A year of growth

Annual Report & Accounts 2012

BLME
BANK ON OUR PRINCIPLES

Opened in 1894, Tower Bridge represented an innovation in bridge building.

The design allowed tall mast ships access to the port of London whilst at the same time providing London with an extra river crossing. Tower Bridge enabled the increased commercial activity in London’s east end to flourish. A different way of thinking backed up by solid industrial design paved the way for rapid economic growth as London moved into the 20th Century.

Launched in 2007, BLME is an independent wholesale bank founded on the principles of ethics, transparency, and accountability – values that underpin every element of our business. BLME offers competitive products and bespoke client-focused solutions to the UK mid-market, institutions and individuals. BLME is a bridge between the UK and Middle East markets.

With our balance sheet now exceeding £1 billon and with our strong business and operating platform developed over the last five years, BLME is well placed to undertake the next phase of its development and to increase profitability.

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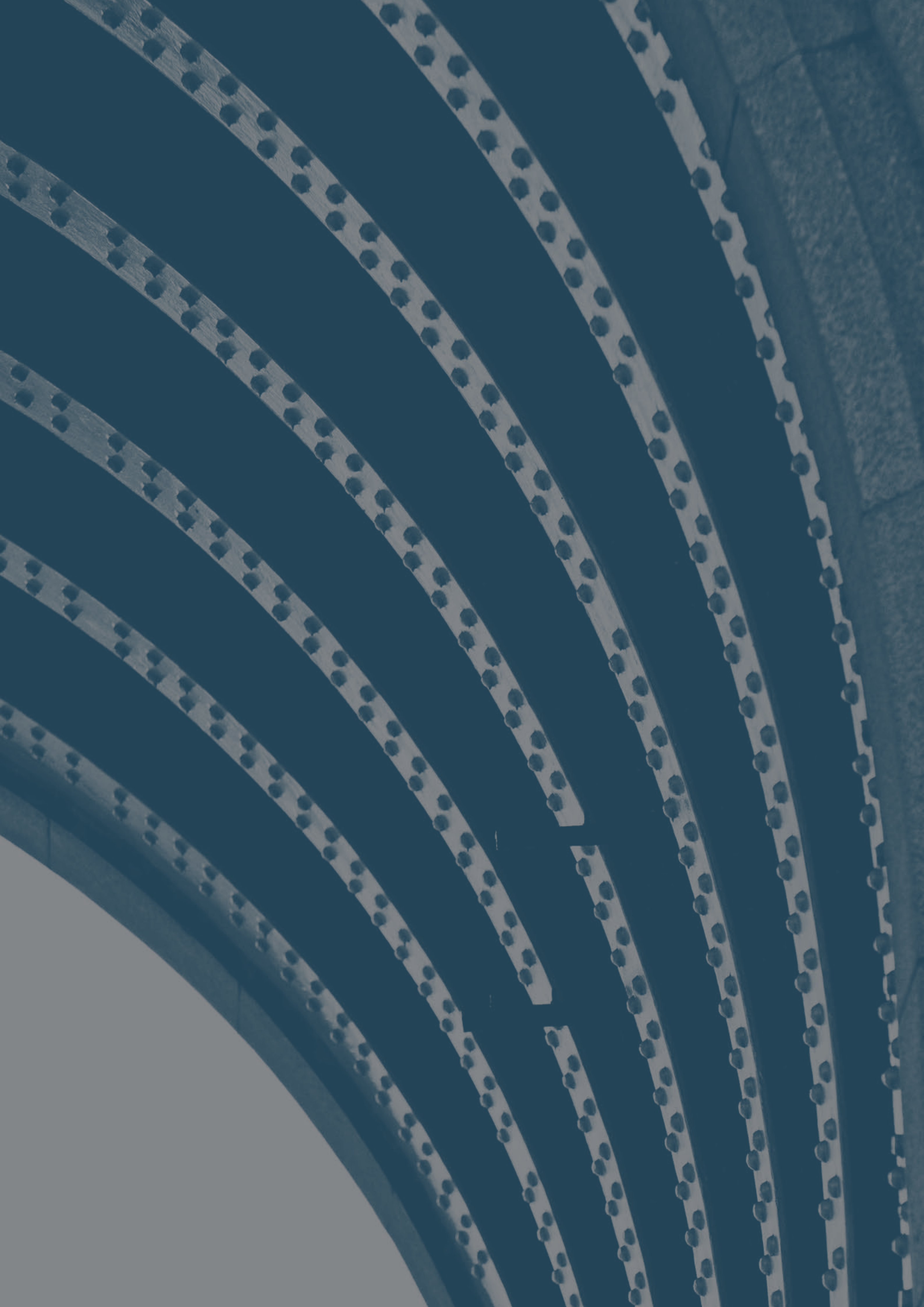


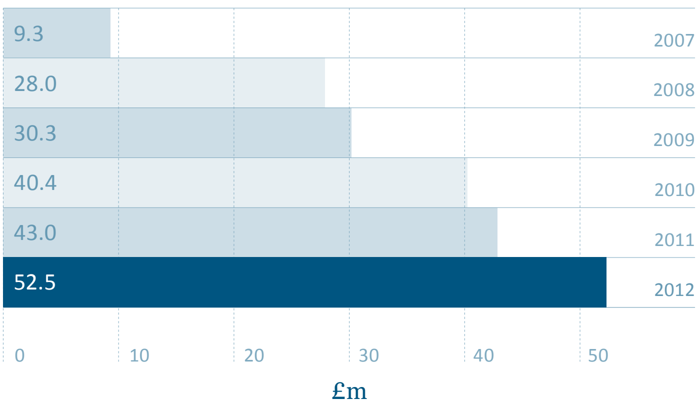
2012 Group Highlights for Bank of London and The Middle East plc:

BLME has delivered consistent and sustained growth in 2012...

- A 67% increase in Operating Profit before Impairment Charges
- A 490% increase in the value of BLME Premier Deposit Accounts which, together with increases in institutional deposits, enabled the Group's Total Assets to break through the £1 billion mark for the first time

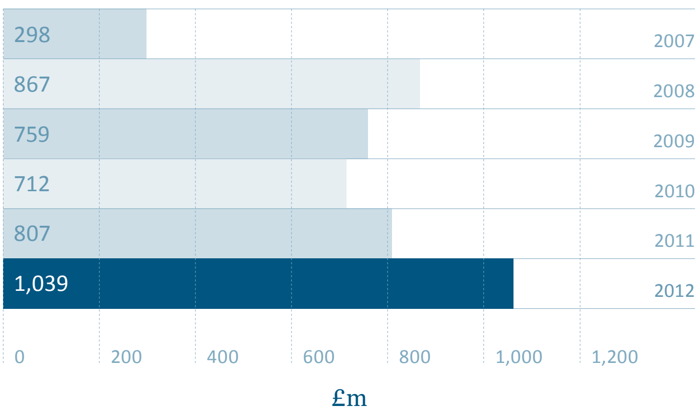
Consolidated Total Operating Income (£m)

£52.5m



Consolidated Total Assets (£m)

£1,039m



...while investing in people, product development and infrastructure:

- Continued development of innovative products as demonstrated by the successful launch of the Commodity Trade Finance and Asset Based Lending businesses within the Corporate Banking Division
- The investment grade BLME US$ Income Fund was ranked 6th out of a peer group of 758 funds by Lipper Hindsight, Reuter's Fund ranking service

Exposure by Country

(as at 31 December 2012)

	%
Bahrain	2.29
France	1.41
Kuwait	3.23
Luxembourg	0.45
Other Countries	6.79
Qatar	5.79
Saudi Arabia	4.86
Switzerland	1.62
United Arab Emirates	7.70
United Kingdom	63.43
USA	2.43

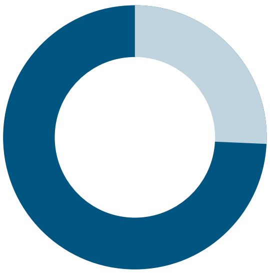
Exposure by Sector

(as at 31 December 2012)

	%
Commodities	2.35
European financial institutions	1.98
GCC financial institutions	14.63
Government	5.04
Healthcare	0.08
Manufacturing	0.82
Mining and quarrying	1.54
Oil and Gas	1.21
Other financial institutions	2.74
Others	4.68
Real estate	25.31
Transportation and storage	12.27
UK financial institutions	20.83
Wholesale / Retail	6.52

25.31%

Exposure to Real Estate



In this document the bank's name is shortened to "BLME" in narrative text. The expression "the Bank" refers to the parent company, Bank of London and The Middle East plc, while the expression "the Group" refers to the parent company and its subsidiaries.

Chairman's statement

In the name of Allah, the Most Gracious, the Most Merciful
To the shareholders of Bank of London and The Middle East plc

I am very pleased to report to shareholders on the improved financial performance and the return to profitability that the Bank of London and The Middle East plc achieved in the 12 months to 31 December 2012. In particular I draw attention to the 22% increase in Group Total Operating Income from £43.0 million to £52.5 million over this period. A key milestone achieved is that Group Total Assets have reached £1,039 million, exceeding £1.0 billion for the first time. This represents growth of 29% in the Group Balance Sheet for the year. In addition to this healthy Balance Sheet development, I am also pleased to report a Group Operating Profit before Tax of £5,515,158 for the year.

In 2012 market participants had to contend with additional regulation which required increased levels of liquidity and changes to capital adequacy in preparation for the full implementation of Basel III. In this more onerous regulatory environment I welcome the progress made by BLME over the past year. The Bank's strong capital base demonstrates that it is well positioned to deliver on its strategy whilst continuing to meet the higher capital ratios required of banks over the next few years. BLME has taken important steps to strengthen further the Bank's liquidity and funding, including a significant expansion of the BLME Premier Deposit Account balances. This has improved the Bank's longer term funding position and diversified its deposit base.

I wish to highlight that, throughout the year, your Board maintained a high level of focus on corporate governance and remuneration policy standards. Your Board played an active role with management in overseeing and evaluating the medium-term strategic plan that was introduced at the beginning of the year.

Having reached the fifth anniversary of the Bank receiving FSA authorisation, it is important that BLME builds upon its strong foundation and focuses on delivering sustained levels of higher profitability. An important aspect of this is to develop closer relationships with our customers. In this respect, I anticipate that the opening of the BLME representative office in Dubai during the first half of 2013 will bring significant benefits to the Bank. The opening of an office in the GCC will complement the efforts that have already been made to expand the Bank's product range and areas of specialisation, notably in Wealth Management and Capital Markets capabilities.

I would like to express my deep appreciation for the expertise and support provided by our Sharia'a Supervisory Board. This support is an essential and integral part of the leading role that BLME plays in pioneering the development of new Islamic products. These accomplishments have helped to make BLME the most diverse and innovative Islamic financial institution in Europe. I would like to express my thanks for the loyalty and hard work of our staff for the much improved financial performance in 2012, and for their on-going efforts in the development of BLME.

I am also grateful for continued support from shareholders for the Bank. I look forward to BLME entering the next phase in its development both in the UK and internationally and, to that end, at the Board Meeting on 7 February 2013, it was approved that the Executive should take the necessary actions in preparation for a listing of our shares on an appropriate exchange at the earliest opportunity in 2013.

Yacob Al-Muzaini
Chairman
28 February 2013

£1,000,000,000

In 2012, the Group's Total Assets broke through the £1 billion mark for the first time

Chief Executive Officer's statement

Business summary and results

In the year to 31 December 2012 Bank of London and The Middle East plc reported an Operating Profit before Tax for the Group of £5,515,158. The key factor behind this achievement was a 67% increase in Operating Profit before Impairment Charges. In addition there were no significant new impairments in the credit portfolio and there was revenue growth across the Bank's Corporate Banking and Wealth Management businesses.

During this period the Group Balance Sheet increased by 29% from £807 million to £1,039 million, and the capital adequacy ratio remained well in excess of current and impending Basel standards. Total Operating Income for the Group increased by 22% whilst Operating Expenses continued to be rigorously managed. This is reflected in the significant increase in Operating profits. It is also pleasing to note the increasing diversification of earnings across BLME's three business divisions: Corporate Banking, Wealth Management and Treasury, and the growth in Net Fee Income from £642,348 to £1,777,424.

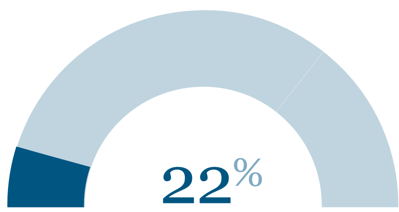
The significant increase in the Group Balance Sheet met the twin strategic priorities of developing a more diversified liability base and increasing our ability to fund asset growth. The Bank is now well placed to support the planned increase in customer financing and to satisfy the more stringent regulatory liquidity ratios.

Credit situation

The Bank has deliberately avoided credit exposure to those countries most impacted by economic events in the Eurozone and the countries impacted by the political crises in the Middle East. The Bank has strengthened its Risk department and it is encouraging to report on the improved performance of the credit portfolio, where no new provisions of any significance have been required and almost all of the 2012 impairment charge of £1,761,293 related to increasing the reserve for an existing exposure. The improved credit situation is reflected in non-performing loans as a percentage of total loans and operating lease assets, reducing from 6.5% to 5.1%.

£5,515k

Operating Profit before Tax for the Group



Increase in Total Operating Income.

Corporate Banking

Corporate Banking achieved a significant increase in both revenues and customer assets in 2012. It is encouraging to see that the strategic investments made in the business in 2012 are already strongly contributing to the growth in operating income. The Division's two core businesses, Leasing and Property Finance, both delivered strong increases in earnings. Both are now recognised as key players in their respective sectors of the UK market. It is pleasing to note the increased revenue diversification within the Division, which saw good contributions from the newly established Asset Based Lending, Acquisition Finance and Commodity Trade Finance units. BLME now provides a full suite of products to the Small and Medium-sized Enterprise sector in the UK and has established itself as a leading mid-market banking services provider.

Wealth Management

Wealth Management comprises both BLME's Asset Management and Private Banking businesses. BLME's Private Banking expertise is in providing advice and finance to customers seeking to acquire high-end UK residential property. The uncertainty created by the UK Government's announcement on Stamp Duty Land Tax in the March 2012 Budget led to a slow-down in customer enquiries which was subsequently reversed following finalised Government policy on the position at the end of the year. Following this clarification, Private Banking has seen a marked increase in demand for its services.

In Asset Management, both the US$ Income Fund and the Global Sukuk Fund (formerly called the High Yield fund) maintained their excellent performance. The US$ Income Fund was ranked as the 6th best performing fund out of a peer group of 758 funds by Lipper Hindsight, the Reuters fund ranking service. The Global Sukuk Fund was rated as the top performing Sukuk Fund in 2012 by Zawya, the industry benchmarking specialist. For 2012 the US$ Income Fund and Global Sukuk Fund have produced returns of 3.83% and 13.19% respectively. This represents very significant out-performance over their respective benchmarks.

The Bank will shortly close its Light Industrial Building Fund to new subscriptions. This closed-ended real estate fund with income generating assets will complement BLME's existing fixed income funds.

In preparation for the opening of the representative office in Dubai, BLME has expanded its Institutional Coverage team and more closely aligned it with the Capital Markets group. This will strengthen the Bank's relationships with, and improve product delivery in, the GCC.

£1,039m

The value of the Group Balance Sheet, an increase of 29% from the previous year

6/758

The US$ Income Fund was ranked as the 6th best performing fund out of a peer group of 758

Treasury

Treasury's role is to manage the Bank's capital, liquidity and funding. In 2012 the major accomplishment was the sizeable growth and diversification in the Bank's liability base. This was achieved by a combination of attracting new customers to the BLME Premier Deposit Accounts, which grew from £40 million to £236 million over the past 12 months and increasing institutional deposits. BLME has increased the number of its depositors from 525 to 3,279 in 2012. This has enabled the Group Balance Sheet to grow by 29% and allowed BLME to meet the planned growth of customer assets. It has also substantially strengthened BLME's ability to meet the increasing regulatory demands for banks to establish longer term sources of funding.

BLME has increased the number of its depositors from 525 to:

3,279

Our staff and expertise

BLME has continued to gain recognition for its professionalism and commitment to developing Islamic Finance. In 2012 it was voted Best Islamic Bank in Europe in the annual market poll conducted by Islamic Finance News, the fourth consecutive year that BLME has won this award. This is testament to the quality and dedication of the Bank's staff in expanding the role of Islamic banking in Europe, and providing a wide range of financial solutions and investment products to customers, institutional investors and market participants.

BLME is the largest and most diverse Sharia'a compliant bank in Europe. I am therefore particularly aware of the value of the Bank's human capital. BLME remains committed to promoting the Islamic Finance Qualification, and undertaking Chartered Institute for Securities and Investment training so that its staff and business operations remain fully compliant with both Islamic banking principles and the rapid changes in UK and global banking regulation.

Outlook for the future

I am much encouraged by both the good 2012 results and the significant steps taken this year to position the Bank for growth and enhanced financial performance. The imminent opening of the Dubai representative office as well as further new product launches, will allow the Bank to expand the reach and distribution of its established business capabilities in partnership with key stakeholders and clients. Based on the strong business and operating platform developed over the last five years, BLME is now well placed to undertake the next phase of its development and to increase profitability.

Humphrey Percy
Chief Executive Officer
28 February 2013

£40m

to £236m

The value of BLME Premier Deposit Accounts have grown by 490% over the past 12 months

67%

BLME had a 67% increase in Operating Profit before impairment charges in 2012

The Board and Executive Management

Yacob Yousef Al-Muzaini – *Chairman*

Yacob is the non-executive Chairman of the Board of BLME. He has 30 years of leadership experience in private and public sector financial institutions. Until 2008 he was the Chairman and Managing Director of Boubyan Bank, thereafter he became the Managing Director of Hayat Invest Company, Kuwait. Yacob has also held several board memberships of national and international companies and investment funds.

Sheikh Abdullah Jaber Al-Ahmed Al-Sabah – *Vice Chairman*

Abdullah is the non-executive Vice Chairman of the Board of BLME. He is the Deputy Director General for Investment at Kuwait's Public Institution for Social Security (PIFSS) and Chairman of Housing Finance Company (ISKAN) and Ahli United Bank of Kuwait (AUBK). Previously he was Vice President at Wafra Investment Advisory Group in New York between 1991 – 1998, where he was involved with projects in direct equity, real estate and equity portfolios.

EXECUTIVE DIRECTORS

Humphrey Richard Percy – *Chief Executive Officer*

Humphrey joined BLME as Chief Executive Officer in August 2006. Humphrey has more than 30 years of international banking experience. In the course of his career he has worked at J. Henry Schroder Wagg, Barclays Merchant Bank (later Barclays de Zoete Wedd/BZW) and WestLB where he held positions including Chief Executive Ofiicer, Managing Director, General Manager, and Head of Global Financial Markets. Humphrey is experienced in building new functions and product areas, and has managed a number of global businesses within both Barclays and WestLB as well as founding his own business in 2002 where he remains non-executive Chairman.

Richard Radway Williams – *Chief Financial Officer*

Richard joined BLME as Chief Financial Officer and Company Secretary in November 2006. Having qualified as a Chartered Accountant with KPMG in 1980, Richard's early career in Investment Banking was spent with Chase Manhattan, Credit Agricole and Bankers Trust. He then spent 10 years at Robert Fleming & Co setting up their Global Equities Derivatives business, including three years in Hong Kong with Jardine Fleming. Richard also has experience with start-up companies and in private equity with Legal & General Ventures.

Nigel Brodie Denison – *Head of Wealth Management & Treasury*

Nigel joined BLME as Director and Head of Treasury in November 2006. In 2009 he established the Asset Management business and in 2011 took over the Private Banking unit creating a single Wealth Management Division. Before joining BLME he was Head of European Distribution for WestLB's Global Markets unit which included Treasury, Capital Markets and Emerging Markets. Nigel began his career at Barclays Merchant Bank (later Barclays de Zoete Wedd/BZW), where he became Head of Trading for Barclays Swaps and Options European business, based in London. He then worked in New York where he ran the derivatives trading operations for Barclays.

NON–EXECUTIVE DIRECTORS

Neil Jonathan Holden

Neil is Chairman of BLME's Board Risk Committee. He is a mathematician and Chartered Accountant with more than 25 years experience of international banking focusing on financial control, risk management and governance. His executive roles included Head of Corporate and Investment Banking Credit for Standard Bank Group, Head of Risk for Standard Bank Plc, and previously various senior roles at WestLB and Hambros Bank covering all risk, finance and operational disciplines. He is also a non-executive director of Stanbic International Insurance Limited and Integrated Financial Arrangements Plc.

Frank Willem Vermeulen

Frank is Chairman of BLME's Audit Committee. He has a Master's Degree in Dutch law and has more than 20 years experience in finance. For most of this period Frank worked for ABN Bank NV in a variety of roles in different countries, including Head of Corporate Banking, Syndications & International for Saudi Hollandi Bank, Riyadh. In 1992 he joined Olayan Financing Company in Riyadh, where he worked until his retirement at the end of 2006. At Olayan he held positions including Treasurer and Chief Financial Officer and various board positions in affiliated companies and now is an advisor. Frank currently holds Board positions with Mining & Minerals Opportunity, Inc. and Bolsa Resources Inc. He also acts as an advisor for Jarir Marketing Company, Riyadh, where he is a member of the Audit Committee, and is involved in risk management at Saudi Hollandi Bank.

Ibrahim Al Qadhi

Ibrahim is a non-executive member of the Board of BLME. He is currently the Chief Executive Officer of the Gulf Investment Corporation, the Chairman and General Manager of Kuwait Clearing Company and has been a member of the Kuwait Stock Exchange Committees since 1998. From 2009 until March 2012 he was the Chairman of Boubyan Bank. Ibrahim has more than 28 years experience in international banking and during his career to date he has worked for Kuwait Investment Company and National Commercial Bank in Jeddah (Saudi Arabia) where he held a variety of senior positions. He was Executive Director of the Supervision Sector at the Central Bank of Kuwait and representative for the Central Bank of Kuwait in the Institute of International Finance (IIF) in Washington for five years until 2008. From 2003 to 2008 Ibrahim was a member of the Technical Committee of The Islamic Financial Services Board (IFSB) in Kuala Lumpur.

Michael Williams

Michael is Chairman of BLME's Remuneration Committee. He is a qualified banker with an extensive background in international finance. He has held a number of senior and board level positions in the UK and more recently in the Middle East. Michael currently is Chairman of a UK PLC with interests in IT and Recruitment, is Deputy Chairman of a Mutual Friendly Society where he also chairs the Audit and Risk Committee, and is on the board of a Business Services Group in the United Arab Emirates. Michael also holds a consultancy role with a major Middle Eastern bank advising on their international expansion. Prior to this he was Chief Executive Officer of the International Bank of Qatar in Doha before which he was the CEO of the National Bank of Fujairah in the UAE having previously been the Managing Director of Nomura Bank International Plc for 6 years. Michael started his career with Barclays Bank Group working for them for 25 years holding a number of senior positions including Managing Director of Barclays Global Services and Corporate Banking Director at Barclays Bank PLC.

Adel Abdul Wahab Al-Majed

Adel is a non-executive member of the Board of BLME. He has over 30 years of experience in banking. He is currently Chairman of BLME's largest shareholder, Boubyan Bank, having previously held the positions of Vice Chairman and Chief Executive Officer. From 1980 to 2009 Adel worked for National Bank of Kuwait where he held a number of positions including Deputy Chief Executive Officer and General Manager. Adel has played a key role in the development of the Kuwait banking sector including regulation, shared enterprises (Credit Bureau and K-Net Shared Switch) and Islamic Banking. He currently holds a board position with Visa APCEMEA – Senior Client Council and is Chairman of United Capital Bank.

Directors' report

The Directors present their annual report and audited financial statements for the year ended 31 December 2012.

Principal activities

Bank of London and The Middle East plc was originally incorporated in the United Kingdom on 7 August 2006 (as United House of Britain plc) and received FSA authorisation to launch and start trading as a bank in the City of London on 5 July 2007. BLME, an independent wholesale bank, provides a range of Sharia'a compliant banking services and advice to businesses and individuals, with a strong focus on Europe, the Middle East and North Africa regions, requiring access to innovative Islamic financial products.

Financial results

The financial statements for the reporting period ended 31 December 2012 are shown on pages 29 to 110. The consolidated Group profit for the year after taxation amounts to £3,840,755 (2011: loss of £8,897,990). The unconsolidated profit for the Bank for the year after taxation amounts to £2,563,372 (2011: loss of £8,983,963).

Financial review

In the year to 31 December 2012 BLME continued to build on its established Treasury and Corporate Banking businesses and develop its more recently established Asset Management and Private Banking activities.

Further information on the development of the BLME businesses is included in the Chief Executive Officer's statement on pages 8 to 10.

Dividends

The Directors do not recommend the payment of a dividend.

Risk

The Group and Bank have exposure to the following risk categories arising from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk

A full description of how the Group and Bank manages these risks is provided in Note 34.

Sharia'a Supervisory Board members

The Sharia'a Supervisory Board members during the year were as follows:

- Sheikh Dr. Abdulaziz Al-Qassar (Chairman)
- Sheikh Dr. Esam Khalaf Al-Enezi
- Sheikh Dr. Mohammed Daud Bakar
- Sheikh Dr. Mohammad Imran Usmani (resigned 31 December 2012)

Policy and practice on payment of creditors

BLME's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated.

Political and charitable contributions

BLME made no political contributions during the period (2011: Nil). No charitable donations were made during the period (2011: £52,385).

Going concern

The Directors have reviewed the business activities and financial position of BLME and have a reasonable expectation that it has adequate resources to continue in operational existence for the foreseeable future. In making this assessment the Directors have considered a wide range of information about the current and future condition of the Group including the strategic direction, activities and risks that affect the financial position. In particular the Directors have assessed the 2013 budget and future plans. For these reasons the financial statements have been prepared on a going concern basis.

Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' report confirm that so far as they are each aware there is no relevant audit information of which the Bank's auditors are unaware, and each Director has taken all steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

Auditors

A resolution concerning the re-appointment of KPMG as auditors and authorising the Directors to set their remuneration will be proposed at the Annual General Meeting.

By order of the Board

Richard Williams
Company Secretary
28 February 2013

The Directors who held office during the year were as follows:

Name	Date of appointment	Committee
Yacob Yousef Al-Muzaini *Chairman of the Board* *Chairman of the Nominations Committee*	7 August 2006	Nominations
Sheikh Abdullah Jaber Al-Ahmed Al-Sabah *Vice Chairman of the Board*	22 October 2007	Nominations Audit Remuneration Risk
Humphrey Richard Percy	21 September 2006	Executive
Richard Radway Williams	28 November 2006	Executive
Nigel Brodie Denison	28 November 2006	Executive
Neil Jonathan Holden *Chairman of the Risk Committee*	1 November 2006	Audit Risk Remuneration
Frank Willem Vermeulen *Chairman of the Audit Committee*	1 January 2007	Nominations Audit Risk
Ibrahim Al Qadhi	25 September 2009	Audit
Michael Williams *Chairman of the Remuneration Committee*	2 March 2012	Remuneration Risk
Adel Abdul Wahab Al-Majed	6 December 2012	

Under the Articles of Association Sheikh Abdullah Jaber Al-Ahmed Al-Sabah, Humphrey Richard Percy and Ibrahim Al Qadhi will retire by rotation at the next Annual General Meeting. They may offer themselves for re-appointment at the next Annual General Meeting.

The Group provided all Directors with qualifying third party indemnity provisions during the financial year and at the date of this report.

£236m

...the BLME Premier Deposit Accounts, which grew from £40 million to £236 million over the past 12 months

£40m

Corporate governance report

The Board considers that good corporate governance is central to achieving the Bank's objectives. The following statement describes BLME's structure and processes in relation to the Board, Directors' remuneration, accountability and audit, and relations with shareholders.

BOARD AND BOARD COMMITTEES

The Board of Directors

The Board is responsible for BLME's system of corporate governance. At 31 December 2012 the Board of Directors comprised three executive Directors: Humphrey Percy – Chief Executive Officer, Richard Williams – Chief Financial Officer, Nigel Denison – Director and Head of Wealth Management and Treasury, and seven non-executive Directors including the non-executive Chairman.

Yacob Yousef Al-Muzaini is non-executive Chairman and Sheikh Abdullah Jaber Al-Ahmed Al-Sabah is Vice Chairman of the Board. The other non-executive Directors are Neil Holden – Chairman of the Risk Committee, Frank Vermeulen – Chairman of the Audit Committee, Michael Williams – Chairman of the Remuneration Committee, Ibrahim Al-Qadhi and Adel Abdul Wahab Al-Majed.

The appointment of Directors is considered by the Nominations Committee and then the Board. Following the provisions in the Articles of Association all Directors who have been appointed by the Board, rather than at a General Meeting of Shareholders, must stand for re-election by the shareholders at the first Annual General Meeting following their appointment and, following that meeting, must stand for re-election by the shareholders at least every three years.

Non-executive Directors are appointed for three-year renewable terms, which may be terminated by giving three months' notice.

All the Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring compliance with Board procedures and applicable regulations. Independent professional advice is available to the Directors at the Bank's expense where they judge it necessary to discharge their duties as Directors.

Board meetings

The Board of Directors meets at least quarterly and has a defined agenda of matters reserved for its decision. The Board is responsible for the overall company strategy, setting the risk appetite of the Bank, approval of major capital expenditure projects and consideration of major financing matters. The Directors discharge their duties within a framework of controls relating to the assessment and management of risk.

The matters specifically referred to the Board for decision include the approval of the annual report and financial statements, the payment of dividends, the long-term objectives of the Bank, the strategies necessary to achieve these objectives, the Bank's budgets and plans, significant credit exposures, significant capital expenditure items, significant investments and disposals, the organisational structure of the Bank, the arrangements for ensuring that the Bank manages risk effectively and any significant change in accounting policies or practices.

The Board met six times during the year; each meeting was attended by all members, other than the meeting on 15 June when Sheikh Abdullah Jaber Al-Ahmed Al-Sabah was absent, the meeting on 19 October when Frank Vermeulen was absent and the meeting on 7 December when Adel Abdul Wahab Al-Majed was absent.

Board Committees

The Board has delegated to the Committees of the Bank the responsibility to review and make recommendations to the full Board.

The Board Committees operate within clearly defined terms of reference.

Board Audit Committee

The Audit Committee is chaired by Frank Vermeulen and comprises Sheikh Abdullah Jaber Al-Ahmed Al-Sabah, Neil Holden and Ibrahim Al-Qadhi.

The Committee's main responsibility is to review any reports from

BOARD AND BOARD COMMITTEES (CONTINUED)

management, the internal auditor, and the external auditors regarding the accounts and the internal control systems implemented throughout the Bank, along with consideration of both interim and annual accounts. It also makes recommendations to the Board on the appointment of the auditors and their audit fee.

The Board considers that the members of the Audit Committee possess recent and relevant financial experience. The Audit Committee has unrestricted access to BLME's auditors. The external auditors, KPMG, provide non-audit services in addition to the provision of audit services. In the year ending 31 December 2012, non-audit services provided by KPMG comprised advice with regard to taxation, share schemes and other miscellaneous services.

The Audit Committee met eight times during the year; each meeting was attended by all members, other than the meetings on 14 June and 5 July when Sheikh Abdullah Jaber Al-Ahmed Al-Sabah was absent and the meetings on 17 February, 5 July and 30 August when Ibrahim Al-Qadhi was absent.

Board Risk Committee

The Risk Committee is chaired by Neil Holden and comprises Frank Vermeulen, Sheikh Abdullah Jaber Al-Ahmed Al-Sabah and Michael Williams.

The role of the Risk Committee is to oversee, on behalf of the Board, the risk appetite and policies for managing risk, and to review the exposures and risk concentrations across the Group's portfolio.

The Risk Committee met nine times during the year; each meeting was attended by all members, other than the meetings on 19 March, 2 June and 10 October when Sheikh Abdullah Jaber Al-Ahmed Al-Sabah was absent.

Board Remuneration Committee

The Remuneration Committee is chaired by Michael Williams and comprises Neil Holden and Sheikh Abdullah Jaber Al-Ahmed Al-Sabah.

The Remuneration Committee considers matters relating to the overall reward framework across BLME, including policy for Executive Management and their individual remuneration awards. In addition, it will advise on the remuneration policy for the Group's employees. The Remuneration Committee has appointed Kepler Associates as its advisor.

The Remuneration Committee met six times during the year; each meeting was attended by all members, other than the meeting on 14 June when Sheikh Abdullah Jaber Al-Ahmed Al-Sabah was absent.

Board Nominations Committee

The Nominations Committee is chaired by Yacob Yousef Al-Muzaini and comprises Sheikh Abdullah Jaber Al-Ahmed Al-Sabah and Frank Vermeulen.

The Nominations Committee is responsible for matters relating to the composition of the Board, including the appointment of new Directors, and making recommendations to the Board as appropriate.

The Nominations Committee is also responsible for determining and recommending to the Board the framework and reporting timetable for commissioning and overseeing the annual performance evaluation of the Board, its principal Committees and the respective Chairmen of those committees.

The Nominations Committee met four times during the year; each meeting was attended by all members, other than the meeting on 19 October when Frank Vermeulen was absent.

Chairman and Chief Executive

The roles of Chairman and executive management, led by the Chief Executive Officer, are separated and clearly defined:

a. The non-executive Chairman, Yacob Yousef Al-Muzaini, is responsible for the leadership of the Board, ensuring effectiveness in all aspects of its role, reviewing the Board's agenda and conducting Board meetings, and ensuring effective communication with shareholders and the conduct of shareholders meetings; and

b. Executive management is led by the Chief Executive Officer, Humphrey Percy, who has been delegated responsibility by the Board for the day-to-day management of the Bank within the control and authority framework set by the Board. The Chief Financial Officer, Richard Williams, and Head of Wealth Management and Treasury, Nigel Denison, assist the Chief Executive Officer in managing the business.

Board balance

The Board includes a balance of executive and non-executive Directors such that no individual, or small group of individuals, can dominate the Board's decision taking. The size of the Board and balance of skills is considered appropriate for the requirements of the business. No one other than the committee chairman and committee members is entitled to be present at a meeting of the Audit, Nomination, Risk or Remuneration Committees, but others may attend at the invitation of each committee.

Information and professional development

The Board is supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. The Chief Financial Officer is responsible for ensuring the Directors receive accurate, timely and clear information, which is provided by operational management and enhanced or clarified where necessary.

Financial reporting

The Board is responsible for presenting a balanced and understandable assessment of the Group and Bank's position and prospects, extending to interim reports and returns to regulators, including statutory requirements.

Internal control

The Directors are responsible for reviewing the effectiveness of the Bank's internal controls on an annual basis. There is an on-going process to identify, evaluate and manage risk, which has been in place throughout the period and is regularly reviewed by the Board.

The system includes internal controls covering financial, operational and compliance areas, and risk management. There are limitations to any system of internal control, which can only provide reasonable but not absolute assurance with respect to the preparation of financial information, the safeguarding of assets and the possibility of misstatement or loss.

Relations with shareholders

The Directors place great importance on maintaining good communications with all investors. The Bank reports formally to shareholders twice a year with the publication of its interim and annual reports.

Sharia'a Supervisory Board report

In the name of Allah, the Most Gracious, the Most Merciful
To the shareholders of Bank of London and The Middle East plc

Assalamu Alaikum wa Rahmat Allah wa Barakatuh.

The management of BLME is responsible for ensuring that the Bank conducts its business in accordance with the principles of the Sharia'a. It is the responsibility of the Sharia'a Supervisory Board to form an independent opinion, based on the review of the operations, agreements and transactions conducted by BLME. It is the responsibility of BLME management to implement the decisions of the Sharia'a Supervisory Board.

We, the Sharia'a Supervisory Board of BLME have reviewed and monitored the operations, agreements and transactions conducted by BLME during the period 1 January 2012 to 31 December 2012 and have reviewed the BLME Annual Report and Accounts for the year ended 31 December 2012. We conducted our reviews to form an opinion as to whether BLME has complied with the principles of the Sharia'a and with specific fatwa rulings and guidelines issued by the Sharia'a Supervisory Board.

It is the Sharia'a Supervisory Board's opinion that:

1. The operations, agreements and transactions entered into and conducted by BLME during the year 1 January 2012 to 31 December 2012 and which were reviewed by the Sharia'a Supervisory Board are in compliance with the principles of the Sharia'a.
2. The distribution of profits and the sharing of losses in terms of the investment accounts at BLME are in compliance with the principles of the Sharia'a.
3. All income and profit generated by BLME during the year 1 January 2012 to 31 December 2012 has been derived from Sharia'a compliant sources other than £10,839 which has been segregated for payment to approved charities.

Moreover, BLME does not pay zakat on behalf of its shareholders and it is the sole responsibility of the individual shareholders to make their zakat payments.

We ask Allah to lead the management and staff of BLME towards integrity, correctness and further success.

Wassalam Alaikum wa Rahmat Allah wa Barakatuh.

Signed on behalf of the Sharia'a Supervisory Board of Bank of London and The Middle East plc

Sheikh Dr. Abdulaziz Al-Qassar
Chairman – 28 February 2013

£43.0m

to

£52.5m

2012 saw a 22% increase in Group Total Operating Income from £43.0 million to £52.5 million over this period

I am also pleased to report a Group Operating Profit before Tax of £5,515,000 for the year

Yacob Al-Muzaini, *Chairman*

£5,515,000

Statement of Directors' responsibilities

In respect of the annual report and financial statements

The directors are responsible for preparing the Directors' report and the Group and the Bank financial statements, in accordance with applicable laws and regulations.

Company law requires the directors to prepare the Group and the Parent company financial statements for each financial year. Under that law the directors have elected to prepare both the Group and the Parent company financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and applicable Law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Parent company and of their profit or loss for that period.

In preparing each of the Group and Parent company's financial statements, the directors are required to:

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

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

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

Independent auditor's report

TO THE MEMBERS OF BANK OF LONDON AND THE MIDDLE EAST PLC

We have audited the financial statements of Bank of London and The Middle East plc for the year ended 31 December 2012 set out on pages 29 to 110. The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards ("IFRS") as adopted by the EU and, as regards the Parent company's financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 25, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's web-site at www.frc.org.uk/auditscopeukprivate

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent company's affairs as at 31 December 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the EU;

- the Parent company's financial statements have been properly prepared in accordance with IFRS as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

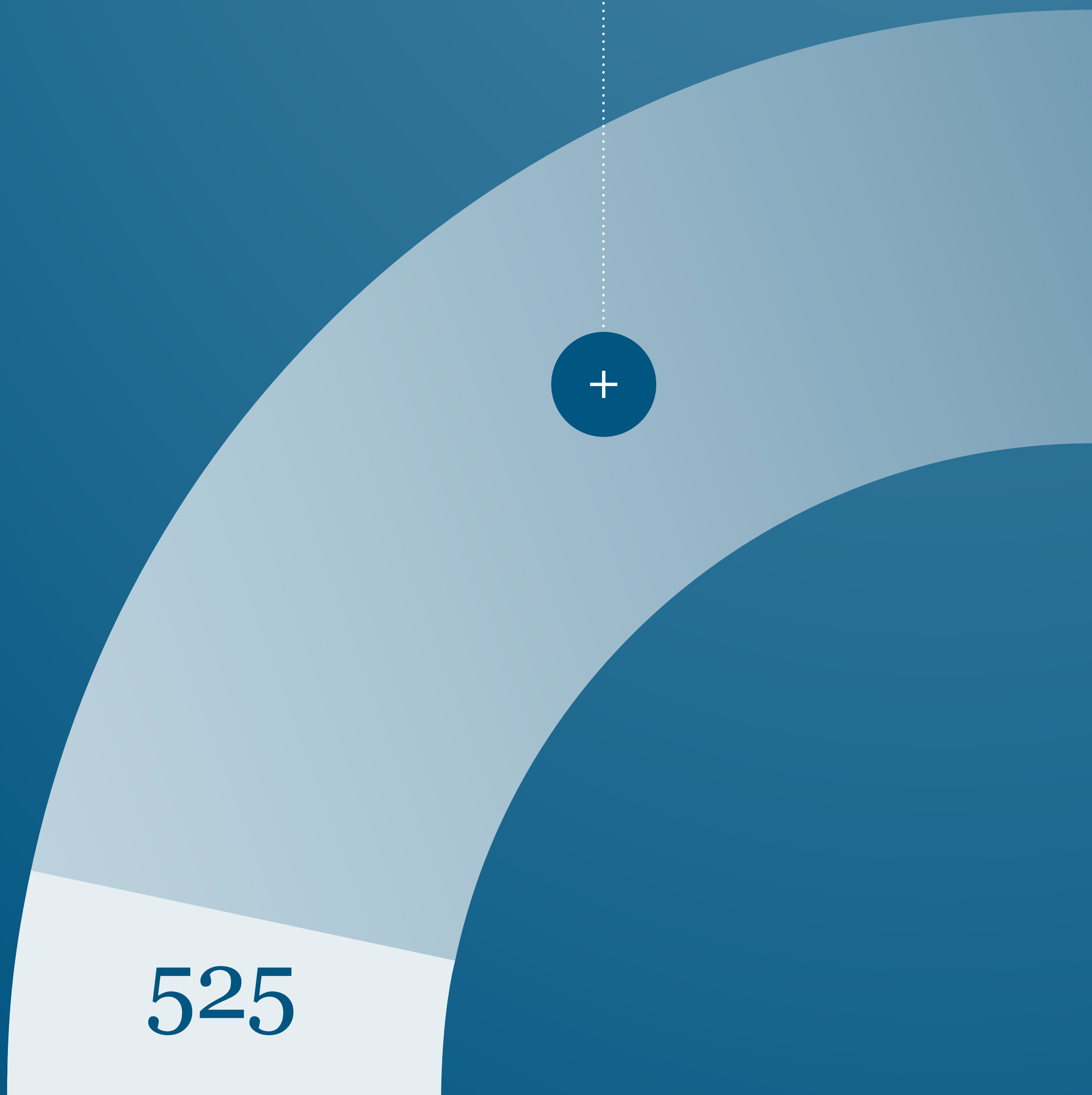
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Paul Furneaux
Senior Statutory Auditor
For and on behalf of KPMG
Audit Plc, Statutory Auditor
Chartered Accountants
London 28 February 2013

3,279

BLME has increased the number of its depositors from 525 to 3,279 in 2012



Consolidated income statement

For the year 1 January 2012 to 31 December 2012

Income	Note	2012	2011
		£	£
Income from financing and investing activities	5	30,779,337	25,721,315
Returns to financial institutions and customers	6	(13,637,879)	(9,430,933)
Net margin		**17,141,458**	**16,290,382**
Fee and commission income		2,007,364	735,263
Fee and commission expense		(229,940)	(92,915)
Net fee income		**1,777,424**	**642,348**
Net fair value gains / (losses) on investment securities	7	3,601,119	(975,203)
Net fair value losses on investment properties	19	(1,049,455)	(326,155)
Operating lease income		27,250,053	25,259,609
Other operating income	8	3,746,636	2,128,353
Total operating income		**52,467,235**	**43,019,334**
Expenses			
Personnel expenses	10	(12,145,670)	(9,519,860)
Operating lease depreciation	23	(21,646,350)	(20,606,721)
Other depreciation and amortisation	22, 24	(383,660)	(667,208)
Other operating expenses	12	(10,174,384)	(7,820,969)
Change in third party interest in consolidated funds	32	(840,720)	(50,732)
Total operating expenses		**(45,190,784)**	**(38,665,490)**
Operating profit before impairment charges		**7,276,451**	**4,353,844**
Net impairment charge on financial assets	14	(1,761,293)	(15,202,534)
Net operating profit / (loss) before tax		**5,515,158**	**(10,848,690)**
Tax (expense) / credit	15	(1,674,403)	1,950,700
Profit / (loss) for the year		**3,840,755**	**(8,897,990)**

All of the profit for the financial year and the loss for the prior year were derived from continuing activities.
The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year 1 January 2012 to 31 December 2012

Income	2012	2011
	£	£
Profit / (loss) for the year	**3,840,755**	**(8,897,990)**
Other comprehensive income / (expense)		
Foreign currency translation differences for foreign operations	10,932	3,113
Foreign currency translation differences for cash flow hedging reserve	252,175	(8,152)
Changes in fair value of cash flow hedges taken to equity	761,896	(755,500)
Ineffective portion of change in fair value of cash flow hedges transferred to income statement	271,001	168,294
Change in fair value of available-for-sale financial assets taken to equity	(393,849)	200,006
Transfer from fair value reserve to income statement in respect of amortisation of reclassified financial assets	74,324	377,886
Income tax on other comprehensive income	(273,700)	1,010
Other comprehensive income / (expense) for the year net of income tax	**702,779**	**(13,343)**
Total comprehensive profit / (loss) for the year attributable to equity holders of the Bank	**4,543,534**	**(8,911,333)**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of financial position

As at 31 December 2012

Assets	*Note*	2012	2011
		£	£
Cash and balances with banks		159,600,938	97,298,498
Due from financial institutions	*17*	132,413,746	76,671,550
Investment securities	*18*	104,840,753	81,401,505
Financing arrangements	*20*	359,379,248	299,102,091
Finance lease receivables	*21*	151,925,014	131,012,099
Operating lease assets	*23*	84,930,433	93,282,765
Investment properties	*19*	27,816,788	12,858,712
Property and equipment	*22*	406,353	452,346
Intangible assets	*24*	734,532	474,018
Other assets	*25*	13,217,372	8,437,532
Current tax asset		–	500,000
Deferred tax assets	*15*	3,693,000	5,640,300
Total assets		**1,038,958,177**	**807,131,416**

Liabilities			
Due to financial institutions	*26*	512,113,261	500,474,105
Due to customers	*27*	257,747,298	51,031,160
Profit rate swaps	*9*	5,308,045	7,268,757
Third party interest in consolidated funds	*32*	11,235,024	1,763,834
Other liabilities	*28*	12,905,427	7,953,098
Total liabilities		**799,309,055**	**568,490,954**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of financial position *(continued)*

As at 31 December 2012

Equity	*Note*	2012	2011
		£	£
Share capital	*31*	48,933,422	48,933,422
Share premium	*31*	206,226,328	206,226,328
Fair value reserve		(49,624)	213,567
Cash flow hedging reserve		(3,231,046)	(4,186,084)
Share-based payment reserve		1,069,056	4,403,930
Foreign currency translation reserve		(61,825)	(72,757)
Retained losses		(13,237,189)	(16,877,944)
Total equity attributable to equity holders of the Bank		**239,649,122**	**238,640,462**
Total liabilities and equity		**1,038,958,177**	**807,131,416**

These financial statements were approved by the Board of Directors on 28 February 2013 and were signed on its behalf by:

Humphrey Percy
Chief Executive Officer

Richard Williams
Chief Financial Officer

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of financial position

As at 31 December 2012

Assets	*Note*	2012	2011
		£	£
Cash and balances with banks		154,898,982	93,620,120
Due from financial institutions	*17*	121,283,053	67,616,508
Investment securities	*18*	124,699,528	97,651,844
Financing arrangements	*20*	418,953,751	376,049,738
Finance lease receivables	*21*	138,458,469	110,848,277
Operating lease assets	*23*	49,055,211	46,451,474
Property and equipment	*22*	406,353	452,346
Intangible assets	*24*	734,532	474,018
Other assets	*25*	10,071,970	7,435,707
Current tax asset		–	500,000
Deferred tax assets	*15*	3,249,200	4,810,094
Total assets		**1,021,811,049**	**805,910,126**

Liabilities			
Due to financial institutions	*26*	508,445,761	500,474,105
Due to customers	*27*	257,747,298	51,031,160
Profit rate swaps	*9*	5,308,045	7,268,757
Other liabilities	*28*	9,570,843	5,717,328
Total liabilities		**781,071,947**	**564,491,350**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of financial position *(continued)*

As at 31 December 2012

Equity	*Note*	2012	2011
		£	£
Share capital	*31*	48,933,422	48,933,422
Share premium	*31*	206,226,328	206,226,328
Fair value reserve		(49,624)	213,567
Cash flow hedging reserve		(2,752,048)	(3,307,067)
Share-based payment reserve		1,069,056	4,403,930
Retained losses		(12,688,032)	(15,051,404)
Total equity attributable to equity holders of the Bank		**240,739,102**	**241,418,776**
Total liabilities and equity		**1,021,811,049**	**805,910,126**

These financial statements were approved by the Board of Directors on 28 February 2013 and were signed on its behalf by:

Humphrey Percy
Chief Executive Officer

Richard Williams
Chief Financial Officer

Company Registration Number: 05897786

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year 1 January 2012 to 31 December 2012

Cash flows from operating activities	2012	2011
	£	£
Operating profit / (loss) before tax	5,515,158	(10,848,690)
Adjusted for:		
Exchange differences	6,984,323	(3,329,833)
Fair value losses on investment properties	1,049,455	326,155
Fair value (gains) / losses on investment securities	(1,059,288)	1,804,369
Provision for impairment	1,844,621	17,642,159
Depreciation and amortisation	22,030,009	21,273,929
Share-based payment awards	135,627	1,359,816
Accretion of instruments held under financing arrangements	(80,926)	(686,166)
Mark to market movement in profit rate swaps	(284,946)	(11,181)
Amortisation of fair value reserve	74,324	377,886
	36,208,357	**27,908,444**

Net increase in operating assets:		
Due from financial institutions	(55,589,891)	17,790,789
Financing arrangements	(62,456,735)	10,476,807
Recovery of impaired assets	(83,328)	(2,439,625)
Finance lease receivables	(20,852,751)	(12,692,204)
Operating lease assets	(15,187,032)	(25,040,666)
Other assets	(5,279,800)	71,322
	(159,449,537)	**(11,833,577)**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of cash flows *(continued)*

For the year 1 January 2012 to 31 December 2012

Net increase in operating liabilities:	2012	2011
	£	£
Due to financial institutions	11,851,169	78,382,251
Due to customers	206,698,151	26,798,326
Third party interest in consolidated funds	528,760	45,997
Other liabilities	1,244,063	261,172
	220,322,143	**105,487,746**
Corporation tax repayment received / (paid)	499,219	(1,459)
Net cash inflow from operating activities	**97,580,182**	**121,561,154**

Cash flows from investing activities

Purchase of property and equipment	(187,200)	(47,771)
Purchase of intangible assets	(410,981)	(350,444)
Purchase of investment properties	(16,334,859)	(5,938,529)
Purchase of investment securities	(263,201,343)	(123,980,422)
Sale of investment securities	235,958,455	68,157,041
Net cash outflow from investing activities	**(44,175,928)**	**(62,160,125)**

Cash flows from financing activities

Subscriptions to consolidated funds	11,051,378	715,518
Redemptions from consolidated funds	(912,105)	(54,764)
Net cash inflow from financing activities	**10,139,273**	**660,754**

Net change in cash and cash equivalents	**63,543,527**	**60,061,783**
Cash and cash equivalents at the beginning of the year	97,298,498	37,228,323
Exchange differences in respect of cash and cash equivalents	(1,241,087)	8,392
Cash and cash equivalent at the end of the year	**159,600,938**	**97,298,498**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of cash flows

For the year 1 January 2012 to 31 December 2012

Cash flows from operating activities	2012	2011
	£	£
Operating profit / (loss) before tax	4,000,495	(10,993,345)
Adjusted for:		
Exchange differences	6,920,368	(3,465,590)
Fair value (gains) / losses on investment securities	(1,256,100)	2,344,689
Provision for impairment	1,844,621	17,642,159
Depreciation and amortisation	10,685,545	9,039,104
Share-based payment awards	135,627	1,359,816
Accretion of instruments held under financing arrangements	(80,926)	(686,166)
Mark to market movement in profit rate swaps	(284,946)	(11,181)
Amortisation of future swap present value	(498,455)	(630,737)
Amortisation of fair value reserve	74,324	377,886
	21,540,553	**14,976,635**
Net (increase) / decrease in operating assets:		
Due from financial institutions	(53,464,499)	17,618,302
Financing arrangements	(44,845,115)	29,368,231
Recovery of impaired assets	(83,328)	(2,439,625)
Finance lease receivables	(27,666,896)	(22,026,454)
Operating lease assets	(12,905,623)	(21,889,368)
Other assets	(3,149,725)	494,114
	(142,115,186)	**1,125,200**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of cash flows *(continued)*

For the year 1 January 2012 to 31 December 2012

Net increase in operating liabilities:	2012	2011
	£	£
Due to financial institutions	8,183,669	78,382,251
Due to customers	206,698,151	26,798,326
Other liabilities	156,123	(30,592)
	215,037,943	**105,149,985**
Corporation tax repayment received	500,022	–
Net cash inflow from operating activities	**94,963,332**	**121,251,820**

Cash flows from investing activities		
Purchase of property and equipment	(187,200)	(47,771)
Purchase of intangible assets	(410,981)	(350,444)
Purchase of investment securities	(192,987,720)	(102,449,324)
Sale of investment securities	163,177,895	41,827,920
Net cash outflow from investing activities	**(30,408,006)**	**(61,019,619)**

Net change in cash and cash equivalents	64,555,326	60,232,201
Cash and cash equivalents at the beginning of the year	93,620,120	33,385,602
Exchange differences in respect of cash and cash equivalents	(3,276,464)	2,317
Cash and cash equivalents at the end of the year	**154,898,982**	**93,620,120**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2012

	Share capital £	Share premium account £	Fair value reserve £	Cash flow hedging reserve £	Share-based payment reserve £	Retained losses £	Foreign currency translation reserve £	Total £
Balance at 31 December 2011	48,933,422	206,226,328	213,567	(4,186,084)	4,403,930	(16,877,944)	(72,757)	238,640,462
Profit for the year	**—**	**—**	**—**	**—**	**—**	**3,840,755**	**—**	**3,840,755**
Other comprehensive income / (expense)								
Foreign currency translation	—	—	—	252,175	—	—	10,932	263,107
Changes in fair value of cash flow hedges	—	—	—	761,896	—	—	—	761,896
Ineffective portion of changes in fair value of cash flow hedges transferred to income statement	—	—	—	271,001	—	—	—	271,001
Recognition of tax asset on cash flow hedge reserve	—	—	—	(330,034)	—	—	—	(330,034)
Change in fair value of available-for-sale financial assets taken to equity	—	—	(393,849)	—	—	—	—	(393,849)
Transfer to income statement in respect of amortisation of reclassified financial assets	—	—	74,324	—	—	—	—	74,324
Tax on amortisation of reclassified financial assets	—	—	56,334	—	—	—	—	56,334
Total other comprehensive income	**—**	**—**	**(263,191)**	**955,038**	**—**	**—**	**10,932**	**702,779**
Total comprehensive income for the year	**—**	**—**	**(263,191)**	**955,038**	**—**	**3,840,755**	**10,932**	**4,543,534**
Contributions by and distributions to owners								
Share-based payment awards	—	—	—	—	135,627	—	—	135,627
Settlement of share-based payment awards	—	—	—	—	(2,288,333)	—	—	(2,288,333)
Transfer to other laibilities	—	—	—	—	(1,182,168)	—	—	(1,182,168)
Purchase of own shares	—	—	—	—	—	(200,000)	—	(200,000)
Total transactions with owners	**—**	**—**	**—**	**—**	**(3,334,874)**	**(200,000)**	**—**	**(3,534,874)**
Balance at 31 December 2012	**48,933,422**	**206,226,328**	**(49,624)**	**(3,231,046)**	**1,069,056**	**(13,237,189)**	**(61,825)**	**239,649,122**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity *(continued)*

For the year ended 31 December 2011

Fair value reserve

The fair value reserve includes the cumulative net change in fair value of available-for-sale investments until the investment is either derecognised or becomes impaired. £74,324 of the change in the fair value reserve transferred to income statement relates to the financial assets reclassified to loans and receivables on 1 July 2008 in accordance with the amendments to IAS 39.

Cash flow hedging reserve

comprises the effective portion of the cumulative net change in fair value of cash flow hedging instruments.

Share-based payment reserve

includes the amortised portion of the fair value of equity instruments. The transfer to other liabilities relates to the reclassification of the Deferred Annual Bonus Scheme from equity-settled to cash-settled accounting.

Foreign currency translation reserve

comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations.

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity *(continued)*

For the year ended 31 December 2011

	Share capital £	Share premium account £	Fair value reserve £	Cash flow hedging reserve £	Share - based payment reserve £	Retained losses £	Foreign currency translation reserve £	Total £
Balance at 31 December 2010	48,933,422	206,226,328	(238,645)	(3,717,416)	3,044,114	(7,179,954)	(75,870)	246,991,979
Loss for the year	**—**	**—**	**—**	**—**	**—**	**(8,897,990)**	**—**	**(8,897,990)**
Other comprehensive income / (expense)								
Foreign currency translation	—	—	—	(8,152)	—	—	3,113	(5,039)
Changes in fair value of cash flow hedges	—	—	—	(755,500)	—	—	—	(755,500)
Ineffective portion of changes in fair value of cash flow hedges transferred to income statement	—	—	—	168,294	—	—	—	168,294
Recognition of tax asset on cash flow hedge reserve	—	—	—	126,690	—	—	—	126,690
Change in fair value of available-for-sale financial assets taken to equity	—	—	200,006	—	—	—	—	200,006
Transfer to income statement in respect of amortisation of reclassified financial assets	—	—	377,886	—	—	—	—	377,886
Tax on amortisation of reclassified financial assets	—	—	(125,680)	—	—	—	—	(125,680)
Total other comprehensive expense	**—**	**—**	**452,212**	**(468,668)**	**—**	**—**	**3,113**	**(13,343)**
Total comprehensive loss for the year	**—**	**—**	**452,212**	**(468,668)**	**—**	**(8,897,990)**	**3,113**	**(8,911,333)**
Contributions by and distributions to owners								
Share-based payment awards	—	—	—	—	1,359,816	—	—	1,359,816
Purchase of own shares	—	—	—	—	—	(800,000)	—	(800,000)
Total transactions with owners	**—**	**—**	**—**	**—**	**1,359,816**	**(800,000)**	**—**	**559,816**
Balance at 31 December 2011	**48,933,422**	**206,226,328**	**213,567**	**(4,186,084)**	**4,403,930**	**(16,877,944)**	**(72,757)**	**238,640,462**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of changes in equity

For the year ended 31 December 2012

	Share capital £	Share premium account £	Fair value reserve £	Cash flow hedging reserve £	Share - based payment reserve £	Retained losses £	Total £
Balance at 31 December 2011	48,933,422	206,226,328	213,567	(3,307,067)	4,403,930	(15,051,404)	241,418,776
Profit for the year	**—**	**—**	**—**	**—**	**—**	**2,563,372**	**2,563,372**
Other comprehensive income / (expense)							
Foreign currency translation	—	—	—	200,682	—	—	200,682
Changes in fair value of cash flow hedges	—	—	—	761,896	—	—	761,896
Ineffective portion of changes in fair value of cash flow hedges transferred to income statement	—	—	—	271,001	—	—	271,001
Amortisation of future swap present value	—	—	—	(498,455)	—	—	(498,455)
Recognition of tax asset on cash flow hedge reserve	—	—	—	(180,105)	—	—	(180,105)
Change in fair value of available-for-sale financial assets taken to equity	—	—	(393,849)	—	—	—	(393,849)
Transfer to income statement in respect of amortisation of reclassified financial assets	—	—	74,324	—	—	—	74,324
Tax on amortisation of reclassified financial assets	—	—	56,334	—	—	—	56,334
Total other comprehensive income	**—**	**—**	**(263,191)**	**555,019**	**—**	**—**	**291,828**
Total comprehensive income for the year	**—**	**—**	**(263,191)**	**555,019**	**—**	**2,563,372**	**2,855,200**
Contributions by and distributions to owners							
Share-based payment awards	—	—	—	—	135,627	—	135,627
Settlement of share-based payment awards	—	—	—	—	(2,288,333)	—	(2,288,333)
Transfer to other liabilities	—	—	—	—	(1,182,168)	—	(1,182,168)
Purchase of own shares	—	—	—	—	—	(200,000)	(200,000)
Total transactions with owners	**—**	**—**	**—**	**—**	**(3,334,874)**	**(200,000)**	**(3,534,874)**
Balance at 31 December 2012	**48,933,422**	**206,226,328**	**(49,624)**	**(2,752,048)**	**1,069,056**	**(12,688,032)**	**240,739,102**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of changes in equity *(continued)*

For the year ended 31 December 2012

Fair value reserve

The fair value reserve includes the cumulative net change in fair value of available-for-sale investments until the investment is either derecognised or becomes impaired. £74,324 of the change in the fair value reserve transferred to income statement relates to the financial assets reclassified to loans and receivables on 1 July 2008 in accordance with the amendments to IAS 39.

Cash flow hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in fair value of cash flow hedging instruments. It also includes amortisation of the present value of certain profit rate swaps as at 1 July 2009 following their reclassification from a fair value hedge to a macro cash flow hedge.

Share-based payment reserve

The share-based payment reserve includes the amortised portion of the fair value of equity instruments. The transfer to other liabilities relates to the reclassification of the Deferred Annual Bonus Scheme from equity-settled to cash-settled accounting.

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Bank statement of changes in equity *(continued)*

For the year ended 31 December 2011

	Share capital £	Share premium account £	Fair value reserve £	Cash flow hedging reserve £	Share - based payment reserve £	Retained losses £	Total £
Balance at 31 December 2010	48,933,422	206,226,328	(238,645)	(2,407,983)	3,044,114	(5,267,441)	250,289,795
Loss for the year	**—**	**—**	**—**	**—**	**—**	**(8,983,963)**	**(8,983,963)**
Other comprehensive income / (expense)							
Foreign currency translation	—	—	—	(5,300)	—	—	(5,300)
Changes in fair value of cash flow hedges	—	—	—	(755,500)	—	—	(755,500)
Ineffective portion of changes in fair value of cash flow hedges transferred to income statement	—	—	—	168,294	—	—	168,294
Amortisation of future swap present value	—	—	—	(630,737)	—	—	(630,737)
Recognition of tax asset on cash flow hedge reserve	—	—	—	324,159	—	—	324,159
Change in fair value of available-for-sale financial assets taken to equity	—	—	200,006	—	—	—	200,006
Transfer to income statement in respect of amortisation of reclassified financial assets	—	—	377,886	—	—	—	377,886
Tax on amortisation of reclassified financial assets	—	—	(125,680)	—	—	—	(125,680)
Total other comprehensive expense	**—**	**—**	**452,212**	**(899,084)**	**—**	**—**	**(446,872)**
Total comprehensive loss for the year	**—**	**—**	**452,212**	**(899,084)**	**—**	**(8,983,963)**	**(9,430,835)**
Contributions by and distributions to owners							
Share-based payment awards	—	—	—	—	1,359,816	—	1,359,816
Purchase of own shares	—	—	—	—	—	(800,000)	(800,000)
Total transactions with owners	**—**	**—**	**—**	**—**	**1,359,816**	**(800,000)**	**559,816**
Balance at 31 December 2011	**48,933,422**	**206,226,328**	**213,567**	**(3,307,067)**	**4,403,930**	**(15,051,404)**	**241,418,776**

The notes on pages 46 to 110 are an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

BLME
BANK ON OUR PRINCIPLES

Notes to the consolidated financial statements

Reporting entity

Bank of London and The Middle East plc ("BLME" or the "Bank") is a company domiciled in the United Kingdom. The address of the Bank's registered office is Sherborne House, 119 Cannon Street, London, EC4N 5AT. BLME is a wholly Sharia'a compliant wholesale bank involved in investment, corporate banking, private client banking and asset management. The consolidated financial statements of the Group for the year ended 31 December 2012 comprise the Bank and its subsidiaries (together referenced as "the Group").

The following terms are used in the financial statements:

Murabaha

A Murabaha contract is a deferred sale of goods at cost plus an agreed profit mark-up under which one party purchases goods from a supplier and sells the goods to another party at cost price plus an agreed mark-up. The delivery of the goods is immediate, payment is deferred. Murabaha has a variety of applications and is often used as a financing arrangement, for instance for working capital and trade finance.

Commodity Murabaha

A Commodity Murabaha contract (a subset of Murabaha) is often used as a liquidity management tool by financial institutions. The Commodity Murabaha is today the mainstay of the Islamic interbank short term liquidity market. In these transactions the commodity, usually a London Metal Exchange base metal, is sold on a deferred basis with a mark-up. The mark-up is close to conventional money market levels.

Wakala

Wakala means agency and is often used in an arrangement where one party (the principal) places funds with another (the agent). The agent invests funds on the behalf of the principal for an agreed fee or profit share.

Ijara

An Ijara is a contract allowing the granting of the right to use an asset by one party to another which equates to the leasing of an asset in return for rental payments. Ijara is typically used for medium to long term financing of real estate, equipment, machinery, vehicles, vessels or aircraft.

Mudaraba

A Mudaraba is a partnership contract in which a capital owner (Rab al Mal) enters into a contract with a partner (Mudarib) to undertake a specific business or project. The Mudarib provides the labour or expertise to undertake a business or activity. Profits are shared on a pre-agreed ratio but losses are borne by the Rab al Mal unless negligence of the Mudarib is demonstrated.

Musharaka

An agreement under which the Islamic bank provides funds which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is distributed among the partners in predetermined ratios, while the loss is borne by each partner in proportion to his/her contribution.

Sukuk

Sukuk (usually referred to as Islamic bonds) are certificates that reflect ownership in an underlying asset. Profits are calculated according to the performance of the underlying asset or project. Sukuk are usually issued by Special Purpose Vehicles ("SPV") which are set up to acquire and to issue financial claims on the assets. Such financial claims represent a proportionate beneficial ownership for a defined period when the risk and the return associated with cash-flows generated by the underlying asset are passed to the Sukuk holders. Sukuk are commonly used as funding and investment tools.

Istisna

An Istisna contract is usually used for construction finance. The asset is not in existence at the start of the contract and is built or manufactured according to detailed specifications defined by the client, and delivered at the agreed date and price. Payment is deferred. Istisna contracts are commonly applied in project finance, construction finance and pre-export finance where the bank acts as an intermediary between the producer and the ultimate client.

Profit rate swaps

A profit rate swap is a contract between two parties where each counterparty agrees to pay either a fixed or floating rate denominated in a particular currency to the other counterparty. The fixed or floating rate is multiplied by a notional amount.

Participation agreement

A participation agreement is an agreement executed between the relevant SPV and the Bank. The main objective of this agreement is to facilitate the required funding to enable the SPV to acquire leased assets or investment property and to convey the beneficial ownership of the leased equipment or investment property to the Bank. Under this agreement the risks and rewards are transferred to the Bank and the SPV is indemnified against actual losses that arise as a result of any lease or investment property transaction it enters into except in cases where it misappropriates any funds.

1. Basis of preparation

a. Presentation of financial statements

The Group has prepared its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and effective for the Group's reporting for the year ended 31 December 2012. IFRS comprise accounting standards issued by the International Accounting Standards Board ("IASB") and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and its predecessor body.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. The results form the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In October 2008, the IASB issued amendments to IAS 39, "Financial Instruments: Recognition and Measurement", and IFRS 7, "Financial Instruments: Disclosures", titled "Reclassification of Financial Assets". The amendments to IAS 39 permitted (1) certain reclassifications of non-derivative financial assets (other than those designated under the fair value option) out of financial assets held for trading and (2) also allowed the reclassification of financial assets from the available-for-sale category to the loans and receivables category in particular circumstances. The amendments to IFRS 7 introduced additional disclosure requirements if an entity reclassified financial assets in accordance with the amendments to IAS 39.

BLME identified assets, eligible under the amendments, for which at 1 July 2008 it had a clear change of intent to hold for the foreseeable future rather than to exit or trade in the short term. In these instances, BLME believes the intrinsic value of the assets exceeds their estimated fair value, which had been significantly adversely impacted by the reduced liquidity in the financial markets; the returns on these assets will be optimised by holding them for the foreseeable future rather than through exit in the short term. The reclassifications align more closely the accounting treatment with the business intent.

Under the terms of the amendments, the reclassifications were made with effect from 1 July 2008 at fair value on that date. All reclassifications were to the IAS 39 category loans and receivables.

The impact of the reclassifications in the year ended 31 December 2012 was to increase operating profit before impairment charges and taxes by £142,296 (2011: £526,701). For further information, please refer to note 4.

The Group applies revised IAS 1 Presentation of Financial Statements (2007), which became effective as of 1 January 2009. As a result the Group presents in the consolidated statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the consolidated statements of income and other comprehensive income.

The Group has also applied Improving Disclosures about Financial Instruments (Amendments to IFRS 7) issued in March 2009 which requires enhanced disclosure about fair value measurements and liquidity risk in financial instruments. The amendments require that fair value measurement disclosures use a three level fair value hierarchy that reflects the significance of the inputs used in measuring fair values of financial instruments. Specific disclosures are required when fair value measurements are categorised as Level 3 (significant unobservable inputs) in the fair value hierarchy. The amendments require that any significant transfers between Level 1 and Level 2 of the fair value hierarchy be disclosed separately together with changes in valuation techniques from one period to another. The definition of liquidity risk has been amended and is now defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Judgements made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 3 and Note 34.

b. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for IFRS 9 Financial Instruments, which becomes mandatory for the Group's 2015 consolidated financial statements and could change the classification and measurement of financial assets. The Group does not plan to adopt this standard early and the full extent of the impact on the financial statements is currently under review by the Group.

c. Basis of consolidation

i. Subsidiaries

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of the subsidiaries are included in the consolidated financial statements from the date the control commences until the date control ceases (see note 32).

ii. Special Purpose Vehicles ('SPV')

An SPV is an entity that is created to accomplish narrow and well-defined objectives such as the execution of a specific financing transaction. The assets and liabilities of SPVs are included in the Group's consolidated financial statements where the substance of the relationship is that the Bank controls the SPV (see note 32).

iii. Employee Benefit Trust ('EBT')

An EBT acts as an agent for the purpose of the employee share-based compensation plans. Accordingly, the EBT is included within the Group's consolidated financial statements.

d. Consolidation of foreign entities

All assets and liabilities of foreign consolidated companies and other entities with a functional currency other than Sterling are translated using the exchange rates in effect at the balance sheet date.

Income and expenses are translated at the average exchange rate for the period. Translation differences arising from the application of this method are classified in equity until the disposal of the investment. Average rates of exchange are used to translate the cash flows of foreign subsidiaries in preparing the consolidated statement of cash flows.

e. Basis of measurement

The financial statements have been prepared on the historical cost basis, except for investment property and financial instruments, specifically investment securities and profit rate swaps, which are stated at their fair value. Financial instruments are recognised on a trade date basis.

f. Functional and presentation currency

The financial statements are presented in Sterling, which is also the Bank's functional currency. Supplementary information has been provided in Notes 9, 14, 19, 33 and 34 to enhance the understanding of the reader. The method of translation is explained in the foreign currency note.

2. Significant accounting policies

a. Foreign currency

Transactions in foreign currencies are translated to the functional currency at the exchange rate ruling at the date of each transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate ruling at that date. Foreign currency differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities are translated into the functional currency at the effective historical rate used on the date of initial recognition. Foreign exchange for non-monetary items measured at fair value is determined at the spot rate at the time the fair value is determined. The associated foreign exchange differences for both monetary and non-monetary assets and liabilities go to the same place that the gains and losses are booked to, i.e. equity or profit and loss.

b. Revenue recognition

i. Murabaha, Wakala, Mudaraba, Sukuk, Ijara, Istisna and Participation Agreement income and expense

Profits and costs are recognised in the income statement throughout the period of the contract using the "effective profit share" basis. The "effective profit share rate" is the rate that exactly discounts the estimated future cash payments and receipts through the agreed payment term of the contract to the carrying amount of the financial asset or liability.

The Bank has a portfolio of Sukuk which has been classified as loans and receivables since 1 July 2008. The Bank also has an available-for-sale Sukuk portfolio. Sukuk reported by the Group as a result of the consolidation of the BLME Sharia'a Umbrella Fund SICAV-SIF have been classified under the fair value option as investment securities at "fair value through profit and loss". Any fair value gain or loss is accounted for in the consolidated income statement in the line "net fair value gains on investment securities". In addition the Bank has a small portfolio of Sukuk in a trading book which is also marked to market under the fair value option and accounted for as "fair value through profit and loss".

ii. Fees and commission

Fees and commission which are not recognised on an effective yield basis over the life of the financial instruments to which they relate, such as fees for negotiating transactions for third parties, underwriting fees and commission, and non-discretionary asset management fees are recognised in revenue when it is probable that the economic benefit will flow to the Bank. This will normally be at the point when the activity to which the fees and commission relate has been completed.

c. Financial assets and liabilities

The Bank classifies its financial assets in the following categories: "due from financial institutions"; "financing arrangements"; and "investment securities". Investment securities can be either financial assets at fair value through profit and loss or available-for-sale financial assets. Management determines the classification of financial assets and liabilities at initial recognition.

Financial assets are designated upon initial recognition as fair value through profit and loss, if the financial asset is managed and its performance evaluation is on a fair value basis.

i. Due from financial institutions and financing arrangements

Due from financial institutions and financing arrangements are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available-for-sale. These assets are initially recognised at fair value including direct and incremental transaction costs. These are subsequently measured at amortised cost using the effective profit share basis and any impairment losses are deducted. They are derecognised when the rights to receive cash flows have expired or the Bank has transferred all the risks and rewards of ownership.

ii. Investment securities

- Financial instruments at fair value through profit or loss

  Financial assets are classified in this category if they are held for trading, or if they are designated by management under the fair value option. Financial assets are designated at fair value through profit or loss if the Bank manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy.

  Financial instruments included in this category are recognised initially at fair value and transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement. The instruments are derecognised when the rights to receive cash flows have expired or the Bank has transferred substantially all the risks and rewards of ownership.

- Available-for-sale

  Available-for-sale assets are either debt or equity non-derivative financial assets that are designated as available-for-sale ("AFS") and are not classified into the categories described above. The assets are intended to be held for an indefinite period of time, but may be sold in response to liquidity requirements or changes in profit rates, exchange rates or equity prices. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in the fair value of AFS financial assets, other than foreign exchange gains and losses from monetary items, are recognised directly within a separate component of equity, until the financial assets are derecognised or impaired at which time the cumulative gain or loss previously recognised within equity is transferred to the income statement. For debt instruments, income is determined using the effective profit share rate and recognised in the income statement. Dividends on equity instruments are recognised in the income statement when the Group's right to receive payment is established. The instruments are derecognised when the rights to receive cash flows have expired or the Bank has transferred substantially all the risks and rewards of ownership.

iii. Offsetting financial assets

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

iv. Derecognition of financial assets

Financial assets are derecognised when the rights to receive cash flows from the assets have expired; or where the Group has transferred its contractual right to receive the cash flows of the financial assets and either:

– substantially all the risks and rewards of ownership have been transferred; or

– substantially all the risks and rewards have neither been retained nor transferred but control is not retained.

Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged or cancelled or expires.

v. Impairment of financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or portfolio of financial assets is impaired. A financial asset or a portfolio 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 portfolio of financial assets that can be reliably estimated.

Objective evidence that a financial asset or portfolio of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

i. significant financial difficulty of the issuer or obligor;
ii. a breach of contract, such as default or delinquency in profit or principal payments;
iii. the Group granting to the client, for economic or legal reasons relating to the client's financial difficulty, a concession that the financier would not otherwise consider;
iv. it becoming probable that the client will enter bankruptcy or other financial reorganisation;
v. the disappearance of an active market for that financial asset because of financial difficulties; or
vi. observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:

– adverse changes in the payment status of clients in the portfolio; or

– national or local economic conditions that correlate with defaults on the assets in the portfolio.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a portfolio of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

- Assets carried at amortised cost

  If there is objective evidence that an impairment loss on loans and receivables 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 (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective profit 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 has a variable profit rate, the discount rate for measuring any impairment loss is the current effective profit rate determined under the contract.

  The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

- Available-for-sale assets

  The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. In the case of equity investments classified as available-for-sale ("AFS"), a significant or prolonged decline, typically nine months, in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for AFS equity instruments, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that equity instrument 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.

  In the case of AFS debt instruments, impairment is assessed against the impairment indicators discussed in detail on page 51. If there is objective evidence that an impairment loss has occurred, the cumulative loss, measured as the difference between the asset's amortised cost and current fair value, less any impairment loss on the debt instrument previously recognised in the income statement, is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as AFS increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

vi. Financial liabilities

Financial liabilities include funds received from financial institutions and customers. These are initially measured at fair value less the transaction costs that are directly attributable to the acquisition of the financial liability. All financial liabilities are subsequently measured at amortised cost using the effective profit share rate payable to the deposit holders. Financial liabilities are derecognised only when the obligations specified in the contract are discharged, cancelled or expired.

vii. Determining fair value

Where the classification of a financial instrument requires it to be stated at fair value, this is determined by reference to the quoted bid price or asking price (as appropriate) in an active market wherever possible. Where no such active market exists for the particular asset or liability, the Bank uses a valuation technique to arrive at the fair value, including the use of prices obtained in recent arms-length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants (see Note 3b).

viii. Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently re-measured, at fair value. Fair values of over-the-counter derivatives (profit rate swaps) are obtained using valuation techniques, including discounted cash flow models.

Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments and, if the latter, the nature of the risks being hedged. When derivatives are designated as hedges, BLME classifies them as either:

i. hedges of the change in fair value of recognised assets or liabilities or firm commitments “fair value hedges”; or

ii. hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction “cash flow hedges”.

Hedge accounting is applied to derivatives designated as hedging instruments in a fair value hedge or cash flow hedge provided certain criteria are met.

- Hedge accounting

  At the inception of a hedging transaction, the Group documents the relationship between the hedging instruments and the hedged items, as well as its risk management objective and its strategy for undertaking the hedge. The Group policy also requires a documented assessment, both at the hedge inception and on an on-going basis, of whether or not the hedging instruments, primarily profit rate swaps, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Ineffective changes in profit share on designated qualifying hedges are included in “Other operating income / expenses” as applicable.

- Fair value hedge

  Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

  If the hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of a hedged item for which the effective yield method is used, is amortised to the income statement over the residual period to maturity.

- Cash flow hedge

  The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity within the cash flow hedging reserve. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement under “Other operating income / expenses” as applicable.

  Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

  When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is eventually recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

- Hedge effectiveness testing

  To qualify for hedge accounting, IAS 39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an on-going basis. The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed.

  For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent, for the hedge to be deemed effective.

- Sharia'a compliant derivatives (hereafter described as profit rate swaps, "PRSs") that do not qualify for hedge accounting

  All gains and losses from changes in the fair values of PRSs that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in "Other operating income / expenses" as applicable.

d. Collateral and netting

The Bank enters into master agreements with counterparties whenever possible and, when appropriate, obtains collateral. Master agreements provide that, if an event of default occurs, all outstanding transactions with the counterparty will fall due and all amounts outstanding will be settled on a net basis.

- Collateral

  The Bank obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Bank a claim on these assets for both existing and future liabilities.

- Netting

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

e. Investment property

Properties held for long term rental yields not occupied by the Group are classified as investment property. This category includes investment properties reported by the Group as a result of the consolidation of the BLME Sharia'a Umbrella Fund SICAV-SIF. More detail is provided in Notes 19 and 32.

The Group has elected to adopt the fair value model under IAS 40; as such investment property is measured initially at cost, including related transaction costs. After initial recognition, investment property is carried at fair value. Fair value is based on active market prices, adjusted, if necessary, for any differences in the nature, location or condition of the specific asset. If this information is not available, the Group uses alternative valuation methods such as recent prices on less active markets or discounted cash flow projections. These valuations are conducted annually by independent external professionally qualified valuation agents.

The fair value of investment property reflects, among other things, rental income from current leases and assumptions about rental income from future leases in the light of current market conditions.

Subsequent expenditure is charged to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred. Changes in fair value are recorded in the income statement within "Net fair value gains / (losses) on investment property".

f. Property and equipment

i. Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.

ii. Depreciation

Depreciation is recognised in the income statement on a straight line basis over the estimated useful life of each part of an item of property and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives.

- Computer equipment, software and licences - 3 years
- Fixtures and fittings - 4 years
- Office equipment - 3 years
- Leasehold improvements - 4 years or over the life of the lease, whichever is shorter

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

g. Intangible assets

Intangible assets consist of computer licences and software development costs. Intangible assets acquired by the Bank are stated at cost less accumulated amortisation and accumulated impairment losses, if any.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in the income statement on a straight line basis over the estimated useful life of the software and computer licences, from the date that they are available for use. The estimated useful life of software and computer licences is three years.

h. Impairment of property and equipment and intangible assets

At each balance sheet date, or more frequently where events or changes in circumstances dictate, property, equipment and intangible assets are assessed for indications of impairment. If indications are present, these assets are subject to an impairment review. An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

The impairment review comprises a comparison of the carrying amount of the asset with its recoverable amount, which is taken as the lower of the asset's net selling price and its value in use. Net selling price is calculated by reference to the amount at which the asset could be disposed of in a binding sale agreement in an arm's length transaction evidenced by an active market or recent transactions for similar assets. Value in use is calculated by discounting the expected future cash flows obtainable as a result of the assets continued use, including those resulting from its ultimate disposal, at a market based discount rate on a pre-tax basis.

i. Other assets

Other assets include loans made by the EBT to facilitate employees investing in BLME shares, prepayments associated with legal fees incurred in the set-up of trades and amounts owed by HMRC in respect of VAT.

Additionally, within other assets are returned leased assets which are stated at the lower of cost and net realisable value. When returned leased assets are not readily convertible into cash, the policy is to dispose of such assets at auction. Net realisable value is the estimated selling price observed at recent auctions less any applicable costs.

j. Operating leases

i. Lessor

Assets leased to customers under agreements, which do not transfer substantially all the risks and rewards of ownership, are classified as operating lease assets on the balance sheet. Depreciation is taken on the depreciable amount of these assets on a straight line basis over their estimated useful lives. Leased income is recognised on a straight line basis over the period of the lease unless another systematic basis is more appropriate.

ii. Lessee

Operating lease rentals payable are recognised as an expense in the income statement on a straight line basis over the lease term unless another systematic basis is more appropriate.

k. Finance leases

Assets leased to customers under agreements which transfer substantially all the risks and rewards associated with ownership, other than legal title, are classified as finance leases. Finance charges receivable are recognised on the balance sheet and income is recognised over the period of the lease so as to give a constant rate of return on the net cash investment in the lease, taking into account all receipts associated with the lease.

l. Employee benefits

The Group operates a defined contribution pension scheme for all staff. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity, and where the Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The Group pays contributions to Standard Life. 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.

Short-term employee benefits such as salaries, paid absences and other benefits are accounted for on an accruals basis over the period for which employees have provided services. Bonuses are recognised to the extent that the Bank has a present obligation to its employees that can be measured reliably.

m. Share-based payments to employees

The Group operates equity-settled and cash-settled share-based incentive schemes for employees. The cost of equity-settled share-based payment arrangements is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight line basis over the vesting period, with a corresponding credit to the "Share-based payment reserve". For cash-settled share-based payment transactions the cost of the services acquired is measured at the fair value of the liability and is re-measured at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in the profit or loss for the period. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are reflected as an adjustment to the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not factored into the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant. The incremental fair value is calculated by comparing the fair value of the modified grant with the fair value of the original grant at the modification date. The incremental fair value of the modified grant is recognised over the remaining vesting period.

n. Own shares

Own shares are held by the EBT and comprise own shares that have not vested unconditionally to employees of the Group. In both the Group and Bank, own shares are recorded at cost and are deducted from retained earnings.

o. Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of cost of funds and, where appropriate, the risks specific to the liability.

p. Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

q. Cash and cash equivalents

Cash and cash equivalents comprise demand deposits with banks held in non-interest earning accounts.

r. Other receivables

Trade and other receivables are stated at their nominal amount less impairment losses.

3. Use of critical accounting estimates and judgements in applying accounting policies

a. Key sources of estimation uncertainty

Allowance for credit losses

Assets accounted for at amortised cost are evaluated monthly for impairment on a basis described in Note 2c (v) and 34a (v). 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 individual financing arrangements. This evidence may include observable data indicating that there has been an adverse change in the payment status of counterparties in a portfolio, or national or local economic conditions that correlate with defaults on assets in the portfolio. The specific counterparty component of the total allowance for impairment applies to claims evaluated individually and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about each counterparty's financial situation and the realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the present value of estimated cash flows considered recoverable is approved by the Counterparty Credit Risk Committee.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of claims with similar economic characteristics when there is objective evidence to suggest that they contain impaired claims, but the individual impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions.

b. Determining fair values

The Group's accounting policy on fair value measurements is in accordance with IFRS 7 Financial Instruments: Disclosures and is discussed in Note 34.

The Group measures fair values using the following fair value hierarchy that reflects the significance of inputs used in making the measurements.

Level 1: Valuation is based upon quoted market price in an active market for an identical instrument. This category comprises Sukuk held at fair value through profit and loss and Sukuk held at fair value designated as available-for-sale.

Level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category comprises profit rate swaps, which are valued using reference to quoted market data such as yield curves, and investments in Sharia'a compliant funds.

Level 3: Valuation techniques using significant unobservable inputs. This category comprises unlisted equity investments valued by reference to third party valuations.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using valuation techniques.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk free and benchmark profit rates, credit spreads and other premia used in estimating discount rates, bond prices and foreign currency exchange rates. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models in determining the fair value of common and more simple financial instruments, such as profit rate swaps, that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities and simple over the counter derivatives such as profit rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

Deferred tax relating to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

4. Amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets"

Following the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets", the Bank reclassified certain trading assets and financial assets from available-for-sale to loans and receivables. The Bank identified assets, eligible under the amendments for which, at 1 July 2008, it had a clear change of intent to hold for the foreseeable future rather than to exit or trade in the short term. Under IAS 39, as amended, the reclassifications were made with effect from 1 July 2008 at fair value ("FV") at that date. The disclosures below detail the impact of the reclassifications to the Bank and Group. The following table shows carrying values and fair values of the reclassified assets:

	At 31 December 2012	At 31 December 2012	At 31 December 2011	At 31 December 2011
	Carrying Value £	Fair Value £	Carrying Value £	Fair Value £
US Dollar trading assets: Sukuk at FV through P&L reclassified to loans and receivables	–	–	12,859,719	12,450,688
US Dollar financial assets: available-for-sale Sukuk reclassified as loans and receivables	–	–	10,901,068	10,249,984
Total financial assets reclassified to loans and receivables	–	–	**23,760,787**	**22,700,672**

	At 31 December 2010	At 31 December 2010	At 31 December 2009	At 31 December 2009	At 1 July 2008
	Carrying Value £	Fair Value £	Carrying Value £	Fair Value £	Fair Value £
US Dollar trading assets: Sukuk at FV through P&L reclassified to loans and receivables	15,835,150	15,059,940	14,915,723	12,958,012	11,861,841
US Dollar financial assets: available-for-sale Sukuk reclassified as loans and receivables	16,370,485	14,357,229	39,170,696	34,776,783	39,925,758
Total financial assets reclassified to loans and receivables	**32,205,635**	**29,417,169**	**54,086,419**	**47,734,795**	**51,787,599**

USD/GBP exchange rates were 1.9901 at 1 July 2008, 1.6195 at 31 December 2009, 1.5485 at 31 December 2010, 1.5461 at 31 December 2011 and 1.61715 at 31 December 2012.

The carrying value and the fair value of the reclassified assets have decreased to nil over the accounting periods since 1 July 2008. This is mainly due to the maturity of various Sukuk issues but also due to the disposal during 2010 of an impaired Sukuk issued by a Saudi based company and the disposal of one other Sukuk during 2012. In addition the weakening of sterling against the US dollar impacted the downward trend between 1 July 2008 and 31 December 2011.

If the reclassification had not been made, excluding the impact of foreign exchange rates referred to above, the Group and Bank income statement for the year to 31 December 2012 would have included unrealised fair value profits on the reclassified trading assets of £nil (2011: £530,351 profits, 2010: £1,508,231 profits, 2009: £1,210,559 profits and 2008: £2,358,638 profits).

For the year to 31 December 2012, as a result of the reclassification, the Bank made an unrealised fair value gain of £142,296 (2011: £526,701 gain, 2010: £962,907 gain, 2009: £972,471 gain and 2008: £426,616 gain) excluding the impact of foreign exchange rates referred to above and impairment charges.

For the twelve months to 31 December 2012 shareholders' equity would have included unrealised fair value net profits on the reclassified AFS financial assets of £nil (2011: £854,261 profits, 2010: £2,402,096 profits, 2009: £4,355,441 losses and 2008: £3,547,284 losses).

After reclassification, the reclassified financial assets contributed the following amounts to income before taxes for the year to 31 December 2012:

Trading assets Sukuk	12 months to 31 December 2012 £	12 months to 31 December 2011 £	12 months to 31 December 2010 £	12 months to 31 December 2009 £	6 months to 31 December 2008 £
Profit share	52,101	233,419	489,248	225,691	235,194
Impairment provision for credit losses	–	–	–	–	–
Income before taxes on reclassified trading assets Sukuk	**52,101**	**233,419**	**489,248**	**225,691**	**235,194**
Available-for-sale Sukuk					
Profit share	90,194	293,282	473,659	746,780	47,225
Impairment provision for credit losses	–	–	–	(11,322,269)	–
Income before taxes on reclassified financial assets available-for-sale Sukuk	**90,194**	**293,282**	**473,659**	**(10,575,489)**	**47,225**

Prior to 1 July 2008 unrealised fair value losses of £1,421,411 on reclassified AFS financial assets that were not impaired were recorded directly in shareholders' equity. From 1 July 2008 this amount will be released from shareholders' equity and accreted to the carrying value of the reclassified AFS financial assets on an effective profit basis over the life of the respective financial assets unless they are impaired or sold. The average effective profit rate on the reclassified Sukuk was 1.35% (2011: 1.35%, 2010: 1.40%, 2009: 2.33% and 2008: 3.05%).

5. Income from financing and investing activities

Income from:

Financial institutions	2012 £	2011 £
Wakala income	161,894	201,381
Murabaha income	173,554	194,651

Financing arrangements		
Murabaha income	17,108,662	13,543,737
Mudaraba income	232,432	40,953
Musharaka income	101,893	93,591
Istisna and Ijara income	138,602	107,051
Finance lease income	8,927,383	7,360,577
Sukuk income	3,644,612	4,179,374
Wakala income	290,305	–
	30,779,337	**25,721,315**

6. Returns to financial institutions and customers

	2012 £	2011 £
Murabaha	5,289,240	4,274,095
Wakala	1,241,304	869,308
Profit rate swap	3,115,746	3,507,332
Customer deposits	3,991,589	780,198
	13,637,879	**9,430,933**

7. Net fair value gains / (losses) on investment securities

	2012 £	2011 £
Net realised gains on sale of investment securities	2,541,831	167,831
Net unrealised gains / (losses) on investment securities	1,059,288	(1,143,034)
	3,601,119	**(975,203)**

8. Other operating income

	2012 £	2011 £
Gains on foreign exchange transactions	285,156	367,447
Gains on leased asset sales	1,078,236	464,477
Rental income from investment properties	2,272,978	957,679
Other	110,266	338,750
	3,746,636	**2,128,353**

9. Profit rate swaps

The Group uses Sharia'a compliant derivatives, profit rate swaps (PRSs), for hedging purposes in the management of its own asset and liability portfolios. This enables the Group to mitigate the market risk associated with re-pricing its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. PRSs may qualify as hedges for accounting purposes if they are fair value hedges or cash flow hedges. These are described under the relevant headings below:

Notional contract amounts of PRSs held for hedging purposes by product type:

Group and Bank	2012 Cash flow hedge $	2012 Cash flow hedge £	2012 Fair value hedge $	2012 Fair value hedge £
Profit rate swaps	**127,000,000**	**78,533,222**	**35,000,000**	**21,643,014**

Group and Bank	2011 Cash flow hedge $	2011 Cash flow hedge £	2011 Fair value hedge $	2011 Fair value hedge £
Profit rate swaps	**157,000,000**	**101,545,825**	**35,000,000**	**22,637,604**

With regard to PRSs, the notional contract amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value hedges

BLME's fair value hedges consist of PRSs that are used to protect against changes in the fair value of fixed rate financial instruments due to movements in market rates and to accommodate the Bank's risk management policy. For effective fair value hedges, all changes in the fair value of the PRSs and in the fair value of the item in relation to the risk being hedged are recognised in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item is amortised to the income statement on an even yield basis over the remainder of the hedging period.

Effective 1 July 2009, the Bank moved from fair value hedge accounting for the PRSs held as at 1 July 2009 to cash flow hedge accounting to bring consistency to hedge accounting across the Group. Both the Bank and the Group designated liabilities under a macro cash flow hedge. In the last quarter of 2009 the Bank and Group transacted PRSs to hedge fixed rate Sukuk. These PRSs in both the Bank and the Group were accounted for under the fair value hedge accounting rules.

The fair value adjustment to the hedged item as at 1 July 2009 will be amortised to the income statement over the remainder of the hedging period.

Fair value of PRSs designated as fair value hedges:

Group and Bank	2012 Fair value assets £	2012 Fair value liabilities £	2011 Fair value assets £	2011 Fair value liabilities £
Profit rate swaps	**–**	**1,057,606**	**–**	**1,375,531**

Gains or losses arising from fair value hedges:

Group and Bank	2012 £	2011 £
Net profit rate swap liability at 1 January	(1,375,531)	(1,117,860)
Gains / (losses):		
Exchange translation	60,434	(1,772)
On hedging instruments through the profit and loss	18,992	34,354
On the hedged items attributable to the hedged risk	238,499	(290,253)
Net profit rate swap liability as at 31 December	**(1,057,606)**	**(1,375,531)**

The gains and losses on ineffective portions of fair value hedges are recognised immediately in "Other operating income / expense". During the year to 31 December 2012 a gain of £18,992 (2011: £34,354 gain) was recognised due to hedge ineffectiveness.

Cash flow hedges

The Group's cash flow hedges consist of US dollar denominated PRSs that are used to protect against exposures to variability in future cash flows on selected US dollar liabilities placed by financial institutions. The objective of the hedge relationship is to minimise the volatility of cash flows in respect of floating rate liabilities due to fluctuations in market rates. A macro approach is taken in designating the hedge relationship as described in IAS 39 and the hedged item is a portfolio of existing and future highly probable liabilities. Gains and losses on effective cash flow hedges are initially recognised directly in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

Fair value of PRSs designated as cash flow hedges:

Group and Bank	2012 Fair value assets £	2012 Fair value liabilities £	2011 Fair value assets £	2011 Fair value liabilities £
Profit rate swaps	**–**	**4,250,439**	**–**	**5,893,226**

Gains or losses arising from cash flow hedges:

Group and Bank	2012 £	2011 £
Net profit rate swap liability as at 1 January	(5,893,226)	(5,435,959)
Gains / (losses):		
Exchange translation	258,920	(8,614)
On hedging instruments through the profit and loss	350,970	138,553
On hedging instruments through reserves	1,032,897	(587,206)
Net profit rate swap liability as at 31 December	**(4,250,439)**	**(5,893,226)**

The gains and losses on ineffective portions of such PRSs are recognised immediately in "Other operating income / expense". During the year to 31 December 2012, a gain of £350,970 (2011: £138,553 gain) was recognised due to hedge ineffectiveness.

Contractual principal balances of PRSs designated for cash flow hedging purposes

The schedules of contractual principal balances on which the expected profit cash flows arise as at 31 December 2012 and 31 December 2011 respectively are as follows:

Group and Bank	Less than 3 months £	More than 3 months but less than 6 months £	1 year or less but more than 6 months £	2012 Total £
Liabilities	**9,275,577**	**63,073,926**	**6,183,719**	**78,533,222**

Group and Bank	Less than 3 months £	More than 3 months but less than 6 months £	1 year or less but more than 6 months £	2011 Total £
Liabilities	**3,233,943**	**82,142,164**	**16,169,718**	**101,545,825**

This table reflects the profit rate re-pricing profile of the underlying hedged items. The Group and Bank adopt a macro cash flow hedging strategy to match the existing rollover or forecast liabilities. Therefore the Group and Bank do not expect any maturity mismatch between the hedged liabilities and profit rate swaps at maturity.

10. Personnel expenses

	2012 £	2011 £
Wages and salaries	9,519,939	7,275,784
Social security costs	1,228,038	1,027,138
Defined contribution pension scheme costs	824,204	730,658
Sharia'a Supervisory Board fees	85,544	75,942
Recruitment costs	180,856	178,525
Other staff costs	307,089	231,813
	12,145,670	**9,519,860**

The following table summarises the number of employees within the Group:

	2012 Number	2011 Number
Period end	86	77
Average for the period - management	6	6
Average for the period - non-management	75	64

11. Directors' emoluments

	2012 £	2011 £
Directors' emoluments	1,475,131	996,078
Pension contributions	93,000	93,000
	1,568,131	**1,089,078**

The aggregate of emoluments of the highest paid director was £537,918 (2011: £276,384), and pension contributions of £36,000 (2011: £36,000) were made on his behalf.

12. Other operating expenses

	2012 £	2011 £
Legal and professional fees	1,968,284	1,486,287
Rent and other occupancy costs	1,501,644	1,371,534
Consultancy	430,325	154,951
Communications and IT costs	651,998	608,812
Advertising and market development	1,477,805	1,341,765
Board and SSB related expenses	483,397	458,000
Other operating charges	3,660,931	2,399,620
	10,174,384	**7,820,969**

Included within other operating expenses are fees paid to the Group auditors categorised as follows:

Auditors remuneration	2012 £	2011 £
Audit of financial statements: Year end	202,300	189,170
Audit of financial statements: Interim report	42,000	42,000
Tax services	75,761	51,500
Other services	116,104	131,692
	436,165	**414,362**

13. Share-based payments

During the year £965,281 (2011: £341,481) was charged to the income statement in respect of share-based payment transactions arising under the following employee share schemes in accordance with the Group's reward structures:

	2012 £	2011 £
Approved Share Option Plan ("ASOP")	34,683	43,151
Unapproved Share Option Plan ("USOP")	1,102	2,410
Executive Share Option Scheme ("ESOP")	99,842	266,753
Deferred Annual Bonus Scheme ("DABS")	829,654	29,167
	965,281	**341,481**

Calculation of fair values

The fair values of equity-settled share options, measured at the date of grant of the option, are calculated using a Black-Scholes model. The fair value of the options granted during the year, together with the main assumptions used in the Black-Scholes model for the ASOPs and USOPs awards, is included in the following tables:

	ASOP 2012	ASOP 2011	USOP issued 11/04/12	USOP issued 01/06/11	USOP issued 17/01/11	DABS 2012	DABS 2011
Fair value (pence)	1.1	1.3	1.1	1.2	1.3	N/A	6.5
Share price (pence)	4.9	5.0	4.9	5.0	5.0	N/A	N/A
Exercise price (pence)	6.5	6.5	6.5	6.5	6.5	N/A	Nil
Expected volatility (% p.a.)	29.0	28.0	29.0	28.0	28.0	N/A	N/A
Option life (years)	6.5	6.5	6.5	6.5	6.5	N/A	N/A
Expected dividends (% p.a.)	Nil	Nil	Nil	Nil	Nil	N/A	Nil
Risk free interest rate (%)	1.2	2.9	1.2	2.4	2.9	N/A	N/A

The expected volatility was determined by reference to the historical volatility of the FTSE 350 Banks Index. Awards of DABS are made in the first quarter of the year as part of the annual discretionary bonus process and relate to, and are accrued in, the previous calendar year. No DABS were awarded in 2012 in respect of the 2011 performance year.

Approved share options

Approved share options are granted to employees under the "BLME Approved Share Option Plan" up to a market value limit of £30,000 to each individual on the date of grant. The options may vest after three years and are exercisable up to the tenth anniversary of the date of grant, after which they lapse.

ASOPs	Number of options 2012	Weighted average exercise price (pence) 2012	Number of options 2011	Weighted average exercise price (pence) 2011
Outstanding at 1 January	10,176,921	6.0	7,038,458	5.8
Granted in the year	2,692,305	6.5	5,076,923	6.5
Forfeited in the year	(1,453,845)	6.2	(1,938,460)	6.2
Outstanding at 31 December	**11,415,381**	**6.1**	**10,176,921**	**6.0**
Exercisable at 31 December	**2,538,458**		**769,229**	

The weighted average remaining contractual life of the above ASOPs outstanding at the balance sheet date was 7.6 years (2011: 8.1 years). The weighted average exercise price was 6.1 pence (2011: 6.0 pence).

During 2010 options were issued in parallel to the existing approved options which had been granted during 2008 and 2009. These new "parallel" options were granted to staff over the same number of shares as their existing approved options but with an exercise price of 5 pence per share as against an exercise price of 6.5 pence per share for their existing approved options. The old and new options will operate in parallel, meaning that staff will be able to choose which to exercise. When one option is exercised, the other option will lapse. Therefore, although participating staff now have two approved options, they will only be able to exercise one of them.

Parallel ASOPs	Number of parallel options 2012	Number of parallel options 2011
Outstanding at 1 January	2,692,305	3,384,612
Granted in the year	–	–
Forfeited in the year	(307,692)	(692,307)
Outstanding at 31 December	**2,384,613**	**2,692,305**
Exercisable at 31 December	**Nil**	**Nil**

The weighted average remaining contractual life of the above parallel options outstanding at the balance sheet date was 7.2 years (2011: 8.2 years). The weighted average exercise price is 5 pence. None of these options were exercisable at the balance sheet date. The issue of these approved parallel options has been accounted for under IFRS 2 as a modification with the incremental fair value being amortised to the income statement over the remaining vesting period.

Unapproved share options

Unapproved share options are granted under the "BLME Unapproved Share Option Plan" to employees who already have received approved share options up to the market value limit of £30,000. The options may vest after three years and are exercisable up to the tenth anniversary of the date of grant, after which they lapse.

USOPs	Number of options 2012	Number of options 2011
Outstanding at 1 January	769,231	–
Granted in the year	769,230	769,231
Forfeited in the year	(923,076)	–
Outstanding at 31 December	**615,385**	**769,231**
Exercisable at 31 December	**Nil**	**Nil**

The weighted average remaining contractual life of the above USOPs outstanding at the balance sheet date was 8.7 years (2011: 9.3 years). The weighted average exercise price is 6.5 pence. None of these options were exercisable at the balance sheet date.

Deferred annual bonus scheme

Awards were first made to employees under the "BLME Deferred Annual Bonus Scheme" in 2008. The Group introduced the scheme to ensure that the long term interests of certain employees were aligned with the interests of shareholders. Participating in the scheme entitles the employee to receive a matching award at no cost providing certain conditions, including a performance condition, are met. Performance conditions are set and monitored by the Remuneration Committee.

Under the original scheme rules the employee was required to surrender a percentage of their annual discretionary bonus in return for a conditional right to receive shares in the Bank at the vesting date being three years following the award date. During 2010 the existing awards were modified so that they took the form of nil cost options. The modified awards gave employees options, to acquire the same number of shares as the original award, which can be exercised at any point from the original vesting date until the tenth anniversary of the original award date. No incremental fair value arose as a result of this modification.

During 2012 employees were given the opportunity to have their vested DABS options from earlier years settled in cash. The resultant cash payment of £2,288,333 was accounted for as a deduction against the share-based payment reserve. The DABS scheme has been reclassified as a cash-settled share-based payment scheme with £1,182,168 being reclassified from the share-based payment reserve to other liabilities. There was no excess payment over the fair value of the award at the settlement date requiring to be recognised as an expense under IFRS 2.

Participating in the scheme entitles the employee to receive a matching award at no cost providing certain conditions, including a performance condition, are met. Performance conditions are set and monitored by the Remuneration Committee.

DABS	Number of nil cost options 2012	Number of nil cost options 2011
Outstanding at 1 January	53,392,306	37,276,921
Awarded and deferred	–	17,000,000
Awarded under matched award	3,763,905	448,718
Forfeited in the year	(64,103)	(128,205)
Settled in the year	(35,499,996)	(1,205,128)
Outstanding at 31 December	**21,592,112**	**53,392,306**
Exercisable at 31 December	**738,467**	**8,846,154**

The weighted average remaining contractual life of the above nil cost options outstanding at the balance sheet date was 8.1 years (2011: 7.6 years). The weighted average exercise price was Nil.

Executive share option scheme

Share options were first granted to senior management under the BLME Unapproved Share Option Plan in 2009. The options granted were split equally into employment options and performance options. Employment options vest upon completion of service periods, performance options vest on meeting or surpassing targets for growth in the Net Asset Value of the Bank. Both categories of options only vest upon BLME being listed on a recognised exchange.

The ESOP awards are made in four equal tranches with different vesting periods. The expected option life is dependent on the behaviour of option holders and is incorporated into the model on the basis of best estimate. No ESOP awards were made in 2012 or 2011.

ESOPs	Number of options 2012	Number of options 2011
Outstanding at 1 January	83,454,759	111,099,163
Granted in the year	–	–
Forfeited in the year	(16,353,452)	(27,644,404)
Outstanding at 31 December	**67,101,307**	**83,454,759**

The options forfeited relate to performance options where the target criteria were not met. The weighted average remaining contractual life of the executive share options outstanding at the balance sheet date was 6.6 years (2011: 7.6 years). The weighted average exercise price was 6.5 pence.

Share purchase plan

BLME launched an Executive Share Purchase Plan in December 2007 to enable certain employees to purchase shares in the Bank. Interest free financing is provided by Appleby Trust (Jersey) Limited in its capacity as Trustee of the Bank of London and The Middle East EBT. Financing is scheduled to be repaid by 30 June 2013.

14. Impairment of financial assets

Group

Impairments of financial assets:	Individual £	Collective £	2012 Total £
Balance at 1 January 2012	20,991,562	460,352	21,451,914
Exchange translation and other movements	(628,743)	(20,225)	(648,968)
Income statement:			
Gross impairment charge for the year	1,795,187	49,434	1,844,621
Amount recovered during the year	(25,278)	(58,050)	(83,328)
Net impairment charge for the year	**1,769,909**	**(8,616)**	**1,761,293**
Amounts written off during the year	25,278	(431,511)	(406,233)
Balance as at 31 December 2012	**22,158,006**	–	**22,158,006**
Being impairments against:			
Financing arrangements	22,091,840	–	22,091,840
Finance lease receivables	–	–	–
Operating lease assets	66,166	–	66,166
	22,158,006	–	**22,158,006**

Group

Impairments of financial assets:	Individual £	Collective £	2011 Total £
Balance at 1 January 2011	6,735,503	1,468,014	8,203,517
Exchange translation and other movements	(61,809)	2,326	(59,483)
Income statement:			
Gross impairment charge for the year	17,642,159	–	17,642,159
Amount recovered during the year	(1,914,502)	(525,123)	(2,439,625)
Net impairment charge for the year	**15,727,657**	**(525,123)**	**15,202,534**
Amounts written off during the year	(1,409,789)	(484,865)	(1,894,654)
Balance as at 31 December 2011	**20,991,562**	**985,475**	**21,451,914**
Being impairments against:			
Financing arrangements	20,991,562	–	20,991,562
Finance lease receivables	–	460,352	460,352
Operating lease assets	–	–	–
	20,991,562	**460,352**	**21,451,914**

Bank

Impairments of financial assets:	Individual £	Collective £	2012 Total £
Balance at 1 January 2012	20,991,562	460,352	21,451,914
Exchange translation and other movements	(628,743)	(20,225)	(648,968)
Income statement:			
Gross impairment charge for the year	1,795,187	49,434	1,844,621
Amount recovered during the year	(25,278)	(58,050)	(83,328)
Net impairment charge for the year	**1,769,909**	**(8,616)**	**1,761,293**
Amounts written off during the year	25,278	(431,511)	(406,233)
Balance as at 31 December 2012	**22,158,006**	–	**22,158,006**
Being impairments against:			
Financing arrangements	22,158,006	–	22,158,006
	22,158,006	–	**22,158,006**

Bank

Impairments of financial assets:	Individual £	Collective £	2011 Total £
Balance at 1 January 2011	6,735,503	1,468,014	8,203,517
Exchange translation and other movements	(61,809)	2,326	(59,483)
Income statement:			
Gross impairment charge for the year	17,642,159	–	17,642,159
Amount recovered during the year	(1,914,502)	(525,123)	(2,439,625)
Net impairment charge for the year	**15,727,657**	**(525,123)**	**15,202,534**
Amounts written off during the year	(1,409,789)	(484,865)	(1,894,654)
Balance as at 31 December 2011	**20,991,562**	**460,352**	**21,451,914**
Being impairments against:			
Financing arrangements	20,991,562	460,352	21,451,914
	20,991,562	**460,352**	**21,451,914**

As at 31 December 2012, 6 individual facilities comprising amounts due to the Group of £38.0 million (2011: 6 facilities, 5 individual and 1 collective, totalling £40.4 million) were deemed to be impaired.

As at 31 December 2012, the individual provisions are £4.9 million ($8.0 million) against the transportation sector (2011: £3.4 million / $5.25 million), £2.1 million (€2.5 million) in respect of a European manufacturing business (2011: £2.1 million / €2.5 million), £0.5 million against the UK real estate sector (2011: £0.5 million), £0.3 million ($0.5 million) against a Sukuk issued by a Bahraini based company (2011: £0.3 million / $0.5 million), £14.2 million (€17.5 million) against a Turkish manufacturing business (2011: £14.6 million / €17.5 million) and a £0.1 million ($0.1 million) provision against a US manufacturing business (2011: £nil / $nil).

The collective provision in 2011 of £0.5 million ($0.7 million) related to a US finance lease portfolio in the transportation sector.

15. Taxation

Group

UK Corporation Tax	2012 £	2011 £
Current tax for the year	(123,771)	–
Overseas tax for the year	803	1,459
Deferred tax for the year	1,797,371	(1,952,159)
Tax charge / credit in income statement	**1,674,403**	**(1,950,700)**

The tax credit for the year is lower than the standard rate of corporation tax which is explained as follows:

Group

Reconciliation of effective tax rate	2012 £	2011 £
Profit / (loss) on ordinary activities	5,515,158	(10,848,690)
Profit / (loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 24.5% (2011: 26.5%)	1,351,214	(2,874,903)
Expenses not deductible for tax purposes	22,370	30,488
Tax exempt income	(166,533)	(9,636)
Share-based payment transactions	63,047	310,503
Effect of change in tax rates	354,236	401,662
Prior year adjustment to deferred tax	50,069	191,186
Tax charge / (credit) in income statement	**1,674,403**	**(1,950,700)**

The Budget announcement on 21 March 2012 to reduce the main UK Corporation Tax rate from 24% to 23% with effect from 1 April 2013 was substantially enacted on 3 July 2012. Accordingly the deferred tax assets recognised below have been calculated using a corporation tax rate of 23% (31 December 2011: 25%).

The Chancellor's Autumn Statement announcement on 5 December 2012 included a proposal to reduce further the UK Corporation Tax rate from 23% to 21% with effect from 1 April 2014. This proposed change had not been enacted into UK law at the balance sheet date. The overall effect of a further tax rate reduction from 23% to 21%, if applied to the deferred tax assets below at 31 December 2012, would be to reduce the Group deferred tax assets by approximately £321,000 and the Company deferred tax assets by approximately £282,500.

Tax recognised in other comprehensive income

Group

	2012 £	2011 £
Cash flow hedging reserve	(330,034)	126,690
Fair value reserve	56,334	(125,680)
	(273,700)	**1,010**

Bank

	2012 £	2011 £
Cash flow hedging reserve	(180,105)	324,159
Fair value reserve	56,334	(125,680)
	(123,771)	**198,479**

Deferred tax

Deferred tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable. It is estimated that the tax losses carried forward will be utilised by the end of the year ended 31 December 2015.

Recognised deferred tax assets at 31 December 2012

Group	Assets £	Liabilities £	Net £
Property, equipment and software	450,535	–	450,535
Tax losses carried forward	2,881,140	–	2,881,140
Cash flow hedges	143,077	–	143,077
Share-based payment transactions	217,108	–	217,108
Other expenses	1,140	–	1,140
Net tax assets at 31 December 2012	**3,693,000**	**–**	**3,693,000**

Recognised deferred tax assets at 31 December 2011

Group	Assets £	Liabilities £	Net £
Property, equipment and software	242,416	–	242,416
Tax losses carried forward	4,453,427	–	4,453,427
Cash flow hedges	293,006	–	293,006
Share-based payment transactions	651,451	–	651,451
Net tax assets at 31 December 2011	**5,640,300**	**–**	**5,640,300**

Recognised deferred tax assets at 31 December 2012

Bank	Assets £	Liabilities £	Net £
Property, equipment and software	450,535	–	450,535
Tax losses carried forward	2,580,417	–	2,580,417
Share-based payment transactions	217,108	–	217,108
Other expenses	1,140	–	1,140
Net tax assets at 31 December 2012	**3,249,200**	**–**	**3,249,200**

Recognised deferred tax assets at 31 December 2011

Bank	Assets £	Liabilities £	Net £
Property, equipment and software	242,416	–	242,416
Tax losses carried forward	3,916,227	–	3,916,227
Share-based payment transactions	651,451	–	651,451
Net tax assets at 31 December 2011	**4,810,094**	**–**	**4,810,094**

16. Profit / (loss) attributable to equity shareholders of the Bank

£2,563,372 of the consolidated profit for the financial year (2011: loss of £8,983,963) has been dealt with in the accounts of the Bank.

As permitted by section 408 of the Companies Act 2006, a separate profit and loss account of the parent has not been presented.

17. Due from financial institutions

Group

	0-3 months £	4-12 months £	1-5 years £	2012 Total £
Murabaha	90,841,495	1,855,115	–	92,696,610
Wakala	36,740,022	–	2,977,114	39,717,136
	127,581,517	**1,855,115**	**2,977,114**	**132,413,746**

Group

	0-3 months £	4-12 months £	1-5 years £	2011 Total £
Murabaha	50,199,285	–	–	50,199,285
Wakala	22,254,221	–	4,218,044	26,472,265
	72,453,506	**–**	**4,218,044**	**76,671,550**

Bank

	0-3 months £	4-12 months £	1-5 years £	2012 Total £
Murabaha	84,348,590	–	–	84,348,590
Wakala	33,957,349	–	2,977,114	36,934,463
	118,305,939	**–**	**2,977,114**	**121,283,053**

Bank

	0-3 months £	4-12 months £	1-5 years £	2011 Total £
Murabaha	42,049,748	–	–	42,049,748
Wakala	21,348,716	–	4,218,044	25,566,760
	63,398,464	**–**	**4,218,044**	**67,616,508**

18. Investment securities

Group

	Listed £	Unlisted £	2012 Total £
Fair value through profit and loss			
Sukuk	40,518,391	–	40,518,391
Available-for-sale			
Equity	191,031	2,213,104	2,404,135
Sukuk	61,918,227	–	61,918,227
	102,627,649	**2,213,104**	**104,840,753**

Group

	Listed £	Unlisted £	2011 Total £
Fair value through profit and loss			
Sukuk	39,259,354	–	39,259,354
Available-for-sale			
Equity	–	2,359,313	2,359,313
Sukuk	39,782,838	–	39,782,838
	79,042,192	**2,359,313**	**81,401,505**

Bank

	Listed £	Unlisted £	2012 Total £
Designated as fair value through profit and loss			
Sukuk	9,327,943	–	9,327,943
Sharia'a compliant funds	–	51,033,665	51,033,665
Available-for-sale			
Equity	191,031	2,213,104	2,404,135
Sukuk	61,918,226	–	61,918,226
Investment in subsidiaries	–	15,559	15,559
	71,437,200	**53,262,328**	**124,699,528**

Investment in subsidiaries includes $25,000 invested in BLME Umbrella Fund Management Sarl and £100 invested in BLME (UK) GP Limited.

Bank

	Listed £	Unlisted £	2011 Total £
Designated as fair value through profit and loss			
Sukuk	8,234,026	–	8,234,026
Sharia'a compliant funds	–	47,259,397	47,259,397
Available-for-sale			
Equity	–	2,359,313	2,359,313
Sukuk	39,782,838	–	39,782,838
Investment in subsidiary	–	16,270	16,270
	48,016,864	**49,634,980**	**97,651,844**

19. Investment properties

Group

	2012 £	2011 £
Opening valuation	12,858,712	7,232,573
Net exchange differences	(327,328)	13,765
Purchases at cost	16,334,859	5,938,529
Movements in fair value	(1,049,455)	(326,155)
Closing valuation	**27,816,788**	**12,858,712**

The Group accounts for its investment properties under IAS 40 "Investment property" using a fair value model. The investment properties are valued by independent external professionally qualified valuation agents based on current prices in an active market.

The purchases during the year, and during 2011, relate to the Group's investment in the BLME Light Industrial Building Fund compartment of the BLME Sharia'a Umbrella Fund SICAV SIF which is consolidated into the Group's results as disclosed in Note 32.

The four commercial property purchases during the year of industrial and office units in Warrington, Cheshire (£2.6 million), Haydock, Merseyside (£6.9 million), Gateshead, Tyne and Wear (£4.0 million) and Middlesbrough, Teesside (£1.8 million) were valued by GVA Grimley Limited. The acquisition costs of these properties totalling £1,003,860 (2011: £388,529) are included in the above purchases at cost figure.

The Group's leasehold interest in a US commercial real estate property in Bettendorf, Iowa was valued by CB Richard Ellis at $11.8 million (2011: $11.3 million). This property is held through the SPVs 'TP Funding Company LLC' and 'Medical Property Investments LLC' (see note 32).

The income statement includes rental income from the investment properties of £2,272,978 (2011: £957,679) in the line "Other operating income" and direct operating expenses of £728,577 (2011: £474,683) including repairs and maintenance in the line "Other operating expenses".

20. Financing arrangements

Group

	Less than 1 year £	1 - 5 years £	Over 5 years £	2012 Total £
Murabaha	197,004,139	137,100,930	20,922	334,125,991
Mudaraba	251	–	3,605,003	3,605,254
Musharaka	217	3,900,756	–	3,900,973
Istisna and Ijara	280	–	9,539,133	9,539,413
Sukuk	1,289,045	22,628,248	3,091,859	27,009,152
Wakala	–	3,290,305	–	3,290,305
	198,293,932	**166,920,239**	**16,256,917**	**381,471,088**
Provision for impairment				(22,091,840)
				359,379,248

Group

	Less than 1 year £	1 - 5 years £	Over 5 years £	2011 Total £
Murabaha	91,084,208	149,117,705	20,922	240,222,835
Mudaraba	3,777,745	–	–	3,777,745
Musharaka	1,555	–	4,561,696	4,563,251
Istisna and Ijara	1,182	–	10,475,949	10,477,131
Sukuk	31,789,849	29,262,842	–	61,052,691
	126,654,539	**178,380,547**	**15,058,567**	**320,093,653**
Provision for impairment				(20,991,562)
				299,102,091

These tables represent contractual maturities.

Bank

	Less than 1 year £	1 - 5 years £	Over 5 years £	2012 Total £
Murabaha	197,004,141	137,100,930	20,922	334,125,993
Mudaraba	251	–	3,605,003	3,605,254
Musharaka	217	3,900,756	–	3,900,973
Istisna and Ijara	280	–	9,539,133	9,539,413
Participation agreement	13,151,669	46,370,912	–	59,522,581
Profit rate swaps	28,292	89,794	–	118,086
Sukuk	1,289,045	22,628,248	3,091,859	27,009,152
Wakala	–	3,290,305	–	3,290,305
	211,473,895	**213,380,945**	**16,256,917**	**441,111,757**
Provision for impairment				(22,158,006)
				418,953,751

Bank

	Less than 1 year £	1 - 5 years £	Over 5 years £	2011 Total £
Murabaha	91,084,207	149,117,705	20,922	240,222,834
Mudaraba	3,777,745	–	–	3,777,745
Musharaka	1,555	–	4,561,696	4,563,251
Istisna and Ijara	1,182	–	10,475,949	10,477,131
Participation agreement	12,551,520	64,202,276	–	76,753,796
Profit rate swaps	68,146	586,060	–	654,206
Sukuk	31,789,848	29,262,841	–	61,052,689
	139,274,203	**243,168,882**	**15,058,567**	**397,501,652**
Provision for impairment				(21,451,914)
				376,049,738

These tables represent contractual maturities.

21. Finance leases

Group

Gross investment in finance lease receivables	2012 £	2011 £
Within one year	65,962,946	52,787,159
One to five years	102,654,369	91,585,235
Over five years	–	1,423,320
	168,617,315	**145,795,714**
Unearned future income on finance leases	(16,692,301)	(14,323,263)
Provision for impairment	–	(460,352)
Net investment in finance leases	**151,925,014**	**131,012,099**

The net investment in finance leases comprises:

Within one year	60,684,864	47,987,557
One to five years	91,240,150	81,799,359
Over five years	–	1,225,183
	151,925,014	**131,012,099**

These tables represent contractual maturities.

Bank

Gross investment in finance lease receivables	2012 £	2011 £
Within one year	60,350,011	45,739,839
One to five years	93,327,706	75,544,790
Over five years	–	1,423,320
	153,677,717	**122,707,949**
Unearned future income on finance leases	(15,219,248)	(11,859,672)
Provision for impairment	–	–
Net investment in finance leases	**138,458,469**	**110,848,277**

The net investment in finance leases comprises:

Within one year	55,563,119	42,042,545
One to five years	82,895,350	67,580,549
Over five years	–	1,225,183
	138,458,469	**110,848,277**

These tables represent contractual maturities.

The Group and Bank's investment in finance leases covers a wide range of equipment types, including transport, construction, mining and heavy machinery equipment.

22. Property and equipment

Group and Bank

Cost	Computer Equipment £	Office Equipment £	Fixtures & Fittings £	2012 Total £
At 1 January 2011	393,985	104,233	1,756,253	2,254,471
Additions	47,645	–	126	47,771
At 31 December 2011	**441,630**	**104,233**	**1,756,379**	**2,302,242**
At 1 January 2012	441,630	104,233	1,756,379	2,302,242
Additions	100,051	–	87,149	187,200
At 31 December 2012	**541,681**	**104,233**	**1,843,528**	**2,489,442**

Depreciation and impairment losses

At 1 January 2011	313,991	74,019	1,090,367	1,478,377
Charge for the year	60,551	26,548	284,420	371,519
At 31 December 2011	**374,542**	**100,567**	**1,374,787**	**1,849,896**
At 1 January 2012	374,542	100,567	1,374,787	1,849,896
Charge for the year	54,430	2,779	175,984	233,193
At 31 December 2012	**428,972**	**103,346**	**1,550,771**	**2,083,089**

Net Book Value

At 1 January 2011	79,994	30,214	665,886	776,094
At 31 December 2011	67,088	3,666	381,592	452,346
At 31 December 2012	**112,709**	**887**	**292,757**	**406,353**

23. Operating lease assets

Group

	At 31 December 2011 £	Additions 2012 £	Disposals 2012 £	Depreciation 2012 £	Translation differences 2012 £	At 31 December 2012 £
Gross carrying amount	135,380,751	22,981,691	(16,457,775)	–	(3,404,111)	138,500,556
Less depreciation	(42,097,986)	–	8,663,116	(21,646,350)	1,577,263	(53,503,957)
	93,282,765	**22,981,691**	**(7,794,659)**	**(21,646,350)**	**(1,826,848)**	**84,996,599**
Provision for impairment						(66,166)
						84,930,433

Group

	At 31 December 2010 £	Additions 2011 £	Disposals 2011 £	Depreciation 2011 £	Translation differences 2011 £	At 31 December 2011 £
Gross carrying amount	123,412,891	33,486,004	(21,652,673)	–	134,529	135,380,751
Less depreciation	(34,225,073)	–	13,231,364	(20,606,721)	(497,556)	(42,097,986)
	89,187,818	**33,486,004**	**(8,421,309)**	**(20,606,721)**	**(363,027)**	**93,282,765**

Rental receipts under operating leases

Future rentals are as follows:	2012 £	2011 £
Less than one year	30,306,341	29,154,337
Between one and five years	63,257,744	77,693,343
More than five years	2,940,700	–
	96,504,785	**106,847,680**

Bank

	At 31 December 2011 £	Additions 2012 £	Disposals 2012 £	Depreciation 2012 £	At 31 December 2012 £
Gross carrying amount	57,900,683	15,654,419	(5,319,115)	–	68,235,987
Less depreciation	(11,449,209)	–	2,570,319	(10,301,886)	(19,180,776)
	46,451,474	**15,654,419**	**(2,748,796)**	**(10,301,886)**	**49,055,211**

	At 31 December 2010 £	Additions 2011 £	Disposals 2011 £	Depreciation 2011 £	At 31 December 2011 £
Gross carrying amount	38,517,019	24,151,331	(4,767,667)	–	57,900,683
Less depreciation	(5,583,018)	–	2,505,703	(8,371,894)	(11,449,209)
	32,934,001	**24,151,331**	**(2,261,964)**	**(8,371,894)**	**46,451,474**

Rental receipts under operating leases

Future rentals are as follows:	2012 £	2011 £
Less than one year	15,830,730	13,979,572
Between one and five years	37,001,055	38,835,480
More than five years	2,940,700	–
	55,772,485	**52,815,052**

The Group and Bank's investment in operating leases covers a wide range of equipment types, including transport, construction, mining and heavy machinery equipment.

24. Intangible assets

Group and Bank

Cost	2012 £	2011 £
Opening balance	2,362,232	2,011,788
Acquisitions	410,981	350,444
Closing balance	**2,773,213**	**2,362,232**
Depreciation and impairment losses		
Opening balance	1,888,214	1,592,525
Charge for the year	150,467	295,689
Closing balance	**2,038,681**	**1,888,214**
Net Book Value	**734,532**	**474,018**

Intangible assets consist of the cost of computer licences and software development.

25. Other assets

Group

	2012 £	2011 £
VAT recoverable	2,645,489	1,739,911
Accrued income	123,983	112,329
Collateral deposits*	802,844	775,633
Prepayments	2,136,048	1,270,244
Operating lease accrued income	274,832	58,878
Other receivables	7,234,176	4,402,971
Returned leased assets	–	77,566
	13,217,372	**8,437,532**

Bank

	2012 £	2011 £
VAT recoverable	2,645,489	1,736,098
Accrued income	54,621	60,621
Collateral deposits*	802,844	775,633
Prepayments	1,228,784	948,186
Other receivables	5,340,232	3,915,169
	10,071,970	**7,435,707**

*The Bank has pledged cash collateral deposits of £802,844 (2011: £775,633) as security against rental payments on its premises.

26. Due to financial institutions

Group

	2012 £	2011 £
Reverse Murabaha	420,569,754	412,216,978
Wakala	91,543,507	88,257,127
	512,113,261	**500,474,105**

Bank

	2012 £	2011 £
Reverse Murabaha	416,902,254	412,216,978
Wakala	91,543,507	88,257,127
	508,445,761	**500,474,105**

27. Due to customers

Group and Bank

	2012 £	2011 £
Security deposits	3,652,379	3,064,231
Customer deposits	254,094,919	47,966,929
	257,747,298	**51,031,160**

28. Other liabilities

Group

	2012 £	2011 £
Trade payables	1,382,964	1,083,227
Deferred income	3,512,564	2,662,975
Social security and income tax	278,659	278,407
Accruals	5,759,654	2,434,929
Other creditors	1,971,586	1,493,560
	12,905,427	**7,953,098**

Bank

	2012 £	2011 £
Trade payables	708,939	507,749
Deferred income	2,164,375	1,647,601
Social security and income tax	278,659	278,407
Accruals	5,665,181	2,421,216
Other creditors	753,689	862,355
	9,570,843	**5,717,328**

29. Commitments under operating leases

There is a commitment for the Group and Bank at the year-end under a non-cancellable operating lease for the Bank's premises at 1st Floor, Sherborne House, 119 Cannon Street, London, EC4N 5AT for a ten year period from 20 April 2007 to 19 April 2017, at an annual rental of £324,564, with an initial rent free period.

Sherborne House

Future minimum rentals are as follows:	2012 £	2011 £
More than five years	1,379,397	1,703,961
	1,379,397	**1,703,961**

During the year £275,880 (2011: £275,880) was recognised as an expense in the income statement in respect of this operating lease.

There is a commitment for the Group and Bank at the year-end under a non-cancellable operating lease for the Bank's Wealth Management Division's premises at 12 Manchester Square, London W1U 3PP for a twenty year period (with a ten year break clause) from 23 June 2008 to 22 June 2028, at an annual rental of £452,945 with an initial rent free period.

Manchester Square

Future minimum rentals are as follows:	2012 £	2011 £
More than five years	6,982,902	7,435,847
	6,982,902	**7,435,847**

During the year £444,084 (2011: £450,108) was recognised as an expense in the income statement in respect of this operating lease.

There is a commitment for the Group and Bank at the year-end under a non-cancellable operating lease for the Bank's representative office in Dubai for a three year period from 1 November 2012 to 31 October 2015, at an annual rental of AED 646,520 (which was equivalent to £108,844 at the balance sheet date) with an initial rent free period.

Dubai Office

Future minimum rentals are as follows:	2012 £	2011 £
Less than five years	308,392	–
	308,392	–

During the year £7,705 (2011: £nil) was recognised as an expense in the income statement in respect of this operating lease.

30. Capital commitments

Group and Bank

	2012 £	2011 £
Undrawn investment call commitments		
BLME Light Industrial Building Fund	**Nil**	**3,984,470**

During 2011 the Bank entered a contract to subscribe for up to £10 million of shares in the BLME Light Industrial Building Fund ("LIBF") compartment of the BLME Sharia'a Umbrella Fund SICAV SIF. During 2012 the balance of the undrawn commitment at 31 December 2011 was invested into LIBF.

31. Share capital and share premium

Group and Bank

Authorised	2012 £	2011 £
6,000,000,000 ordinary shares of £0.01 each	60,000,000	60,000,000

Allotted, called up and fully paid	No. of Shares	Share capital £	Share premium £
At 31 December 2010	4,893,342,281	48,933,422	206,226,328
Shares issued during 2011	–	–	–
At 31 December 2011	**4,893,342,281**	**48,933,422**	**206,226,328**

Allotted, called up and fully paid			
At 31 December 2011	4,893,342,281	48,933,422	206,226,328
Shares issued during 2012	–	–	–
At 31 December 2012	**4,893,342,281**	**48,933,422**	**206,226,328**

32. Subsidiaries and other entities

Subsidiary	Country of incorporation	BLME interest in equity capital %	Issued equity capital
BLME Umbrella Fund Management Sarl	Luxembourg	100	US$ 25,000
BLME (UK) GP Limited	England & Wales	100	£100
BLME Nominees LIBF Limited	England & Wales	100	£100
Bank of London and The Middle East EBT	Jersey	100	£100

In addition, the Bank holds the following investments in three different compartments of the BLME Sharia'a Umbrella Fund SICAV SIF:

Compartment	**Holdings**
BLME US$ Income Fund	1 Management share, 47,883.888 class B shares, 1,234.491 class G shares (2011: 1 Management share, 47,883.888 class B, 1,234.491 class G shares)
BLME US$ High Yield Fund	10,000 class A shares (2011: 10,000)
BLME Light Industrial Building Fund	10,027.628 class A shares (2011: 6,015.528)

These holdings represent a majority interest in all three active compartments of the BLME Sharia'a Umbrella Fund SICAV SIF which are therefore deemed to be controlled by the Bank and thus consolidated into the Group's results. The overall holding in the BLME Sharia'a Umbrella Fund SICAV SIF is approximately 81.9% (2011: 96.5%) of the shares issued. The Group recognised an expense of £840,720 (2011: £50,732) in the income statement line "Change in third party interest in consolidated funds" relating to the minority interest of third party investors in the fund. The minority interest of 18.1% (2011: 3.5%) has been reported in the Group's balance sheet liabilities line "Third party interest in consolidated funds".

In 2011 the Bank subscribed $10 million into the BLME US$ High Yield Fund compartment at launch. A GBP share class of the BLME US$ Income Fund compartment was launched during 2011 and the Bank subscribed the sterling equivalent of $2 million into the GBP share class funded by redeeming $2 million from the US$ share class of the BLME US$ Income Fund compartment. As described in Note 30, during the year the Bank subscribed £3,984,470 (2011: £6,015,530) into the BLME Light Industrial Building Fund compartment.

There are five entities (2011: six) that do not qualify as subsidiaries under UK law but which are consolidated under IAS 27 (SIC-12) as the substance of the relationship is that the entities are controlled by the Bank. These entities are deemed to be controlled by the Bank because the relationships between the Bank and the SPVs are governed by participation agreements which confer the risk and rewards to the Bank and indemnify the SPVs for losses. Therefore this gives rise to benefits and risks that are in substance no different from those that would arise were the entities subsidiaries of the Bank.

The five entities are as follows:

– Kalakane Transatlantic Investors II, Inc. (USA) – Operating leases

– BLX13 Inc (USA) – Operating leases and Finance leases

– DMJ 2 LLC (USA) – Operating leases

– TP Funding Company LLC (USA) – Investment property

– Medical Property Investments LLC (USA) – Investment property

Lease assets owned by the SPVs are reported as Group operating lease assets amounting to £35,875,223 (2011: £46,831,291). Finance leases owned by the SPVs amount to £13,466,545 (2011: £20,163,822).

At the end of the year the Bank had the following balances with the above mentioned subsidiaries and other consolidated entities which are related parties of the Bank:

Bank

Financing arrangements	2012 £	2011 £
Particpation agreement amounts due from leasing SPVs	50,744,973	68,390,839
Participation agreement amounts due from investment property SPVs	7,555,205	7,902,604
Murabaha due from LIBF compartment of the SICAV SIF	1,156,239	263,100
Other assets		
Management fees due from BLME Sharia'a Umbrella Fund SICAV SIF	109,112	61,231
Loan due from BLME (UK) GP Limited	2,752	2,752
Interest free loans due from BLME employees to the BLME EBT	3,350,000	3,550,000
Total	**62,918,281**	**80,170,526**

During the year income was received from the following subsidiaries and other consolidated entities as follows:

Bank

Income from financing activities	2012 £	2011 £
Participation agreement income from leasing SPVs	3,479,807	4,061,163
Participation agreement income from investment property SPVs	260,603	229,048
Murabaha income from LIBF compartment of the SICAV SIF	8,319	412
Management fee income		
Management fees from BLME Sharia'a Umbrella Fund SICAV SIF	349,345	167,393
Property acquisition fees from LIBF compartment of the SICAV SIF	153,310	55,500
Total	**4,251,384**	**4,513,516**

During 2011 the Bank incurred costs recharged from BLME Umbrella Fund Management Sarl of £48,992 under a service fee agreement (2012: Nil). At 31 December 2011 £33,491 was due under this agreement and included within "Other liabilities" in the Bank's Statement of Financial Position (2012: Nil).

During the year the BLME EBT purchased 3,076,921 of BLME shares at 6.5 pence per share for a total consideration of £200,000 from employees who had left the company (2011: 6,153,846 shares for £400,000). Consequently the BLME EBT holds a stock of own shares at a cost of £1,000,000 (2011: £800,000) which has been deducted from retained earnings in the Statement of Changes in Equity. During the year the Bank incurred stamp duty costs on behalf of the BLME EBT amounting to £1,000 (2011: £2,000).

33. Related parties

During the year the Bank entered into transactions, other than those disclosed in Note 32 above, on an arm's length basis with related counterparties below.

Boubyan Bank	2012 £	2011 £
Wakala placement	21,548,375	4,186,046
Foreign exchange transactions	25,249	–
The Public Institution for Social Security		
Reverse Murabaha	421,962,540	484,522,220
SGM-FX		
Foreign exchange transactions	7,810,137	7,881,064

The amounts outstanding with Boubyan Bank as at 31 December 2012 were as follows:

Included within:	2012 £	2011 £
Cash and balances with banks		
Nostros	149,476	128,281
Due from financial institutions		
Wakala placement	9,137,766	4,186,046

The maximum amounts outstanding, on and off balance sheet, with Boubyan Bank during the year ended 31 December 2012 were £25,734,421 and £nil respectively (2011: £5,000,000 and £nil).

On 22 September 2010 the Bank entered into a 5 year marketing and advisory services agreement with Boubyan Bank. The Bank will be paying KWD 450,000, which was equivalent to £989,230 at the balance sheet date (2011: £1,044,690), annually in arrears for the services with the first payment made on 30 September 2011. In return Boubyan Bank has committed to a comprehensive range of marketing and advisory initiatives. The cost of these services is being recognised in the income statement over the period of the agreement and is included in the line "Other operating expenses".

On 4 April 2011 the Bank was appointed by Boubyan Bank as agent under a 2 year facility agency agreement with Boubyan Bank in relation to a master murabaha facility agreement between Boubyan Bank and a client of Boubyan Bank for the purpose of the acquisition and development of a property in London. For this service, the Bank will receive a facility agency fee of £124,000 during the first year of the agreement and £62,000 in the second year of the agreement. The fee will be payable in four equal quarterly instalments each year.

As at 31 December 2012, Boubyan Bank held 21.78% (2011: 19.8%) of the Bank's shares. A non-executive director who joined the Board on 25 September 2009 was the Chairman of Boubyan Bank from 2009 until March 2012. A non-executive director who joined the Board on 6 December 2012 is the current Chairman of Boubyan Bank.

The amounts outstanding with The Public Institution for Social Security of Kuwait as at 31 December 2012 were as follows:

Included within:	2012 £	2011 £
Reverse Murabaha	408,750,232	389,332,713

The maximum amounts outstanding, on and off balance sheet, with The Public Institution for Social Security during the year ended 31 December 2012 were £408,750,232 and £nil respectively (2011: £389,332,713 and £nil).

As at 31 December 2012, The Public Institution for Social Security held 7.67% (2011: 7.67%) of the Bank's shares. The Bank's Vice Chairman holds the position of Deputy Director General for Investment of The Public Institution for Social Security.

The maximum outstanding amount with SGM-FX during the year ended 31 December 2012 was £4,463,891 (2011: £9,015,920).

As at 31 December 2012 the Bank had no outstanding foreign currency forward contracts with SGM-FX (2011: £2,815,131 of sell GBP / buy USD). The fair value of these contracts as at 31 December 2011 was £35,892.

SGM-FX has pledged cash collateral deposits with BLME of £50,000 (2011: £150,000) as security against foreign currency forward contracts. The Bank's Chief Executive Officer holds a majority interest in SGM-FX.

Key management of the Bank are the three Executive Directors. The compensation of key management personnel is as follows:

	2012 £	2011 £
Key management emoluments*	1,855,897	897,518
Bank contributions to pension plans	93,000	93,000
	1,948,897	**990,518**

*Key management emoluments includes share-based payments of £679,979 (2011: £187,438).

During the year one of the Executive Directors entered spot foreign exchange transactions with the Bank totalling £19,355 (2011: £12,556). As at 31 December 2012 one non-executive director had an interest in a BLME Premier Deposit Account with a balance of £25,000 (2011: £nil). These transactions arose from the ordinary course of business and were conducted on the same terms as for comparable transactions with third-party counterparties.

34. Financial risk management

The Group and Bank have exposure to the following risk categories arising from the use of financial instruments:

– credit risk

– liquidity risk

– market risk

– operational risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing these risks, and the management of capital.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework, which it exercises through the Risk Committee. Day to day management of risk is undertaken by the Executive Committee ("EXCO"), which has established the Asset and Liability Committee ("ALCO"), Counterparty Credit Risk Committee ("CCRC") and the Investment Committee (IC"). These three bodies are responsible for developing policies, approving risks and limits, and regularly reviewing the Group's exposures to all risk classes.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

The principal risks faced by the Group are described below, together with details of how these risks are managed (which have not changed significantly during the year). Quantitative information indicates the amounts of such risks at the reporting date. The amounts at the reporting date are indicative of the amounts of such risks which have been experienced throughout the period.

a. Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty is not able to repay capital and/or profit, or otherwise meet its contractual obligations under credit facilities or in respect of other agreements. This risk is managed in accordance with the Group's Credit Risk Management Policy. The Group has a quality checking process in place covering all its customers and counterparties whereby it assigns an in-house rating and maximum tenor. External rating agency ratings are used where available. Ratings are subject to regular review and constrain the amount of credit that can be made available to the risk counterparty.

i. Management of credit risk

The Group manages credit risk by the use of Target Market Criteria within the Group's Credit Risk Management Policy. These sector and business based expressions of credit risk appetite provide guidance on the acceptable level of credit exposure by counterparty rating, country and sector, including the adequacy of collateral. Credit risks are independently monitored on a daily basis and regularly re-assessed for creditworthiness. The management and overview of credit exposures also ensures that credit capacities are diversified across the Bank's businesses to facilitate allocation of risk capital and to mitigate against concentrations of risk by customer, country, sector and rating.

Through the Risk Committee the Board of Directors has delegated responsibility for the management of credit risk to the CCRC. A separate Credit Risk Department, accountable to the CCRC, is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with other business units, covering credit assessments, collateral requirements, risk reporting, legal requirements and compliance with regulatory and statutory requirements.
- Establishing authorisation limits and structures for the approval and renewal of credit exposure limits.
- Reviewing and assessing credit risk prior to agreements being entered into with customers.
- Establishing limits for counterparties and reviewing these limits.
- On-going assessment of exposure and implementation of procedures to reduce this exposure.
- Providing advice, guidance and specialist skills to all business areas throughout the Bank in the management of credit risk.

Adherence to country and counterparty limits is monitored on an on-going basis by the Bank's Credit Risk Department, with a detailed review of all limits being undertaken at least annually. Senior management receives regular reports on the utilisation of these limits.

The Group also employs a credit grading system, to facilitate monitoring of the quality of the overall portfolio and individual segments thereof, including movements in the portfolio over time.

ii. Exposure

The tables below present the Group and Bank's maximum exposure to credit risk on their balance sheet financial instruments as at 31 December 2012, before taking account of any collateral held or other credit enhancements. The amounts at the reporting date are indicative of the amounts at risk throughout the period.

Group

	2012 £	2011 £
Cash and balances with banks	159,600,938	97,298,498
Due from financial institutions		
Murabaha	92,696,610	50,199,285
Wakala	39,717,136	26,472,265
Investment securities	104,840,753	81,401,505
Financing arrangements	359,379,248	299,102,091
Finance lease receivables	151,925,014	131,012,099
Total credit exposure	**908,159,699**	**685,485,743**

There were 31 off balance sheet letters of guarantee outstanding at 31 December 2012 (2011: 2) with a total exposure of £13,546,175 (2011: £245,297).

Bank

	2012 £	2011 £
Cash and balances with banks	154,898,982	93,620,120
Due from financial institutions		
Murabaha	84,348,590	42,049,748
Wakala	36,934,463	25,566,760
Investment securities	124,699,528	97,651,844
Financing arrangements	418,953,751	376,049,738
Finance lease receivables	138,458,469	110,848,277
Total credit exposure	**958,293,783**	**745,786,487**

There were 31 off balance sheet letters of guarantee outstanding at 31 December 2012 (2011: 2) with a total exposure of £13,546,175 (2011: £245,297).

iii. Exposure by Country

The Group and Bank assets were dispersed across the following countries:

Group

	2012	2011
GCC countries	£	£
Bahrain	20,842,022	14,424,385
Kuwait	29,378,578	32,579,567
Qatar	52,618,716	35,164,567
Saudi Arabia	44,091,224	23,733,945
United Arab Emirates	69,903,453	115,263,490
EEA countries		
France	12,826,177	844,774
Germany	–	1,811,008
Italy	1,855,115	–
Luxembourg	4,081,282	3,376,107
United Kingdom	576,049,466	353,513,611
Other countries		
Bermuda	6,980,687	8,741,042
China	7,993,210	–
Djibouti	3,900,973	4,563,251
Hong Kong	200,000	200,000
Indonesia	9,522,097	3,708,636
Japan	–	3,111,829
Malaysia	3,092,997	7,136,066
Singapore	201,345	–
South Korea	12,534,501	14,537,377
Switzerland	14,718,099	14,144,469
Turkey	15,273,884	17,072,286
USA	22,095,873	31,559,333
Total credit exposure	**908,159,699**	**685,485,743**

The Group has very limited direct credit exposure to institutions and governments of the European Union ("EU") outside the United Kingdom ("UK"). The non UK EU component above, represents approximately 2% (2011: less than 1%) of the Group's total credit exposure. The Group had no direct exposure to either the governments of, or institutions or corporates in Greece, Portugal, Ireland or Spain.

Bank

	2012	2011
GCC countries	£	£
Bahrain	17,123,508	12,610,379
Kuwait	29,378,578	30,583,616
Qatar	45,277,918	29,204,859
Saudi Arabia	39,983,390	18,948,788
United Arab Emirates	48,780,416	97,407,921
EEA countries		
France	12,826,177	844,774
Germany	–	–
Luxembourg	51,049,124	47,538,912
United Kingdom	576,396,232	353,242,240
Other countries		
Bermuda	6,980,687	8,741,042
China	7,993,210	–
Djibouti	3,900,973	4,563,251
Hong Kong	200,000	200,000
Indonesia	8,193,098	3,708,636
Japan	–	1,302,721
Malaysia	3,092,997	6,469,033
Singapore	201,345	–
South Korea	12,534,501	14,537,377
Switzerland	14,718,099	14,144,469
Turkey	14,655,164	16,233,902
USA	65,008,366	85,504,567
Total credit exposure	**958,293,783**	**745,786,487**

iv. Exposure by economic sector

The Group and Bank assets were dispersed across the following economic sectors:

Group	2012 £	2011 £
Financial services		
GCC financial institutions	132,848,785	167,277,464
UK financial institutions	189,135,315	95,098,633
European financial institutions	17,939,803	5,187,115
Other financial institutions	24,874,664	33,305,792
Mining and quarrying	13,996,003	20,425,954
Manufacturing	7,439,809	1,446,632
Real estate	229,870,368	165,027,324
Transportation and storage	111,469,152	98,210,268
Government	45,798,174	24,802,391
Healthcare	730,477	750,369
Wholesale / Retail	59,171,072	34,427,429
Oil and Gas	10,993,810	14,602,599
Commodities	21,357,109	–
Others	42,535,158	24,923,773
Total credit exposure	**908,159,699**	**685,485,743**

Bank	2012 £	2011 £
Financial services		
GCC financial institutions	114,300,052	141,977,751
UK financial institutions	188,325,842	94,847,335
European financial institutions	12,003,406	–
Other financial institutions	23,790,832	28,473,916
Mining and quarrying	13,996,003	20,425,954
Manufacturing	23,445,317	15,914,695
Real estate	238,581,812	171,206,774
Transportation and storage	111,561,428	98,351,100
Government	33,878,334	21,530,638
Healthcare	3,597,490	2,039,372
Sharia'a compliant funds	51,033,665	47,522,742
Wholesale / Retail	69,173,184	52,494,938
Oil and Gas	16,453,945	24,937,163
Commodities	21,357,109	–
Others	36,795,364	26,064,109
Total credit exposure	**958,293,783**	**745,786,487**

v. Credit risk quality

The Group's credit quality and direct investments are managed by the Counterparty Credit Risk Committee and the Investment Committee respectively, under the oversight of the Executive Committee. Credit quality is assessed using techniques that include information from the major External Credit Assessment Institutions ("ECAI") as well as BLME internal ratings. The latter are mapped to the ratings of the ECAI. The table below shows the breakdown of credit quality as at 31 December 2012. Of the total portfolio 47% was directly rated by at least one of the ECAI, with 53% mapped using internal ratings.

There are many counterparties with whom the Group transacts that are not rated by the major ECAI. For such counterparties the Group determines underlying counterparty credit quality by use of its internal credit rating procedures. These procedures assess in combination, the financial and managerial strength, business model robustness, collateral value and availability and the sector and geography of the counterparty concerned. Following this assessment an internal BLME rating is allocated. BLME's internal ratings range from "aa" considered very strong to "b" considered relatively weak.

Group

	2012 Investment Grade £	2012 Sub-Investment Grade £	2012 BLME Internal Rating £	2012 Total £
Cash and balances with banks	159,600,938	–	–	159,600,938
Due from financial institutions	104,640,815	–	27,772,931	132,413,746
Financing arrangements	27,816,498	12,214,793	319,347,957	359,379,248
Investment securities	87,444,809	12,606,340	4,789,604	104,840,753
Finance lease receivables	23,778,945	–	128,146,069	151,925,014
Total credit exposure	**403,282,005**	**24,821,133**	**480,056,561**	**908,159,699**

Group

	2011 Investment Grade £	2011 Sub-Investment Grade £	2011 BLME Internal Rating £	2011 Total £
Cash and balances with banks	97,298,498	–	–	97,298,498
Due from financial institutions	55,322,498	–	21,349,052	76,671,550
Financing arrangements	53,370,139	12,901,714	232,830,238	299,102,091
Investment securities	75,248,388	2,326,024	3,827,093	81,401,505
Finance lease receivables	31,711,068	–	99,301,031	131,012,099
Total credit exposure	**312,950,591**	**15,227,738**	**357,307,414**	**685,485,743**

The Group cash balances, due from financial institutions and investment securities were neither past due nor impaired as at 31 December 2012 and as at 31 December 2011.

Analysis of past due amounts and impairments

Group	Financing arrangements		Financing leases	
	2012 £	2011 £	2012 £	2011 £
Neither past due nor impaired	343,675,757	277,501,634	151,925,014	129,855,190
Past due but not impaired	24,528	3,808,273	–	–
Gross exposure associated with impairment provision	37,770,803	38,783,746	–	1,617,261
Less: allowance for impairments	(22,091,840)	(20,991,562)	–	(460,352)
Total	**359,379,248**	**299,102,091**	**151,925,014**	**131,012,099**

Past due but not impaired	£	£	£	£
Past due up to 30 days	–	–	–	–
Past due 30 to 60 days	–	–	–	–
Past due 60 to 90 days	–	–	–	–
Past due over 90 days	24,528	3,808,273	–	–
Total	**24,528**	**3,808,273**	**–**	**–**

The "past due over 90 days" category as at 31 December 2011 disclosed above included a balance of £3,777,745 relating to a syndicated facility. The facility was successfully restructured during the year and debt service and repayment of capital has re-commenced.

Based on the credit exposures existing as at 31 December 2012 there had been no instances (2011: none):

- where the Bank waived material financial covenants or agreed to temporary relaxation of repayment terms which were subsequently cured.
- where the Bank agreed to provide temporary facilities beyond the terms upon which the facilities were intended to operate.

Bank

	2012 Investment Grade £	2012 Sub-Investment Grade £	2012 BLME Internal Rating £	2012 Total £
Cash and balances with banks	154,898,982	–	–	154,898,982
Due from financial institutions	93,510,122	–	27,772,931	121,283,053
Financing arrangements	66,583,087	15,094,160	337,276,503	418,953,750
Investment securities	61,896,800	9,349,370	53,453,360	124,699,530
Finance lease receivables	10,312,400	–	128,146,068	138,458,468
Total credit exposure	**387,201,391**	**24,443,530**	**546,648,862**	**958,293,783**

Bank	2011 Investment Grade £	2011 Sub-Investment Grade £	2011 BLME Internal Rating £	2011 Total £
Cash and balances with banks	93,620,120	–	–	93,620,120
Due from financial institutions	46,267,457	–	21,349,051	67,616,508
Financing arrangements	105,143,573	24,768,490	246,137,675	376,049,738
Investment securities	47,349,781	–	50,302,063	97,651,844
Finance lease receivables	12,693,850	–	98,154,427	110,848,277
Total credit exposure	**305,074,781**	**24,768,490**	**415,943,216**	**745,786,487**

The Bank cash balances, due from financial institutions and investment securities were neither past due nor impaired as at 31 December 2012 and as at 31 December 2011.

Analysis of past due amounts and impairments

Bank	Financing arrangements		Financing leases	
	2012 £	2011 £	2012 £	2011 £
Neither past due nor impaired	403,111,255	353,292,372	138,458,469	110,848,277
Past due but not impaired	24,528	3,808,273	–	–
Gross exposure associated with impairment provision	37,975,974	40,401,007	–	–
Less: allowance for impairments	(22,158,006)	(21,451,914)	–	–
Total	**418,953,751**	**376,049,738**	**138,458,469**	**110,848,277**

Past due but not impaired	£	£	£	£
Past due up to 30 days	–	–	–	–
Past due 30 to 60 days	–	–	–	–
Past due 60 to 90 days	–	–	–	–
Past due over 90 days	24,528	3,808,273	–	–
Total	**24,528**	**3,808,273**	**–**	**–**

Additional disclosure regarding the circumstances of the “past due but not impaired” balances of the Bank disclosed in the above table is included in the footnote to the “past due but not impaired” balances of the Group on page 97.

- Allowance for impairment

The Group has established a policy to monitor impairment events that could lead to losses in its asset portfolio. This policy covers specific loss events for individual significant exposures as well as for events that relate to collective losses on groups of homogenous assets that have yet to be identified and assessed individually for impairment.

The Group writes off a balance (and any related allowances for impairment) when the Credit Risk Department determines that the balance is uncollectible. This determination would be reached after considering information such as the occurrence of significant changes in the counterparty’s financial position such that the counterparty can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

vi. Collateral

Within its financing activities, which spans working capital finance provision to term real estate financing, the Group seeks to ensure that, where appropriate, at the inception of a transaction it has sufficient collateral coverage in place to assist with the avoidance of stress should the customer concerned fail to honour its obligations when due. The Group monitors the market value of its collateral on an on-going basis which, dependent upon the collateral type, can vary from monthly to at least once a year. As at 31 December 2012, collateral represented 52% (2011: 47%) of the Group's total credit exposure.

During the year, the Group obtained assets by taking possession of collateral with a total value of £6,411,247 (2011: £225,830). This represented real estate of £6,345,825 and plant and equipment of £65,422 (2011: plant and equipment of £225,830). The carrying amount as at 31 December 2012 was £6,345,825 (2011: £10,303) and was classified as Murabaha within "Financing Arrangements" (2011: returned leased assets were classified within "Other Assets").

Group	2012 Exposure £	2012 Collateral £	2011 Exposure £	2011 Collateral £
Cash and balances with banks	159,600,938	–	97,298,498	–
Due from financial institutions	132,413,746	–	76,671,550	–
Investment securities	104,840,753	–	81,401,505	–
Financing arrangements	359,379,248	322,807,168	299,102,091	187,592,674
Finance lease receivables	151,925,014	151,925,014	131,012,099	131,472,454
Total credit exposure	**908,159,699**	**474,732,182**	**685,485,743**	**319,065,128**

Analysis of collateral	2012 £	2011 £
Plant and equipment	172,452,345	136,129,001
Property	229,214,095	159,846,424
Raw materials/ finished stock	58,978,191	8,049,322
Financial guarantee	14,087,550	15,040,381
Total credit exposure	**474,732,181**	**319,065,128**

Collateral is disclosed at the lower of 100% of the exposure or management estimation of the value of the collateral based on prevailing valuations.

Bank	2012 Exposure £	2012 Collateral £	2011 Exposure £	2011 Collateral £
Cash and balances with banks	154,898,982	–	93,620,120	–
Due from financial institutions	121,283,053	–	67,616,508	–
Investment securities	124,699,528	–	97,651,844	–
Financing arrangements	418,953,751	382,050,269	376,049,738	263,755,261
Finance lease receivables	138,458,469	138,458,469	110,848,277	110,848,277
Total credit exposure	**958,293,783**	**520,508,738**	**745,786,487**	**374,603,538**

Analysis of collateral	2012 £	2011 £
Plant and equipment	209,796,940	184,358,699
Property	237,667,122	167,155,136
Raw materials/ finished stock	58,957,126	8,049,322
Financial guarantees	14,087,550	15,040,381
Total credit exposure	**520,508,738**	**374,603,538**

Collateral is disclosed at the lower of 100% of the exposure or management estimation of the value of the collateral based on prevailing valuations.

vii. Fair value of financial assets and liabilities

The following table summarises the carrying amounts and estimated fair values of financial assets and liabilities.

Group	*Note*	2012 Carrying value £	2012 Fair value £	2011 Carrying value £	2011 Fair value £
Due from financial institutions	*i*	132,416,746	132,413,746	76,671,550	76,671,550
Investment securities	*ii*	104,840,753	104,840,753	81,401,505	81,401,505
Financing arrangements	*iii*	359,379,248	344,801,118	299,102,091	283,612,631
Finance lease receivables	*iv*	151,925,014	143,045,931	131,012,099	122,187,007
Due to financial institutions	*iv*	512,113,261	511,322,591	500,474,105	498,791,155
Profit rate swaps liability	*v*	5,308,045	5,308,045	7,268,757	7,268,757
Due to customers	*iv*	257,747,298	257,747,298	51,031,160	51,031,160

Bank	*Note*	2012 Carrying value £	2012 Fair value £	2011 Carrying value £	2011 Fair value £
Due from financial institutions	*i*	121,283,053	121,283,053	67,616,508	67,616,508
Investment securities	*ii*	124,699,528	124,699,528	97,651,844	97,651,844
Financing arrangements	*iii*	418,953,751	402,420,689	376,049,738	356,899,134
Finance lease receivables	*iv*	138,458,469	130,327,402	110,848,277	103,301,023
Due to financial institutions	*iv*	508,445,761	507,655,091	500,474,105	498,791,155
Profit rate swaps liability	*v*	5,308,045	5,308,045	7,268,757	7,268,757
Due to customers	*iv*	257,747,298	257,747,298	51,031,160	51,031,160

Notes

i. Apart from a £2,954,048 (2011: £4,186,047) Wakala placement with Boubyan Bank, which is disclosed in further detail in Note 33, these assets represent short term liquidity with an average residual life of 1 week for the Bank and 2 weeks for the Group and a maximum individual residual maturity of 4 weeks for the Bank and 4 months for the Group. The assets are placed with banks with an average credit rating of BBB for the Bank and BBB+ for the Group. On this basis, carrying value reflects fair value.

ii. Fair value represents independent external valuation or last trade.

iii. Fair value reflects screen based quotes where appropriate and available or replacement value based on current profit rates with reference to residual maturity from balance sheet date.

iv. Fair value represents present replacement value based on current profit rates with reference to residual maturity from balance sheet date. Fair value is less than carrying value due to liabilities with fixed profit share agreements.

v. Fair value represents replacement value based on current profit rates with reference to residual maturity from balance sheet date.

Valuation of Financial Instruments

The Group measures fair values using the fair value hierarchy that reflects the significance of inputs used in making the measurements.

Level 1: Valuation is based upon quoted market prices in an active market for an identical instrument. This category comprises Sukuk held at fair value through profit and loss and Sukuk held at fair value designated as available-for-sale.

Level 2: Valuation techniques based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category comprises profit rate swaps and investments in Sharia'a compliant funds.

Level 3: Valuation techniques using significant unobservable inputs. This category comprises unlisted equity investments valued by reference to third party valuations.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using valuation techniques based on observable and unobservable inputs.

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the fair value hierarchy.

Group	2012 Level 1 £	2012 Level 2 £	2012 Level 3 £	2012 Total £
Investment securities	102,627,649	–	2,213,104	104,840,753
Profit rate swaps liability	–	5,308,045	–	5,308,045

Group	2011 Level 1 £	2011 Level 2 £	2011 Level 3 £	2011 Total £
Investment securities	79,304,972	–	2,096,533	81,401,505
Profit rate swaps liability	–	7,268,757	–	7,268,757

Bank

	2012 Level 1 £	2012 Level 2 £	2012 Level 3 £	2012 Total £
Investment securities	71,437,200	51,033,665	2,228,663	124,699,528
Profit rate swaps liability	–	5,308,045	–	5,308,045

Bank

	2011 Level 1 £	2011 Level 2 £	2011 Level 3 £	2011 Total £
Investment securities	48,279,644	47,259,397	2,112,803	97,651,844
Profit rate swaps liability	–	7,268,757	–	7,268,757

The following table shows a reconciliation from the beginning balances to the ending balances for fair value measurements in Level 3 of the fair value hierarchy.

Group

Investment securities	2012 £	2011 £
Balance at 1 January	2,096,533	1,581,140
Total gains/(Losses) recognised in:		
– profit or loss	(19,250)	1,896
– other comprehensive income	(15,000)	40,848
Purchases	150,821	472,649
Balance at 31 December	**2,213,104**	**2,096,533**

Bank

Investment securities	2012 £	2011 £
Balance at 1 January	2,112,803	1,597,284
Total gains/(Losses) recognised in:		
– profit or loss	(19,961)	1,922
– other comprehensive income	(15,000)	40,848
Purchases	150,821	472,749
Balance at 31 December	**2,228,663**	**2,112,803**

viii. Financial assets and liabilities

The following table details the carrying value by category of financial assets and liabilities as at 31 December 2012.

Group

Assets	2012 Fair value through profit and loss £	2012 Designated at fair value through profit and loss upon initial recognition £	2012 Available-for-sale £	2012 Financial assets at amortised cost £	2012 Total £
Cash and balances with banks	–	–	–	159,600,938	159,600,938
Due from financial institutions	–	–	–	132,413,746	132,413,746
Investment securities:					
Sukuk	40,518,391		61,918,227	–	102,436,618
Equity	–	–	2,404,135	–	2,404,135
Financing arrangements	–	–	–	359,379,248	359,379,248
Finance lease receivables	–	–	–	151,925,014	151,925,014
Total assets	**40,518,391**	**–**	**64,322,362**	**803,318,946**	**908,159,699**

Group

Liabilities	Profit Rate Swaps designated as fair value hedging instruments £	Profit Rate Swaps designated as cash flow hedging instruments £	Financial liabilities at amortised cost £	2011 Total £
Due to financial institutions	–	–	512,113,261	512,113,261
Due to customers	–	–	257,747,298	257,747,298
Profit rate swaps	1,057,607	4,250,438	–	5,308,045
Total liabilities	**1,057,607**	**4,250,438**	**769,860,559**	**775,168,604**

Group

Assets	2011 Fair value through profit and loss £	2011 Designated at fair value through profit and loss upon initial recognition £	2011 Available-for-sale £	2011 Financial assets at amortised cost £	2011 Total £
Cash and balances with banks	–	–	–	97,298,498	97,298,498
Due from financial institutions	–	–	–	76,671,550	76,671,550
Investment securities:					
Sukuk	39,259,354	–	39,782,838	–	79,042,192
Equity	–	–	2,359,313	–	2,359,313
Financing arrangements	–	–	–	299,102,091	299,102,091
Finance lease receivables	–	–	–	131,012,099	131,012,099
Total assets	**39,259,354**	**–**	**42,142,151**	**604,084,238**	**685,485,743**

Liabilities	Profit Rate Swaps designated as fair value hedging instruments £	Profit Rate Swaps designated as cash flow hedging instruments £	Financial liabilities at amortised cost £	2011 Total £
Due to financial institutions	–	–	500,474,105	500,474,105
Due to customers	–	–	51,031,160	51,031,160
Profit rate swaps	1,375,531	5,893,226	–	7,268,757
Total liabilities	**1,375,531**	**5,893,226**	**551,505,265**	**558,774,022**

Bank

Assets	2012 Fair value through profit and loss £	2012 Designated at fair value through profit and loss upon initial recognition £	2012 Available-for-sale £	2012 Financial assets at amortised cost £	2012 Total £
Cash and balances with banks	–	–	–	154,898,982	154,898,982
Due from financial institutions	–	–	–	121,283,053	121,283,053
Investment securities:					
Sukuk	9,327,943	–	61,918,226	–	71,246,169
Unlisted Sharia'a compliant funds	–	51,033,665	–	–	51,033,665
Equity	–	–	2,404,135	–	2,404,135
Investment in subsidiaries	–	–	–	15,559	15,559
Financing arrangements	–	–	–	418,953,751	418,953,751
Finance lease receivables	–	–	–	138,458,469	138,458,469
Total assets	**9,327,943**	**51,033,665**	**64,322,361**	**833,609,814**	**958,293,783**

Liabilities	Profit Rate Swaps designated as fair value hedging instruments £	Profit Rate Swaps designated as cash flow hedging instruments £	Financial liabilities at amortised cost £	2012 Total £
Due to financial institutions	–	–	508,445,761	508,445,761
Due to customers	–	–	257,747,298	257,747,298
Profit rate swaps	1,057,606	4,250,439	–	5,308,045
Total liabilities	**1,057,606**	**4,250,439**	**766,193,059**	**771,501,104**

Bank

Assets	2011 Fair value through profit and loss £	2011 Designated at fair value through profit and loss upon initial recognition £	2011 Available-for-sale £	2011 Financial assets at amortised cost £	2011 Total £
Cash and balances with banks	–	–	–	93,620,120	93,620,120
Due from financial institutions	–	–	–	67,616,508	67,616,508
Investment securities:					
Sukuk	8,234,026	–	39,782,838	–	48,016,864
Unlisted Sharia'a compliant funds	–	47,259,397	–	–	47,259,397
Equity	–	–	2,359,313	–	2,359,313
Investment in subsidiaries	–	–	–	16,270	16,270
Financing arrangements	–	–	–	376,049,738	376,049,738
Finance lease receivables	–	–	–	110,848,277	110,848,277
Total assets	**8,234,026**	**47,259,397**	**42,142,151**	**648,150,913**	**745,786,487**

Liabilities	Profit Rate Swaps designated as fair value hedging instruments £	Profit Rate Swaps designated as cash flow hedging instruments £	Financial liabilities at amortised cost £	2011 Total £
Due to financial institutions	–	–	500,474,105	500,474,105
Due to customers	–	–	51,031,160	51,031,160
Profit rate swaps	1,375,531	5,893,226	–	7,268,757
Total liabilities	**1,375,531**	**5,893,226**	**551,505,265**	**558,774,022**

b. Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting its financial obligations as they fall due, arising from the differing maturity profile of its assets and liabilities. This risk is managed by ensuring that the Group always has sufficient liquidity to meet its liabilities when due.

The Treasury Department is responsible for monitoring the liquidity profile of financial assets and liabilities, including projected cash flows from current and future business. This area maintains a portfolio of short-term money market assets and marketable securities to ensure that sufficient liquidity is maintained. The liquidity position is monitored on a daily basis in accordance with guidelines issued by the Asset and Liability Committee ("ALCO") and approved by the Board Risk Committee. Overall, the management of liquidity risk is conducted in accordance with the Group's Liquidity Risk Management Policy and its annual Individual Liquidity Adequacy Assessment, as required by the Financial Services Authority.

Over and above regulatory liquidity, ALCO establishes its own liquidity performance measures and prudential guidelines. These include a series of early warning triggers and management data on liability stability (i.e. the likelihood of deposits being withdrawn), liability diversification and reserve liquidity. As at 31 December 2012, the Bank had acquired £748,199,428 (2011: £540,076,590) of term deposits and held £25,720,107 (2011: £59,443,979) of secondary market assets.

Residual contractual maturities of financial liabilities

Group and Bank	Less than 1 month £	1-3 months £	3-12 months £	1-5 years £	5+ years £	2012 Total £
Due to financial institutions	147,263,962	96,297,596	266,133,799	4,817,493	–	514,512,850
Due to customers	19,622,424	4,822,356	52,066,728	205,287,616	–	281,799,124
Profit rate swaps	144,269	214,461	605,111	4,344,204	–	5,308,045
	167,030,655	**101,334,413**	**318,805,638**	**214,449,313**	**–**	**801,620,019**

Group and Bank	Less than 1 month £	1-3 months £	3-12 months £	1-5 years £	5+ years £	2011 Total £
Due to financial institutions	104,584,788	105,879,748	290,626,624	2,040,257	–	503,131,417
Due to customers	9,063,798	2,282,132	26,230,984	16,247,076	–	53,823,990
Profit rate swaps	478,945	–	351,394	6,438,418	–	7,268,757
	114,127,531	**108,161,880**	**317,209,002**	**24,725,751**	**–**	**564,224,164**

The table above shows the contractual, undiscounted cash flows of the Group's and Bank's financial liabilities.

c. Market risks

Market risk is the risk that changes in market prices will affect the Group's income. It covers profit rate risk, credit spread risk and foreign exchange risk. In accordance with the Group's Market Risk Management Policy, ALCO is responsible for reviewing all classes of market price risk and positions, sanctioning dealing limits and approving BLME's stress testing program in accordance with BLME's Stress Testing and Scenario Analysis Policy.

The principal exposure to market risk relates to Asset and Liability market rate re-price risk within the accrual based Banking Book. These risks are governed by mismatch limits expressed as the present value sensitivity of a 1 basis point change in profit rates. The main stress tests relate to Asset and Liability re-price, credit spread and FX risks.

i. *Profit rate risk*

This risk arises from the effects of changes in profit rates on the re-pricing of assets and liabilities, and covers both fixed and variable profit rates. The Group manages such risks through the use of time based limits that measure the profit rate sensitivity to changes in profit rates.

As at 31 December 2012, the Group's net profit rate sensitivity to profit and loss on its fixed and variable rate assets, and its capital and reserves, as measured by the discounted value of a one basis point change in market rates, was £13,284 (2011: £55,236). The impact of an increase or decrease of 100 basis points in profit rates at the statement of financial position date would be to increase or decrease profit and loss by £3,406,026 (2011: £8,646,621) and to increase or decrease equity by £1,328,448 (2011: £5,523,600).

ii. *Credit spread risk*

BLME operates a Sukuk Trading Book, within which the portfolio size and individual issuer risks are limited to modest proportions since BLME does not have a material appetite for Trading Risk. The value of this Trading Book as at 31 December 2012 was £9,327,943 (2011: £8,234,027). The impact of an increase or decrease of 10 per cent in Sukuk trading prices at the statement of financial position date would be to increase or decrease equity and profit or loss by £920,691 (2011: £816,549).

iii. *Foreign exchange risk*

Foreign exchange risk is the risk that the value in a non-Sterling asset or liability position will fluctuate due to changes in currency rates. The Bank does not take significant foreign exchange positions and the majority of risk relates to earnings on US Dollar assets and US Dollar liabilities whose maturities are broadly matched. The Board has established position and stop loss limits to ensure that positions and revaluation results are subject to independent daily monitoring and reporting to senior management.

A 10 percent strengthening or weakening of the net foreign currency positions against Sterling at the statement of financial position date would result in an FX revaluation gain or loss of £76,460 (2011: £481,469). The foreign exchange result for the year to 31 December 2012 was a net gain of £285,156 (2011: £367,447 gain).

d. Operational risk

Operational risk is the risk of loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks.

The Group's objective in managing operational risk is to implement an integrated internal control and operating infrastructure that supports process efficiency and customer needs, whilst reducing the risk of error and financial loss in a cost effective manner. The overall operational risk framework is set by the Board and documented within the Group's Operational Risk Policy. The Bank has undertaken staff training and implemented procedures for operational loss and event forms to be raised where such risks occur. These are evaluated by Risk management, and sanctioned in accordance with an approval matrix that takes account of the severity of the loss.

During the year ended 31 December 2012 the Bank has undertaken a detailed risk assessment by business area as a means of identifying the main operational risks and quantifying the effectiveness of risk mitigants and controls. In addition, it continued to test and refine its Business Continuity Plan including both its businesses and premises in the City of London and the West End of London.

e. Capital adequacy

At 31 December 2012 and throughout the year the Group complied with the capital requirements that were in force as set out by the Financial Services Authority ("the FSA").

The Group's regulatory capital position as at 31 December 2012 was as follows:

Tier 1 capital	2012 £ (unaudited)	2011 £ (unaudited)
Ordinary share capital	48,933,422	48,933,422
Share premium	206,226,328	206,226,328
Retained losses	(13,237,189)	(16,877,944)
Total Tier 1 capital	**241,922,561**	**238,281,806**
Deductions from Tier 1 capital:		
Intangible assets	(734,532)	(474,018)
Total Tier 1 capital after deductions	**241,188,029**	**237,807,788**
Tier 2 capital		
Collective allowances for impairment	–	460,352
Total Tier 2 capital	–	**460,352**
Total Tier 1 and Tier 2 capital	**241,188,029**	**238,268,140**
Deductions from Tier 1 and Tier 2 capital:		
Investment in BLME Sharia'a Umbrella Fund SICAV SIF	(51,033,665)	(46,838,983)
Investment in DMJ II LLC	–	(4,451,418)
Investment in BLME Umbrella Fund Management Sarl	(15,459)	(16,170)
Investment in BLME (UK) GP Limited	(100)	(100)
Investment in portfolio of Private Equity investments	–	(2,359,313)
Total regulatory capital	**190,138,805**	**184,602,156**

The amounts of regulatory capital shown above differ from the equity balances shown in the Group's statement of financial position in light of adjustments in respect of certain reserves, which are not eligible under the FSA's capital adequacy rules.

Under the capital adequacy rules applicable from 1 January 2008, the Group adopted the Standardised Approach to Credit Risk and the Basic Indicator Approach to Operational Risk. Counterparty Credit Risk ("CCR") is measured using the CCR mark-to-market method, and Market Risk is determined using the standard Position Risk Requirement ("PRR") rules.

BLME's overall minimum capital resource requirement under Pillar 1 is calculated by adding the credit risk charge to that required for operational risk, for market risk and for counterparty credit risk.

The following table shows both the Group's overall minimum capital requirement and capital adequacy position under Pillar 1 at 31 December 2012.

Pillar 1 capital requirements	2012 £ (unaudited)	2011 £ (unaudited)
Credit Risk	60,100,000	45,970,000
Market Risk – Foreign Exchange PRR	5,000	227,000
Counterparty risk capital component	225,000	638,000
Operational Risk	5,687,000	4,941,000
Total Pillar 1 capital requirement	**67,126,000**	**51,776,000**
Total regulatory capital in place	**190,138,805**	**184,602,156**
Excess of capital in place over minimum requirement under Pillar 1	**123,121,805**	**132,826,156**

The Group undertakes regular internal assessments of the amount of capital which it requires to support its activities. This assessment process is called the Internal Capital Adequacy Assessment Process ("ICAAP"). The ICAAP identifies a number of other risks faced by the Group which do not explicitly attract a capital requirement under the Pillar 1 rules. The Group allocates additional capital for these Pillar 2 risks ("the Pillar 2 capital requirement"). The total capital requirement of the Group is determined as the sum of the Pillar 1 and the Pillar 2 capital requirements.

The FSA reviews the Group's ICAAP assessment of its Pillar 2 capital requirement as part of the Individual Capital Guidance ("ICG") process. The Group manages its capital in accordance with its Pillar 2 capital requirement and was in compliance throughout the year.

The Group has put in place processes to monitor and manage capital adequacy which includes reporting regulatory capital headroom against the Pillar 2 capital requirement to executive management on a daily basis. Further information regarding the Group's approach to risk management and its capital adequacy are contained in the unaudited disclosures made under the requirements of Basel II Pillar 3 (the Pillar 3 disclosures) which can be found in the Investor Relations section of the BLME website www.blme.com

Notes

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