new skills, experience and long term commitment to serving our clients.

Our sole trusteeship services, where we act as the sole trustee of final salary schemes and deliver one-stop governance cost effectively, continue to evolve and attract new clients. We have confirmed our position at the forefront of developing best practice for independent governance committees for providers of workplace personal pensions. We are finding increased demand for scheme secretarial and effective implementation oversight services, as appreciation grows of the positive impact of a close collaboration with the trustee chairman on project management and costs of delivery. We continue to develop our team in response to this demand.

Corporate services

The corporate services business (provision of corporate directors, company secretary, accounting and administration of special purpose vehicles, facility agency) performed adequately. The structured finance market is not as busy as we would prefer but in other markets, we won new customers through our company secretarial, facility agency, M&A and corporate governance offerings. Notable was the demand for our services from participants in the alternative energy and recycling markets.

Our long established and highly regarded service of process business had another solid year.

Safecall

Our external whistleblowing service had another successful year, with an encouraging number of new appointments. The demand for our services remains strong, both in the UK and across Europe, as more and more organisations recognise the value of an external whistleblowing service. The introduction of the modern slavery act was helpful, as organisations reviewed their policies to ensure that robust procedures (including a reliable external whistleblowing service) are in place for individuals to report wrongdoing, not only within their own company but within companies in the supply chain. Notable appointments during the year included Marks & Spencer, Boehringer Ingelheim, Computacenter and Keller.

Overseas

United States

When we opened an office in New York in 2002, we hoped to win primarily trustee work, involving both US and European elements. Instead, it became clear that the stronger market demand was for an independent trustee to take “successor” roles in bankruptcy (Chapter 11) situations. These roles required us to have significant capital of US\$50 million. Over time, the number of these roles has diminished and the opportunities to win conventional trust work have been more limited than we would prefer. The cost-benefit of the regulatory capital requirement became marginal. Simultaneously, we have built up other business, mainly in the corporate services and process agent sector and these business lines continue to deliver profits, but are not dependent on the retention of the capital commitment. Consequently, we decided to exit the trust business, while retaining our profitable other businesses. The US corporate

trust business is now in run-off. In December, substantially all the business was transferred, with the majority of the staff being made redundant. In difficult circumstances, all the staff continued to behave in a professional manner and their contribution is very much appreciated. It is expected that the small number of trusts we have had to retain may take up to two years to unwind and a provision has been made for the expected net costs of this.

Hong Kong

Hong Kong's trade and its financial sector have been affected adversely to a certain extent by Brexit because of the close economic relationship with the EU and the UK. Coupled with the continuing economic downturn in Hong Kong and an uncertain global outlook, levels of new business generally remained modest in 2016. More positively, recurring income from existing clients remained solid, and it is possible that the weakened confidence at present might increase demand for other of our independent third party services, such as escrows.

Channel Islands

There was continued transaction activity on existing appointments during 2016, which contributed to good returns. There were some transaction terminations, but these were offset by new appointments and further growth in the number of service of process appointments.

Republic of Ireland

I am pleased to announce that we have recently opened a new office in Dublin, from where we will provide a wide range of services including corporate trust and agency, corporate services and service of process. Dublin has long been a significant financial services sector and while it suffered badly in the aftermath of the financial crisis, it has begun to bounce back. I feel that the time is right to establish a presence there and we have recruited an experienced locally based managing director, Ronan Reilly, to establish and run the business, with additional local hires to follow.

Outlook

Competition in our market place is fierce and there seems to be a constant downward pressure on our fees. However, by focusing on our strengths – namely the quality of our service, our people, our reputation and our clients – and combining that with an increase in promoting our whole range of businesses, I feel that we can retain our existing business and win more than our current share of new business in these difficult times.

I expect in 2017 our core businesses to deliver similar returns to those seen in the recent past. It will be a year of consolidation and investment, ahead of growth in later years.

I would like to thank our staff around the world for their work during 2016 and I look forward to working with them in the years to come as we look to build up our businesses globally.

Michael Adams

Statement of financial position

as at 31 December

	2016	2015
	£000	£000
Assets		
Non current assets		
Goodwill	1,968	2,256
Property, plant and equipment	161	206
Other intangible assets	70	16
Investments held at fair value through profit or loss	696,080	621,613
Deferred tax assets	1,312	824
Total non current assets	699,591	624,915
Current assets		
Trade and other receivables	6,680	7,073
Other accrued income and prepaid expenses	4,603	4,888
Cash and cash equivalents	94,804	60,301
Total current assets	106,087	72,262
Total assets	805,678	697,177
Current liabilities		
Trade and other payables	13,346	13,816
Corporation tax payable	-	506
Other taxation including social security	444	686
Deferred income	3,826	3,934
Derivative financial instruments	2,029	725
Total current liabilities	19,645	19,667
Non current liabilities and deferred income		
Long term borrowings	114,024	113,980
Retirement benefit obligations	2,300	1,400
Deferred income	4,318	4,810
Provision for onerous contracts	3,106	-
Total non current liabilities	123,748	120,190
Total net assets	662,285	557,320
Equity		
Called up share capital	5,917	5,916
Share premium	8,722	8,667
Own shares	(1,197)	(1,493)
Capital redemption	8	8
Translation reserve	2,156	909
Capital reserves	609,077	503,649
Retained earnings	37,602	39,664
Total equity	662,285	557,320

Statement of cash flows

for the year ended 31 December

Operating activities

	2016 £000	2015 £000
Operating profit before interest payable and taxation	129,796	5,218
(Gains)/losses on investments	(105,428)	20,620
Foreign exchange	(68)	(43)
Depreciation of property, plant and equipment	112	94
Amortisation of intangible assets	20	30
Provision for impairment of goodwill	418	-
Decrease in receivables	678	209
Increase in payables	1,763	1,105
Transfer (from) capital reserves	(157)	(385)
Normal pension contributions in excess of cost	(1,300)	(650)

Cash generated from operating activities	25,834	26,198
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Taxation	(560)	(803)
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Operating cash flow	25,274	25,395
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Investing activities

Acquisition of property, plant and equipment	(53)	(168)
Expenditure on intangible assets	(75)	-
Purchase of investments	(91,494)	(96,541)
Sale of investments	122,248	55,595

Cash flow from investing activities	30,626	(41,114)
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Financing activities

Derivative financial instrument	(4,775)	-
Interest paid	(5,542)	(3,632)
Dividends paid	(19,122)	(19,118)
Long term borrowings	-	74,477
Proceeds of increase in share capital	56	45
Purchase of own shares	296	193

Net cash flow from financing activities	(29,087)	51,965
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Net increase in cash and cash equivalents	26,813	36,246
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Cash and cash equivalents at beginning of period	60,301	23,773
Foreign exchange gains on cash and cash equivalents	7,690	282

Cash and cash equivalents at end of period	94,804	60,301
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Statement of changes in equity

	Share capital £000	Share premium £000	Own shares £000	Capital redemption £000	Translation reserve £000	Capital reserves £000	Retained earnings £000	Total £000
Equity 1 January 2015	5,916	8,622	(1,686)	8	619	524,269	36,463	574,211
Profit	-	-	-	-	-	(20,620)	21,359	739
Foreign exchange	-	-	-	-	290	-	-	290
Actuarial gain on pension scheme (net of tax)	-	-	-	-	-	-	960	960
Total comprehensive income	-	-	-	-	290	(20,620)	22,319	1,989
Issue of shares	-	45	-	-	-	-	-	45
Dividend relating to 2014	-	-	-	-	-	-	(12,979)	(12,979)
Dividend relating to 2015	-	-	-	-	-	-	(6,139)	(6,139)
Movement in own shares	-	-	193	-	-	-	-	193
Total equity 31 December 2015	5,916	8,667	(1,493)	8	909	503,649	39,664	557,320
Equity 1 January 2016	5,916	8,667	(1,493)	8	909	503,649	39,664	557,320
Profit	-	-	-	-	-	105,428	18,843	124,271
Foreign exchange	-	-	-	-	1,247	-	-	1,247
Actuarial (loss) on pension scheme (net of tax)	-	-	-	-	-	-	(1,783)	(1,783)
Total comprehensive income	-	-	-	-	1,247	105,428	17,060	123,735
Issue of shares	1	55	-	-	-	-	-	56
Dividend relating to 2015	-	-	-	-	-	-	(12,983)	(12,983)
Dividend relating to 2016	-	-	-	-	-	-	(6,139)	(6,139)
Movement in own shares	-	-	296	-	-	-	-	296
Total equity 31 December 2016	5,917	8,722	(1,197)	8	2,156	609,077	37,602	662,285

Segmental analysis

	Investment trust		Independent fiduciary services		Group charges		2016	Total 2015
	2016	2015	2016	2015	2016	2015		
	£000	£000	£000	£000	£000	£000	£000	£000
Revenue								
Segment income	20,477	19,005	30,735	30,384	-	-	51,212	49,389
Other income	74	25	151	171	-	-	225	196
Cost of sales	-	-	(3,565)	(3,461)	-	-	(3,565)	(3,461)
Administration costs	(2,739)	(2,926)	(17,573)	(17,485)	(464)	-	(20,776)	(20,411)
Provision for onerous contracts					(3,031)	-	(3,031)	-
	17,812	16,104	9,748	9,609	(3,495)	-	24,065	25,713
Interest (net)	(4,964)	(3,117)	(275)	(390)	-	-	(5,239)	(3,507)
Return, including profit on ordinary activities before taxation	12,848	12,987	9,473	9,219	(3,495)	-	18,826	22,206
Taxation	-	-	(405)	(847)	422	-	17	(847)
Return, including profit attributable to shareholders	12,848	12,987	9,068	8,372	(3,073)	-	18,843	21,359
Revenue return per ordinary share	10.88	11.01	7.68	7.09	(2.60)	-	15.96	18.10
Assets	743,248	640,223	62,052	56,954	378	-	805,678	697,177
Liabilities	(97,230)	(101,063)	(43,057)	(38,794)	(3,106)	-	(143,393)	(139,857)
Total net assets	646,018	539,160	18,995	18,160	(2,728)	-	662,285	557,320

The capital element of the income statement is wholly attributable to the investment trust; Group charges have been included as a separate element for the first time this year, to reflect the result of matters relating to group actions.

Group charges before taxation during the year comprised the following

	2016
	£000
Closure of the US trust business	
Staff termination and legal costs incurred	(437)
Provision for onerous contracts	(3,031)
	(3,468)
Impairment of goodwill in Delaware Corporate Services Inc.	(418)
Past service credit on closure of defined benefit pension scheme net of costs of closure	391
	(3,495)

Provision for onerous contracts

Group	2016	2015
	£000	£000
At 1 January	-	-
Provision made in year	3,031	-
Foreign exchange	75	-
At 31 December	3,106	-

In December 2016 the group completed the disposal of substantially all of its US corporate trust business for a consideration of \$1. This resulted in no book loss to the group, however costs totalling £437,000 in respect of staff termination costs and legal costs were incurred as a result of the transaction. The disposal was the completion of the first part of a strategy to exit the US corporate trust business, so as to release the \$50 million of capital required by the business. The contracts remaining at 31 December 2016 do not generate sufficient income to cover the costs of running and financing of the remaining business up to the eventual date of its closure. The provision for onerous costs represents the expected net future costs up to the date of disposal or completion of the remaining contracts. The provision comprises financing costs of £2,262,000 and net running costs (including the cost of closure) of \$1,043,000.

Portfolio changes in geographical distribution

	Valuation 31 December 2015 £000	Purchases £000	Costs of acquisition £000	Sales proceeds £000	Appreciation £000	Valuation 31 December 2016 £000
United Kingdom	449,215	63,276	(263)	(76,995)	57,477	492,710
North America	58,484	9,319	(11)	(12,441)	29,624	84,975
Europe	40,086	7,975	(48)	(1,056)	8,287	55,244
Japan	24,569	5,731	(31)	(17,389)	1,486	14,366
Other Pacific	39,668	3,191	(17)	(14,367)	6,665	35,140
Other	9,591	2,002	(3)	-	2,055	13,645
	621,613	91,494	(373)	(122,248)	105,594	696,080

Investment trust – objectives, investment strategy, business model

Our objective for the investment trust is to achieve long term capital growth in real terms and steadily increasing income. The aim is to achieve a higher rate of total return than the FTSE Actuaries All-Share Index through investing in a portfolio diversified both geographically and by industry.

Law Debenture shares are intended for private investors in the UK ('retail investors'), professionally advised private clients and institutional investors. By investing in an investment trust, shareholders typically accept the risk of exposure to equities but hope that the pooled nature of an investment trust portfolio will give some protection from the volatility in share price movements that can sometimes affect individual equities.

Our investment strategy (which did not change in 2016) is as follows:

The Corporation carries on its business as a global investment trust.

The Corporation's portfolio will typically contain between 70 and 150 listed investments. The portfolio is diversified both by industrial sector and geographic location of investments in order to spread investment risk.

There is no obligation to hold shares in any particular type of company, industry or geographical location. The IFS businesses do not form part of the investment portfolio and are outwith this strategy.

Whilst performance is measured against local and UK indices, the composition of these indices does not influence the construction of the portfolio. As a consequence, it is expected that the Corporation's investment portfolio and performance will from time to time deviate from the comparator indices.

The Corporation's assets are invested internationally and without regard to the composition of indices. There are some guidelines, set by the board, on maximum or minimum stakes in particular regions and all stakes are monitored in detail by the board at each board meeting in order to ensure that sufficient diversification is maintained.

Liquidity and long-term borrowings are managed with the aim of improving returns to shareholders. The policy on gearing is to adopt a level of gearing that balances risk with the objective of increasing the return to shareholders, in pursuit of its investment objective. Investments may be held in, inter alia, equity shares, collective investment products including open ended investment companies ('OEICs'), fixed interest securities, interests in limited liability partnerships, cash and liquid assets. Derivatives may be used but only with the prior authorisation of the board. Investment in such instruments for trading purposes is proscribed. It is permissible to hedge against currency movements on both capital and income account, subject again to prior authorisation of the board. Stock lending, trading in suspended shares and short positions are not permitted. No more than 15% of gross assets will be invested in other UK listed investment trusts. The Corporation's investment activities are subject to the following limitations and restrictions:

- No investment may be made which raises the aggregate value of the largest 20 holdings, excluding investments in collective investment vehicles that give exposure to the Japan, Asia/Pacific or emerging market regions, to more than 40% of the Corporation's portfolio, including gilts and cash. The value of a new acquisition in any one company may not exceed 5% of total portfolio value (including cash) at the time the investment is made. Further additions shall not cause a single holding to exceed 5%, and board approval must be sought to retain a holding, should its value increase above the 5% limit.
- The Corporation applies a ceiling on effective gearing of 50%. While effective gearing will be employed in a typical range of 10% net cash to 20% gearing, the board retains the ability to reduce equity exposure so that net cash is above 10% if deemed appropriate.
- The Corporation may not make investments in respect of which there is unlimited liability.

Our business model is designed to position the Corporation to best advantage in the investment trust sector.

We aim to deliver the investment trust's objective by skilled implementation of the investment strategy, complemented by maintaining and operating our IFS businesses profitably and safely, while keeping them distinct from the portfolio. The operational independence of the IFS means that they can act flexibly and commercially. They provide a regular flow of dividend income to the Corporation. This helps the board to smooth out equity dividend peaks and troughs, means that the investment manager doesn't have to be constrained by choosing stocks just for yield and is an important element in delivering the objective of steadily increasing income for shareholders, fully covered by current revenues. In turn, some of the tax relief at the investment trust level arising from our debenture interest and excess costs, which would otherwise be unutilised, can be transferred to the IFS.

Fee structure, ongoing charges and investment management agreement

Our portfolio of investments is managed under delegation by James Henderson of Henderson Global Investors Limited ('Henderson') under a contract terminable by either side on six months' notice. On a fully discretionary basis, Henderson is responsible for implementing the Corporation's investment strategy and fees are charged at 0.30% of the value of the net assets of the group (excluding the net assets of the IFS), calculated on the basis adopted in the audited financial statements. Underlying management fees of 0.75% on the Corporation's holdings in Henderson Japanese and Pacific OEICs were fully rebated although those holdings were sold in 2016. This means that the Corporation continues to maintain one of the most competitive fee structures in the investment trust sector and this, combined with the good performance of Henderson over the years as our investment manager, has led the board to conclude that the continuing appointment of Henderson as the Corporation's investment manager remains in the best interests of shareholders. The board recognises that performance in recent times, for reasons explained elsewhere, has lagged compared with other investment trusts with a higher overseas weighting. Equity investment needs to be seen over the longer term, however, and here Henderson has delivered over many years.

Investment trusts are required to publish their ongoing charges. This is the cost of operating the trust and includes the investment management fee, depositary and custody fees, investment performance data, accounting, company secretary and back office administration. Law Debenture's latest published level of ongoing charges is one of the lowest in the marketplace at 0.45%. No performance fees are paid to the investment manager.

Capital structure – simple and mainstream

Law Debenture's capital structure is transparent. We have only one class of share – ordinary shares – and each share has the same rights as every other share.

The Corporation conducts its affairs so that its ordinary shares are capable of being recommended by independent financial advisors to ordinary retail investors in accordance with relevant FCA rules. Our ordinary shares are, we consider, mainstream investment products because they are shares in an investment trust. The Corporation intends to continue conducting its affairs for the foreseeable future so that the ordinary shares can continue to be categorised as mainstream.

Transparency

In order to assist shareholders in understanding the nature of the underlying investments they are buying into when investing in Law Debenture shares, we publish our entire portfolio twice a year – in the annual report and half yearly report – with regular monthly updates on the composition of the top ten holdings in the portfolio

Gearing

Investment trusts have the benefit of being able to ‘gear’ their portfolios according to market conditions. This means that they can raise debt (either short or long term) to generate funds for further investment – i.e. to increase the size of the portfolio – or they can sell assets from within the portfolio to reduce debt and even be “negatively geared” – i.e. selling assets to hold cash so that less than 100% of the trust’s assets are invested in equities.

The Corporation has two debentures (long dated sterling denominated financing). At 31 December 2016, our gearing was 8%.

The weighted average interest payable on the Corporation’s structural borrowings is 4.589%. There has been no change in the Corporation’s gearing policy, with effective gearing typically employed in a range of 10% net cash to 20% gearing.

Viability statement

The Corporation is required to publish a longer-term statement about its viability as part of its compliance with the Code and the UKLA listing rules.

The directors believe that a forward looking period of three years is appropriate. The directors assess the Corporation’s future prospects by keeping under close review its current and projected financial position, threats/risks to the delivery over the longer term of the investment strategy objectives and the group business model and a macroeconomic overview based on a reasonable time horizon. A three year time period also takes into account the nature of the markets in which the IFS businesses operate, where fluctuations in revenue can occur year-on-year for reasons beyond Law Debenture’s control.

The directors confirm that they have a reasonable expectation that the Corporation will continue to implement its investment strategy and business model and to operate and be able to meet its liabilities as they fall due for the next three financial years. There are no current plans to amend the investment policy, which has delivered good capital and dividend returns for shareholders over many years. The strategy for the IFS businesses remains to continue to grow them profitably and safely.

The main qualification to this viability statement is that the investment manager is appointed on a fully discretionary basis, so while stocks are picked by the manager within the guidelines in the investment strategy, the board does not dictate what individual stocks are bought or sold. Portfolio over or under performance is only properly measurable over the medium and longer term. Short term fluctuations will not necessarily result in a change of strategy, but might in extreme circumstances pose a risk to viability.

This risk is accepted within the board’s risk appetite.

Key performance indicators (‘KPI’)

The KPIs used to measure the progress and performance of the group are:

- net asset value total return per share (combining the capital and income returns of the group) and how this compares, over various time intervals, with relevant indices;
- the discount/premium in share price to NAV; and
- the cost of running the portfolio as a percentage of its value.

Since the objective of the investment trust is measurable solely in financial terms, the directors do not consider that it is appropriate to adopt non-financial KPIs. The financial measures adopted as KPIs are part of our financial reporting obligations and no Alternative Performance Measures as defined under ESMA guidelines have been adopted.

Top 20 equity holdings by value

		2016	2016	2015	2015
		Value	% of	% of	
Rank	Company	£000	portfolio	portfolio	Rank
1	Royal Dutch Shell	25,883	3.72	1.86	5
2	HSBC	17,309	2.49	2.03	3
3	Rio Tinto	16,559	2.38	1.67	9
4	BP	16,304	2.34	1.99	4
5	GKN	14,934	2.15	2.24	1
6	Prudential	11,913	1.71	1.32	17
7	GlaxoSmithKline	11,704	1.68	1.66	10
8	Hill & Smith	11,201	1.61	1.58	13
9	Senior	11,160	1.60	2.12	2
10	Relx	10,838	1.56	1.44	16
11	Johnson Service	10,751	1.54	1.21	23
12	BAE Systems	10,602	1.52	1.45	15
13	Spectris	10,409	1.50	1.01	30
14	Rolls Royce	10,354	1.49	1.30	18
15	Microsoft (USA)	10,057	1.44	1.20	24
16	Smith (DS)	9,836	1.41	1.76	8
17	IP Group	9,733	1.40	1.80	7
18	Hiscox	9,542	1.37	1.60	12
19	Interserve	9,091	1.31	0.84	41
20	Marshalls	8,863	1.27	1.63	11
			35.49		

Other significant holdings by value

		2016	2016	2015
		Value	% of	% of
	Company	£000	portfolio	portfolio
	Baillie Gifford Pacific*	14,449	2.08	1.97
	Stewart Investors Asia Pacific*	14,045	2.02	1.89
	Templeton Emerging Markets Investment Trust	9,074	1.30	1.00
			5.40	

*Open ended investment companies.

Portfolio by sector 2016

Oil & gas	9.7%
Basic materials	6.7%
Industrials	29.5%
Consumer goods	7.7%
Health care	8.3%
Consumer services	7.5%
Telecommunications	0.7%
Utilities	1.8%
Technology	2.7%
Financials	25.4%

Portfolio by sector 2015

Oil & gas	6.9%
Basic materials	6.5%
Industrials	26.4%
Consumer goods	9.2%
Health care	8.7%
Consumer services	8.8%
Telecommunications	0.7%
Utilities	2.1%
Technology	2.2%
Financials	28.5%

Geographical distribution of portfolio 2016

United Kingdom	70.7%
North America	12.2%
Europe	8.0%
Japan	2.1%
Other Pacific	5.0%
Other	2.0%

Geographical distribution of portfolio 2015

United Kingdom	72.2%
North America	9.4%
Europe	6.5%
Japan	4.0%
Other Pacific	6.4%
Other	1.5%

Acquisition of own shares

During the year, the Corporation did not repurchase any of its shares for cancellation. It intends to seek shareholder approval to renew its powers to repurchase shares for cancellation up to 14.99% of the Corporation's issued share capital, if circumstances are appropriate.

On 16 March 2016, a subsidiary acquired 103,312 of the Corporation's shares on the open market at 476.99 pence per share in anticipation of fulfilling awards made under the Deferred Share Plan.

Significant financial issues relating to the 2016 accounts

No new significant issues arose during the course of the audit. The accounting treatment adopted following the closure of the defined benefit pension scheme was examined in detail and found to be appropriate. As reported in previous years, an area of consideration continues to be consideration of bad debt provisions.

Management makes an estimate of a number of bad debt provisions for non-collection of fees and costs as part of the risk management and control framework. The audit committee has received reports from management describing the basis for assumptions used.

Other issues that arose included: the risk that portfolio investments may not be beneficially owned or correctly valued; and that revenue is appropriately recognised. The audit committee has received assurance on these matters from management.

The audit committee is satisfied that the judgements made by management are reasonable and that appropriate disclosures have been included in the accounts. Taken in its entirety, the committee was able to conclude that the financial statements themselves and the annual report as a whole are fair, balanced and understandable and provide the necessary information for shareholders to assess the Corporation and group's position and performance, business model and strategy. That conclusion was reported to the board.

Total voting rights and share information

The Corporation has an issued share capital at 27 February 2017 of 118,344,399 ordinary shares with voting rights and no restrictions and no special rights with regard to control of the Corporation. There are no other classes of share capital and none of the Corporation's issued shares are held in treasury. Therefore the total number of voting rights in The Law Debenture Corporation p.l.c. is 118,344,399.

Borrowings

	2016	2015
	£000	£000
Long term borrowings		
Long term borrowings are repayable as follows:		
In more than five years		
Secured		
6.125% guaranteed secured bonds 2034	39,525	39,499
3.77% secured senior notes 2045	74,499	74,481
	114,024	113,980

The 6.125% bonds were issued by Law Debenture Finance p.l.c. and guaranteed by the Corporation. The £40 million nominal tranche, which produced proceeds of £39.1 million, is constituted by Trust Deed dated 12 October 1999 and the Corporation's guarantee is secured by a floating charge on the undertaking and assets of the Corporation. The bonds are redeemable at nominal amount on 12 October 2034. Interest is payable semi-annually in equal instalments on 12 April and 12 October in each year.

The 3.77% notes were issued by the Corporation. The £75 million nominal tranche, which produced proceeds of £74.5 million, is constituted by a note purchase agreement and the notes are secured by a floating charge which ranked pari passu with the charge given as part of the 6.125% bond issue. The notes are redeemable at nominal amount on 25 September 2045. Interest is payable semi-annually in equal instalments on 25 March and 25 September in each year.

The long term borrowings are stated in the statement of financial position at book value. Including them at a fair value of £143.1 million at 31 December 2016 (2015: £124.4 million) would have the effect of decreasing the year end NAV by 24.62p (2015: 8.87p). The estimated fair value is based on the redemption yield of reference gilts plus a margin derived from the spread of A rated UK corporate bond yields over UK gilt yields (2015: A).

Related party transactions

The related party transactions between the Corporation and its wholly owned subsidiary undertakings are summarised as follows:

	2016	2015
	£000	£000
Dividends from subsidiaries	7,700	7,725
Interest on intercompany balances charged by subsidiaries	2,670	2,676
Management charges from subsidiaries	240	420
Interest on intercompany balances charged to subsidiaries	480	128

Principal risks and uncertainties – investment trust

The principal risks to the Corporation's ability to continue operations as an investment trust relate to investment activities generally and include market price risk, foreign currency risk, liquidity risk, interest rate risk, credit risk, country/region risk and regulatory risk. The directors have carried out a robust assessment of these risks, which are explained in more detail below.

Market risk could arise from sudden fluctuations in world stock markets. The portfolio deliberately contains a 'long list' of stocks and is diversified on a geographical and sector basis to spread risk. In extreme circumstances, as the Corporation's investments comprise almost entirely of ready realisable, quoted equities, these could be sold to meet funding requirements. The Corporation conducts stress tests each month, as part of its compliance programme, which gives the board a degree of comfort about the Corporation's ability to withstand any significant market shock.

Regulatory risk could arise from failure to comply with legal and regulatory obligations. This could result in suspension of the Corporation's stock exchange listing and/or regulatory sanction (including financial penalties). Breach of the Corporation Tax Act 2010 could lead to the Corporation being subject to tax on capital gains.

The executive team provides regular reports to the board and the audit committee on the monitoring programmes in place to mitigate these risks. As its own AIFM, the Corporation is able to monitor investment positions along with levels of forecast income and expenditure and the depositary carries out regular checks on the Corporation's investment activity and accounting as a separate check.

Operational risk could arise from failure of the Corporation's accounting systems, the systems of the investment manager, or those of the custodian, which might result in an inability to provide accurate reporting and monitoring or a misappropriation of assets. All relevant providers of these services have comprehensive business continuity plans which include robust plans for continued operation of the business in the event of a service disruption or major disruption. The audit committee considers detailed reports on the Corporation's risk profile and the internal controls in place to mitigate such risk, as well as receiving reports by other key third party providers.

Gearing risk could arise where the Corporation has borrowed money for investment purposes. If the value of portfolio investments falls, any borrowings will magnify the extent of this loss. All borrowings require the prior approval of the board and gearing levels are discussed by the board at every meeting. As stated in the investment strategy, there is a ceiling on effective gearing of 50%.

Further disclosures about risk are as follows:

Market risk

Price risk, arising from uncertainty in the future value of financial instruments. The board maintains strategy guidelines whereby risk is spread over a range of investments, the number of holdings normally being between 70 and 150. In addition, the stock selections and transactions are actively monitored throughout the year by the investment manager, who reports to the board on a regular basis to review past performance and develop future strategy. The investment portfolio is exposed to market price fluctuation: if the valuation at 31 December 2016 fell or rose by 10%, the impact on the group's total profit or loss for the year would have been £69.6 million (2015: £62.2 million). Corresponding 10% changes in the valuation of the investment portfolio on the Corporation's total profit or loss for the year would have been £69.6 million (2015: £62.1 million).

Foreign currency risk, arising from movements in currency rates applicable to the group's investment in equities and fixed interest securities and the net assets of the group's overseas subsidiaries denominated in currencies other than sterling. The group's financial assets denominated in currencies other than sterling were:

	2016	2016	2016	2015	2015	2015
Group	Investments	Net monetary assets	Total currency exposure	Investments	Net monetary assets	Total currency exposure
	£m	£m	£m	£m	£m	£m
US Dollar	84.2	6.9	91.1	59.7	6.0	65.7
Canadian Dollar	5.3	–	5.3	2.1	–	2.1
Euro	37.9	0.4	38.3	24.1	0.3	24.4

Danish Krone	2.4	–	2.4	2.3	–	2.3
Swedish Krona	1.6	–	1.6	1.5	–	1.5
Swiss Franc	13.3	–	13.3	12.1	–	12.1
Hong Kong Dollar	–	0.4	0.4	–	0.3	0.3
Japanese Yen	7.8	–	7.8	6.9	–	6.9
	152.5	7.7	160.2	108.7	6.6	115.3

The group US dollar net monetary assets is that held by the US operations of £42.3 million together with £1.0 million held by non-US operations less the US dollar/sterling currency swap notional amount of £36.4 million (\$45 million).

The holdings in the Schroder Japan Growth Fund, Baillie Gifford Pacific and Stewart Investors Asia Pacific OEICs and Templeton Emerging Markets Investment Trust and Scottish Oriental Smaller Companies Trust are denominated in sterling but have underlying assets in foreign currencies equivalent to £50.8 million (2015: £63.6 million). Investments made in the UK and overseas have underlying assets and income streams in foreign currencies which cannot be determined and this has not been included in the sensitivity analysis. If the value of all other currencies at 31 December 2016 rose or fell by 10% against sterling, the impact on the group's total profit or loss for the year would have been £22.7 million and £18.4 million respectively (2015: £19.1 million and £15.6 million). Corresponding 10% changes in currency values on the Corporation's total profit or loss for the year would have been the same. The calculations are based on the investment portfolio at the respective year end dates and are not representative of the year as a whole

Interest rate risk, arising from movements in interest rates on borrowing, deposits and short term investments. The board reviews the mix of fixed and floating rate exposures and ensures that gearing levels are appropriate to the current and anticipated market environment. The group's interest rate profile was:

2016

	Sterling	HK Dollars	US Dollars	Euro
	£m	£m	£m	£m
Floating rate assets	50.7	0.4	43.3	0.4

2015

	Sterling	HK Dollars	US Dollars	Euro
	£m	£m	£m	£m
Floating rate assets	23.4	0.3	36.3	0.3

The group holds cash and cash equivalents on short term bank deposits and money market funds. Interest rates tend to vary with bank base rates. The investment portfolio is not directly exposed to interest rate risk.

	2016	2015
	Sterling	Sterling
	£m	£m
Fixed rate liabilities	114.0	114.0
Weighted average fixed rate	4.589%	5.320%

If interest rates during the year were 1.0% higher the impact on the group's total profit or loss for the year would have been £620,000 credit (2015: £336,000 credit). It is assumed that interest rates are unlikely to fall below the current level.

Liquidity risk

Arising from any difficulty in realising assets or raising funds to meet commitments associated with any of the above financial instruments. To minimise this risk, the board's strategy largely limits investments to equities and fixed interest securities quoted in major financial markets. In addition, cash balances are maintained commensurate with likely future settlements. The maturity of the group's existing borrowings is set out above.

Credit risk

Arising from the failure of another party to perform according to the terms of their contract. The group minimises credit risk through policies which restrict deposits to highly rated financial institutions and restrict the maximum exposure to any individual financial institution. The group's maximum exposure to credit risk arising from financial assets is £101.5 million (2015: £67.4 million).

Trade and other receivables

Trade and other receivables not impaired but past due by the following:

	2016	2015
	£000	£000
Between 31 and 60 days	1,713	1,986
Between 61 and 90 days	210	380
More than 91 days	577	1,777
Total	2,500	4,143

At 31 December 2016, trade and other receivables which were impaired and for which there was a bad debt provision totalled £955,000 (2015: £1,290,000). All the impaired trade and other receivables were more than 91 days past due.

Trade and other payables

	2016	2015
	£000	£000
Due in less than one month	12,851	13,353
Due in more than one month and less than three months	495	463
	13,346	13,816

Fair value

The directors are of the opinion that the fair value of financial assets and liabilities of the group are not materially different to their carrying values, with the exception of the long term borrowings.

Principal risks and uncertainties – IFS businesses

The principal risks to the business model from the IFS arise where transactions to which we provide a service come under stress – say by going into default, or where re-financings or other transaction amendments are required. Such risks may arise from the wider economic pressures on some sectors, borrowers and regions. To mitigate these risks, we work closely with our legal advisers and where appropriate, financial advisers, both in the set up phase to ensure that we have as many protections as practicable and on a continuing basis. The directors, via detailed audit committee review, monitor these risks closely to ensure that the risks of the IFS businesses do not impact the investment portfolio.

The single KPI of the IFS is revenue return per share, which is reported within the financial summary and performance table and the ten year record

Directors' responsibility statement pursuant to DTR4

The directors confirm to the best of their knowledge:

- the group financial statements have been prepared in accordance with IFRSs and Article 4 of the IAS Regulation and give a true and fair view of the assets, liabilities, financial position and profit or loss of the group; and
- the annual report includes a fair review of the development and performance of the business and the position of the group and parent company, together with a description of the principal risks and uncertainties that they face.

Copies of the annual report will be available from the Corporation's registered office or on its website once published on 9 March 2017.

By order of the board

Law Debenture Corporate Services Limited

Secretary

28 February 2017