



Pillar III Disclosures

31st December 2010

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1. Introduction

1.1 Bank of London and The Middle East plc (the “Bank” or “BLME”)

The principal activities of BLME are providing Sharia’a compliant financing facilities and solutions for corporate clients; treasury services to financial institutions, organisations and corporate clients; and wealth management financing, investment and advisory services to a wide spectrum of customers.

2. Scope of Pillar III Application

2.1 Background

The European Union Capital Requirements Directive (“the Directive”) came into effect on 1 January 2007. It introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II framework.

Since its authorisation as a licensed financial institution in July 2007, BLME has adopted the Standardised Approach to credit and market risk under the Basel II Capital Requirements Directive. For operational risk BLME operates under the Basic Indicator Approach.

The overall Basel II framework is structured around three pillars:

- Pillar I is the Bank’s minimum capital requirements.
- Pillar II (supervisory review) requires the Bank to identify, via the Internal Capital Adequacy Assessment Process (“ICAAP”), any specific risks that may result in additional capital being held.
- Pillar III defines the disclosure rules that allow market participants to assess key pieces of information on the Bank’s capital, risk exposures and risk assessment processes.

2.2 Policy Statement

The Directors, having taken into account the size and complexity of the Bank’s operations, believe that an annual disclosure is appropriate, and that these disclosures be made available on the Bank’s website, www.blme.com. This document represents the Bank’s annual public Pillar III disclosure for the financial year ended 31 December 2010.

BLME’s Pillar III disclosures have been prepared under BIPRU 11 of the FSA Handbook. BLME’s Pillar III disclosure has been reviewed by the Bank’s Audit Committee and the Board of Directors. The disclosures are not subject to external audit except where they are also included as accounting disclosure requirements in the Bank’s Annual Report and Accounts.

The Board of Directors is committed to a strong culture of risk management in order to protect the Bank’s market reputation and its ongoing sustainability. It has therefore established governance and management structures, monitoring procedures and reporting for each type of risk that the Bank is exposed to. These risks are principally credit risk, market risk, liquidity risk and operational risk.

2.3 Consolidation Basis

BLME is an EEA parent institution that is regulated as a UK bank by the Financial Services Authority (the FSA). These disclosures have been prepared under the Solo Consolidation rules and regulations. The Special Purpose Vehicles (SPVs) included are as follows:

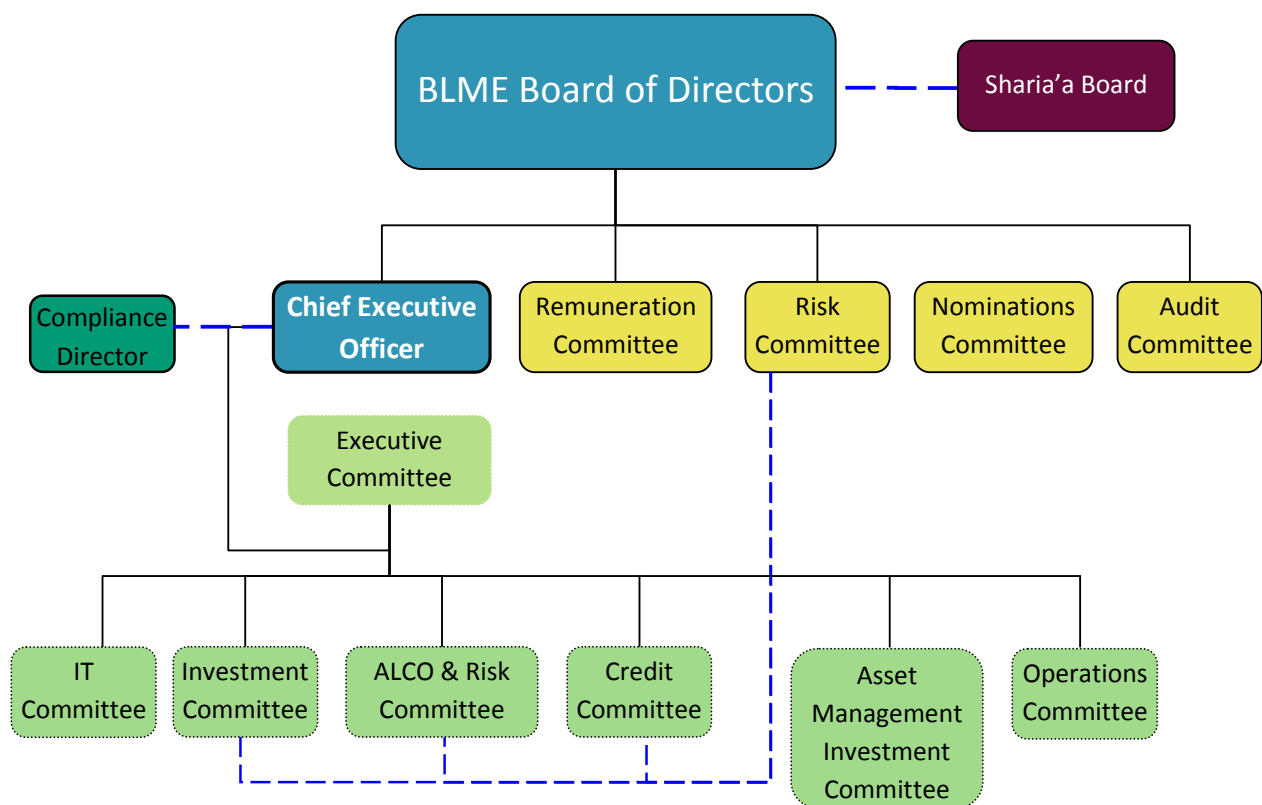
- BLX13 Inc
- Kalakane Transatlantic Investors II Inc
- DMJ I LLC
- DMJ II LLC
- SC-BC LP
- TP Funding Company LLC
- Medical Property Investments LLC

This consolidation is consistent with the accounting basis used for the Financial Statements as at 31 December 2010. At this date, management believes that there were no current or foreseen material issues, or practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities among the Bank and its consolidated SPVs.

3 Risk Management Objectives and Policies

3.1 Risk Governance

The responsibility for the operating framework for risk governance rests with the Board of Directors. This extends to determining risk appetite in line with the Bank's strategy, establishing Board and executive committee structures to oversee risks, and ensuring that there is a clearly defined risk management structure with distinct roles and responsibilities that allow risks to be monitored, controlled and reported effectively. Risk governance is underpinned by ensuring that the Board and its committees are provided with transparent and risk sensitive reporting to facilitate their accountabilities and decision making. The Board has reviewed the Terms of Reference that govern BLME's Board and executive committee structures with a view to ensuring that the Bank operates under the best practices for corporate governance as laid down in the recommendations of the Walker Report.



3.2

BLME Board of Directors

The Board is responsible for ensuring that an effective framework is in place to identify, monitor and report on the risks faced by BLME. At Board level BLME defines its risk philosophy using three main risk steering mechanisms:-

- A Risk Categorisation that defines the governance of risk within BLME's committee structure. This provides a definition of the risk, the responsible committee and the regularity that the committees review each risk type. In addition, it includes an assessment of the materiality of each risk category, including the impact of any mitigating factors.
- A Stress Testing and Scenario Analysis Policy which defines the programme for the stress testing for the major categories of risk. This includes Stress Test Guidance Parameters that define the risk appetite for each class of risk.
- Materiality Thresholds within the Bank's Internal Capital Adequacy Assessment Process (ICAAP) document that additionally define BLME's risk tolerance and which steer the setting of risk limits.

3.3

Non-Executive Committee Structures

The following sections set out the Bank's principal governance structures. The Board and its committees meet on a quarterly basis.

3.3.1 Risk Committee

This is a non-executive committee that meets at least quarterly and reports to the Board. It is responsible for taking decisions within delegated authority and for providing guidance, advice and recommendations to the Board on credit, market, liquidity and operational risks with a view to re-enforcing a culture that encourages good stewardship of risk. Within this mandate it reviews risk levels in consideration of the Bank's overall risk appetite, market conditions and business strategy. It also overviews the Bank's ICAAP and Individual Liquidity Adequacy Assessment (ILAA) submissions to the FSA, and assesses the adequacy of stress testing and risk policy developments.

3.3.2 Audit Committee

This is a non-executive committee that meets at least quarterly and reports to the Board. It is responsible for reviewing any reports from management, the internal auditor and the external auditor regarding the accounts, and the internal control systems and processes implemented throughout the Bank. It also provides guidance and recommendations to the Board on all matters affecting the accuracy and appropriateness of the Bank's financial statements, including the qualifications and role of its auditors, and the performance of the internal audit function. It works with the management and employees of the Bank, the auditors and other professional advisors to ensure that all statutory and regulatory reporting is submitted in an accurate and timely fashion.

3.3.3 Remuneration Committee (RemCo)

As a non-executive committee that reports to the Board, this body ensures that staff, management and executive compensation is appropriately aligned to business and individual performance, and is consistent with shareholder interests. It performs these duties within a framework that takes account of prevailing market conditions, best market practice and regulatory compensation guidelines. RemCo has appointed Kepler Associates as a professional advisor.

3.3.4 Nominations Committee (NomCo)

This Board committee reviews all matters affecting the composition and qualifications of the Board, and sanctions the appointment of Directors, Non-Executive Directors and experts to the Board and its committees.

3.4

Executive Committee Structures

3.4.1 The Executive Committee (EXCO)

EXCO is responsible for the executive management of the Bank. As such, it ensures that all BLME internal committees are working effectively. It is additionally responsible for the strategy and business affairs of the Bank, including its operational and financial performance. It reports directly to the Board.

3.4.2 Asset and Liability and Risk Committee (ALCO)

ALCO is responsible for managing the balance sheet of the Bank, and the optimisation of asset/liability structure and capital allocation. Within this, it is responsible for the operational and structural liquidity of the Bank, and its adherence to regulatory limits and prudential internal guidelines. It also oversees the measurement and monitoring of market risks across all asset classes and risk types in the Bank's trading and banking book businesses. It has responsibility for ensuring the adequacy of the Bank's policies and processes covering stress testing, new products and operational risks. This committee reports directly to EXCO and indirectly to the Risk Committee.

3.4.3 Counterparty Credit Risk Committee (CCRC)

CCRC is responsible for the approval of individual obligor risks using Board approved credit matrices and limit structures that govern the credit risk appetite of the Bank. It also oversees country and sector risks, and undertakes periodic reviews and assessments of portfolio, collateral, residual value and concentration risks. This committee reports directly to EXCO and indirectly to the Risk Committee.

3.4.4 Investment Committee (IC)

IC is responsible for reviewing and approving all direct and equity investments. This covers BLME's modest risk appetite for Property, Private Equity and Venture Capital investments. In addition, it specifically manages the Bank's overall appetite for equity investments that provide seed capital for asset management fund initiatives. Within the annual budget process BLME defines and allocates balance sheet and capital to these risk classes. This committee reports directly to EXCO and indirectly to the Risk Committee.

3.4.5 Information Technology Committee (ITC)

ITC is responsible for the approval, prioritisation, development and management of IT projects, together with software and hardware changes and controls. In addition, it manages and maintains the Business Continuity and Disaster Recovery Plans. It reports to EXCO.

3.4.6 Operations Committee (OPCO)

OPCO provides governance, coordination and operational guidance to the areas that support all of the Bank's businesses. This committee reports to EXCO.

3.4.7 Asset Management Investment Committee (AMIC)

AMIC provides input and oversight of the investment activities within BLME's asset management business. These responsibilities, which take account of the regulatory independence of client based businesses, include investment strategy and risk; fund management; trade execution; broker and counterparty risk; controls and regulatory compliance; and product development and marketing. This committee reports to EXCO.

3.5

Sharia'a Supervisory Board

This independent body is responsible for ensuring that BLME's activities are in compliance with the requirements of the Sharia'a. In this regard the Sharia'a Supervisory Board reviews all contracts, new deal structures and legal documentation. On an annual basis it reports to the Board following a Sharia'a compliance audit of BLME's activities.

3.6 Organisation of Risk Management

The Risk Management Department reports to the BLME Chief Executive Officer. It is managed by a Head of Risk, under which the area is divided into two areas:-

- Credit Risk Management is responsible for the approval and review of individual obligor risks, the development of credit policy and the oversight of portfolio, country, sector, residual value and collateral risk concentrations.
- Risk Management covers market price risk, liquidity risk and operational risk. This area also manages the New Product Approval process and the Bank's Stress Testing and Scenario Analysis policy across all risk classes.

The New Product Approval process involves the assessment of the risks inherent in a new product and how these risks can be managed and mitigated. It covers the review and approval of all relevant risks, including legal, regulatory and Sharia'a aspects. The approval process requires a formal sign off by the all relevant back office and front office areas.

The Risk Management Department is responsible for Stress Testing and Scenario Analysis, and supports the CEO and Finance Director in the management of the Bank's regulatory and economic capital.

3.7 Compliance

Compliance is an independent function. Its role is to identify, manage and mitigate the risk of legal or regulatory sanctions and financial or reputational damage which could arise as a result of the Bank and/or its employees failing to comply with applicable rules, regulations, codes of conduct, and standards of good practice.

It seeks to make a significant contribution to the generation of business by promoting the culture and practice of compliance within the spirit of and by the letter of regulatory, ethical and Sharia'a requirements and standards. To fulfil these duties Compliance:

- is independent from the business activities of BLME;
- has direct access to senior management;
- has direct access to any director, officer or employee of BLME;
- has access to all relevant data and records; and

- will intervene in any transaction where it has reason to believe that a breach of legal, Regulatory or Sharia'a requirements, or internal policies and standards, has occurred or may occur.

The Compliance function reports to the Chief Executive Officer. It produces regular reports for the Executive Committee and the Compliance Officer is a standing member of the Board's Audit Committee.

3.8 Internal Audit

BLME has engaged the services of PricewaterhouseCoopers to co-source the Internal Audit function. This is managed by the Finance Director, who also performs the role of the BLME Internal Audit Manager. This role includes the implementation of a program of internal audits, assessments of audit findings and actions taken, and quarterly reporting of key issues to the Audit Committee.

3.9 Risk Categorisation

BLME has identified and classified its core risks under the following categories:

- Credit Risk
- Market Risk
- Liquidity Risk
- Operational Risk

In addition, within its regular ICAAP and ILAA, BLME assesses a number of Business and Consequential Risks as part of determining its Pillar II capital requirement. The Business Risk evaluation includes an impact analysis of a series of adverse market, political, regulatory, legal and reputational factors on the Bank's business model. In accordance with FSA BIPRU standards, the Consequential Risk assessment covers Insurance Risk, Pension Obligation Risk, Residual Risk, Securitisation Risk and Group Risk.

i. Credit Risk (including Concentration Risk)

Credit risk is a principal risk to BLME. It is reported to the FSA for capital adequacy purposes using the Basel II Standardised Approach. Credit risk is the potential for loss caused by a customer or counterparty failing to meet its obligations on the date that they become due. This includes obligations under guarantees and letters of credit. Credit risks are managed by the Credit Risk Management Department which reports exposures to the Risk Committee on a quarterly basis by sector, region, country, rating and asset type. Large and concentrated exposures are also reported.

BLME's principal credit risks relate to its Corporate Banking, Private Banking, Investment Book and Money Market financing activities. By comparison, the Bank's limited foreign exchange activities give rise to relatively small amounts of settlement risk. In addition, BLME incurs some amount of pre-settlement risk as a result of undertaking Profit Rate Swaps to hedge its fixed rate exposures. Credit limit structures exist for all of the afore-mentioned risks, and these are monitored on a daily basis by the Credit Risk Management Department.

Credit risk limits and guidelines are established in the Bank's Credit Matrix and the associated Base Lending Principles that align strategic priorities with the risk appetite of the Bank. Within this framework the Bank's risk appetite is defined by business sector, tenor and credit rating to ensure that a suitable level of portfolio diversification is achieved. The Bank also monitors its portfolio in terms of industry and country concentration, and residual value risk in the case of Operating Leases. These reports are given to the Board.

Credit ratings are determined by validation of major ECAI (External Credit Assessment Institution) ratings, such as Standard and Poors, Moody's and Fitch where such ratings exist. Where more than one ECAI rating exists the more conservative rating is adopted. This validation takes into account the transactional and collateral attributes of the credit proposal. The same assessment is made of non-rated obligors, who are subject to an internal rating assessment.

All limits are reviewed on at least an annual basis. BLME underpins its credit risk appetite by applying high levels of due diligence and rigorous adherence to Know Your Customers (KYC) best market practice at the origination stage of new business. It also undertakes ongoing active risk management to keep abreast of developments within an obligor's business as well as the impact of any wider market events.

As an additional risk discipline, the Bank's Stress Testing and Scenario Analysis Policy requires semi-annual credit risk stress tests to be undertaken, and sets limits to measure the ability of BLME's capital resources to withstand a series of extreme credit shocks covering both portfolio and concentration risks. These are presented to the CCRC and the Risk Committee for review as part of regular assessment of portfolio and collateral risks.

Group Credit Risk capital requirement as at 31st December 2010

Exposure Class	Capital Requirement (8%) GBP thousands
Central governments or central banks	780
Institutions	1,982
Corporates	16,532
Short term claims on institutions and corporates	3,819
CIUs	139
Other items	18,738
Total Credit Risk Capital	41,990

Within its Credit Risk Capital the following two ancillary risks are identified:-

Leasing

BLME carries residual value risk through its leasing activity. This risk is on the residual value of the underlying assets for Operating Leases. BLME uses independent professional valuation agents to advise the residual value of equipment and monitors the development of these values through the life of the leases. Within its Residual Value Policy framework, the portfolio of assets where BLME is potentially exposed to a fall in residual value is also monitored for concentrations in particular types of asset. Stress tests of residual value risk are also performed every six months. Overall, BLME takes a conservative stance to residual value risk, taking into consideration asset type, length of lease and the secondary market for equipment.

Property

The Bank has an exposure in respect of an investment property that it holds on its balance sheet in anticipation of including the asset as part of a future launch of a specialist property fund. For capital adequacy purposes this asset is reported as Credit Risk. However, for governance purposes it is overseen by the Investment Committee.

ii. Market Risk

Market risk is the potential for loss caused by adverse changes in market prices. In the case of BLME this applies to rate re-price risk in its Asset and Liability (ALM) book, currency rate movements in its Foreign Exchange activities, credit spread movements in its modest Sukuk Trading Book and changes in net asset values of fund investments. With the exception of its seed capital in a BLME fund, the Bank has a small level of equity risk from its modest portfolio of private equity and venture capital investments.

FX activities are subject to relatively small position limits as dealing is mostly focused on facilitating customer transactions. As a consequence, the most significant form of market risk is rate re-price risk in the Banking Book ALM portfolio. This arises from mismatch between the re-pricing dates of the Bank's profit rate bearing assets and liabilities, and from the investment of the Bank's capital and reserves. The Treasury desk within the Markets business area is responsible for managing these risks under the guidance of ALCO. This is accomplished by providing the Treasury desk with "Operating Risk Limits" that define the maximum risk positions by currency and by tenor. These limits are expressed in basis point sensitivity (PV01) terms, and are checked by the Finance Department on a daily basis in conjunction with Risk Management. Compliance with dealing limits is reported to management on a daily basis and reviewed at the monthly ALCO meetings. On an annual basis Risk Management provides the Risk Committee with a report on the development and use of all market risk limits.

Regular mark-to-market assessments are made to gauge the behaviour of the ALM book to changes in market rates. On top of this, the Bank's Stress Testing and Scenario Analysis Policy requires periodic stress testing to be undertaken. Stress Test Guidance Parameters are set to measure the ability of BLME's capital resources to withstand extreme adverse changes in market rates. These are presented to ALCO and the Risk Committee on a quarterly basis.

As regards Foreign Exchange (FX) risk, this emanates from dealer spot deals (usually undertaken to fund and facilitate customer business) and from hedging foreign currency profits and losses. In view of the limited risk appetite for FX risk, BLME has implemented small nominal based Net Open Position Limits within its Operating Risk Limits. The adherence to limits is also checked by the Finance Department, in parallel with Risk Management. Exceptions are reported to management on a daily basis and reviewed at the monthly ALCO meetings and quarterly Risk Committee meetings.

Credit Spread risk emanates from the modest Sukuk Trading business. The Operating Risk Limits for this activity include limits that cover portfolio size, maximum issuer capacities, rating based credit spread sensitivity limits and Management Action Triggers in respect of profits and losses. The monitoring of these limits is undertaken daily by the Risk Management Department. This area also undertakes a programme of regular stress testing in which the results are monitored against Stress Test Guidance Parameters. Exceptions are reported to management on a daily basis and reviewed at the monthly ALCO meetings and the quarterly Risk Committee meetings. BLME's capital adequacy reporting treats this risk as Banking Book capital as permitted by the FSA Handbook (BIPRU Section 1.2.17).

Group Market Price Risk capital requirement as at 31 December 2010

Exposure Class	Capital Requirement GBP thousands
FX Risk	102
Total Market Risk Capital Requirement	

iii. Liquidity Risk

Liquidity risk is the risk that the Bank, even if it has sufficient capital, does not have sufficient cash funds to meet its obligations as they fall due. On a daily basis liquidity risk is managed by the Treasury desk within the Markets area. In conjunction with Finance Department and Risk Management, this area ensures that BLME is compliant on an intra-day basis with its regulatory ALM Mismatch Ratios. Daily reports are circulated to Senior Management showing BLME's actual and projected liquidity profile, and as confirmation that BLME is compliant with both its regulatory and internal liquidity limits. This assessment additionally takes account of the Bank's secondary market assets, which could be sold in extreme circumstances to provide emergency liquidity.

Liquidity planning and strategy are evaluated in the annual budget process, within which detailed balance sheet and liquidity planning is undertaken for each business area. It is further guided by the Individual Liquidity Adequacy Assessment (ILAA) that was introduced by the FSA as a consequence of the December 2009 "Strengthening Liquidity Standards" Policy Statement. The ILAA lays out the Bank's liability gathering strategy, and its internal prudential liquidity ratios and targets, as well the stress testing results that underpin its Individual Liquidity Guidance and the resultant Contingency Funding Plan. ALCO reviews these liquidity measures and ratios on a monthly basis. These ratios also link into the Stress Testing and Scenario Analysis Policy, particularly the ability of BLME to withstand and adapt to an extreme liquidity squeeze. Detailed liquidity reports and assessments are provided to the Risk Committee on a quarterly basis.

iv. Operational Risk

Operational risk is the potential for financial loss or damage to reputation resulting from failed or inadequate internal processes and systems, the actions of individuals or the impact of external events. To mitigate Operational Risk BLME has undertaken the following major initiatives:-

- Implemented a detailed Business Continuity Plan.
- Undertaken a number of full and partial tests of the Disaster Recovery site.
- Implemented the secure SWIFT system for payment messages, as well as a Sharia'a compliant banking system that requires all transactions and data changes to be subject to the four eyes principle.
- Maintained comprehensive insurance policies covering those risks that were identified by an accredited insurance consultant.

- Undertaken an internal legal review, with specialist external support, of all core agreements, contracts and legal documentation.
- Introduced a New Product Approval process that ensures that all new products are reviewed and authorised by relevant business and support areas.
- Ensured that all departments have their own operating procedures.
- Implemented Operations and IT committees to facilitate the support of businesses and development of the new business initiatives within a robust and integrated operational framework.

BLME’s Operational Risk Policy is founded on the Basel “Sound Practices for the Management and Supervision of Operational Risk” guidelines that were updated in December 2010. The Bank operates and reports to the FSA under the Basic Indicator Approach, under which a prescribed percentage of the Bank’s historic and budgeted revenues form the basis of BLME’s Operational Risk Capital Adequacy reporting.

In parallel with issuing its Operational Risk Policy, Risk Management has implemented an internal Operational Risk Database to record, follow-up and report risk events and losses. Risk Management has also undertaken operational risk awareness training for all staff.

As part of its FSA Pillar II ICAAP process, BLME undertakes an annual Operational Risk Assessment across all Front and Back Office functions. This process takes account of the seriousness of the loss potential, the probability of occurrence and the effect of any risk mitigation factors. By asking respondents to identify any further risk mitigating initiatives, BLME has a means of tracking key risks to ensure that these are optimally addressed. The results from this assessment are reported to EXCO, and are included within Risk Management’s reporting to the Risk Committee.

Group Operational Risk capital requirement as at 31 December 2010

Exposure Class	Capital Requirement GBP thousands
Operational Risk – Basic Indicator Approach	3,383

v. Business and Consequential Risks

The management of Business and Consequential Risks is formally and principally undertaken within the Internal Capital Adequacy Assessment Process (ICAAP). On a more regular basis the following other risks are managed through the BLME committee and governance structures:-

	<u>BLME Committee</u>	<u>Board Governance</u>
Sharia’a	EXCO	Risk Committee
Legal Risk	EXCO	Risk Committee
Investment Risk (own account)	IC	Risk Committee
Investment Risk (Asset Mgt)	AMIC	Risk Committee
Compliance Risk	EXCO	Board
Reputational Risk	EXCO	Board

The management of regulatory and legal risk is additionally handled by BLME's in house Sharia'a lawyer, and governed and audited by the Sharia'a Supervisory Board to ensure that contracts, deal structures and legal documentation conform to Islamic principles.

4. Capital Resources

The Group's capital resources are all components of Tier 1 and Tier 2 Capital. At December 31 2010 these were as follows:

	GBP thousands
Tier 1 Capital	
Share capital	48,933
Share premium	206,226
Retained earnings	(7,180)
Fair value reserve	
Total Tier 1 Capital	247,980
Deductions from Tier 1 Capital:	
Intangible assets	419
Total Tier 1 Capital after deductions	247,561
Tier 2 Capital	
Collective allowances for impairment	1,468
Total Tier 2 Capital before deductions	
Total Tier 1 and Tier 2 Capital	249,029
Deductions from Tier 1 and Tier 2 Capital:	
Investment in BLME US\$ Income Fund	34,122
Investment in SPV	1,261
BLME Umbrella Fund Management Sarl	16
Private equity investments	1,581
Total Capital Resources	212,049

5. Capital Adequacy

5.1 Adhering to BIPRU Capital Requirements

In the first instance the Bank assesses the adequacy of its capital resources as part of its annual Budget and Business Planning process, where it looks at projected earnings, balance sheet growth and Pillar I capital usage for the next 3 years. This capital requirement assessment is subsequently referenced to and qualified by the Bank's Internal Capital Adequacy Assessment Process (the ICAAP). The ICAAP calculates BLME's internal (economic) capital for the following principal risk classes:-

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

The calculation of internal capital is the basis upon which the Bank proposes its Pillar II Individual Capital Guidance requirement. In undertaking the ICAAP, the Bank uses a number of economic risk methodologies and models that allow it to assess its internal capital requirements for all risk classes. The ICAAP is undertaken by the Head of Risk Management under the guidance of the Chief Executive Officer.

It is reviewed and endorsed by EXCO before being submitted to the Risk Committee for further review and recommendation to the full Board. The latter is responsible for ensuring that the planned capital levels are sufficient to protect unsecured creditors from loss, having taken account of the Bank's risk appetite within the context of business plans, and having assessed the resilience of capital resources to extreme stress events and adverse scenario conditions.

On a more routine level, BLME reports its capital adequacy to the FSA on a quarterly basis. For internal management purposes it is calculated daily, where it is used by Finance Department to present to EXCO the Bank's financial performance against budget. The Audit Committee reviews these financial and business performance indicators on a quarterly basis, and updates the Board accordingly.

6. Credit Exposure

BLME's credit exposure arises principally through its lending activities to corporate entities and high net worth individuals, as well as to financial institutions through liquidity and investment activities. It should be noted that BLME's lending to corporate entities and private clients is secured. These exposures are well distributed by economic sector and by geography. The following table shows these exposures net of any credit provisions.

Exposure by Economic Sector and Geographical Region as at 31 December 2010:

	GBP mn	Asia	Middle East	Europe	Americas	Africa
Central Government or Central Banks	41	6%	1%			
Institutions	42	5%	1%			
Corporates	223	3%	17%	10%	2%	0%
Real Estate	47	1%	6%	0%	0%	0%
Transport	71	0%	6%	4%	1%	0%
Mining	27	0%	0%	3%	1%	0%
Electrical Medical & Optical	0	0%	0%	0%	0%	0%
Supply of Electric Gas & Hot Water	14	0%	0%	2%	0%	0%
Other Manuf	4	0%	1%	0%	0%	0%
Retail Trade	19	0%	3%	0%	0%	0%
Other	42	2%	1%	2%	0%	0%
Short Term	136	3%	12%	5%	0%	0%
Institutions	119	2%	11%	5%	0%	0%
Other Manuf	8	0%	1%	0%	0%	0%
Real Estate	2	0%	0%	0%	0%	0%
Transport	5	1%	0%	0%	0%	0%
Other	2	0%	0%	0%	0%	0%
CIU	2	0%	0%	0%	0%	0%
Other	246	0%	1%	19%	15%	0%
Retail trade	28	0%	0%	2%	3%	0%
Mining	18	0%	0%	1%	2%	0%
Supply of Electric Gas & Hot Water	4	0%	0%	0%	0%	0%
Health & Social	13	0%	0%	0%	2%	0%
Real Estate	140	0%	0%	15%	5%	0%
Other Manuf	27	0%	0%	0%	4%	0%
Transport	16	0%	1%	1%	0%	0%
Total	690	17%	32%	34%	17%	0%

Average exposure over four quarters in 2010 by Economic Sector:

	Average	
Central Governments or Central Banks		62
Institutions		44
Corporates		436
	<i>Real Estate</i>	138
	<i>Transport, Storage & Comms</i>	87
	<i>Other</i>	57
	<i>Mining & Quarrying</i>	50
	<i>Retail Trade & Repair</i>	39
	<i>Other Manufacturing</i>	26
	<i>Supply of Elec. Gas & Hot Water</i>	19
	<i>Health & Social Work</i>	11
	<i>Food, Beverages & Tobacco</i>	5
	<i>Electrical, Medical & Optical Equip</i>	4
	<i>Pulp, paper, publishing and printing</i>	0
Short Term		138
	<i>Institutions</i>	108
	<i>Other Manufacturing</i>	23
	<i>Real Estate</i>	2
	<i>Retail Trade & Repair</i>	1
	<i>Transport, Storage & Comms</i>	2
	<i>Other</i>	4
CIU		2
		682

The credit exposure to financial institutions tends to be short term. Exposures to Corporate Banking and Private Banking customers are usually longer term, depending on the credit quality of the borrower and the quality of the collateral. A breakdown of residual maturity and exposure class is as follows:-

Exposure by Economic Sector and Maturity as 31 December 2010:

<u>ECONOMIC SECTOR AND MATURITY</u>					
	<12	<24	< 60	>	
	mn	mn	mn	5yrs	
CG & CB	0	3	27	11	41
Institutions	10	22	10	0	42
Corporates	48	34	119	23	223
Short Term	136	0	0	0	136
CIU	0	0	0	2	2
Other	82	19	143	2	246
	276	77	299	37	690

7. Quality of Credit Portfolio

All BLME counterparties are assigned an annually reviewed long term credit rating by Credit Risk Management which must be approved by BLME's Counterparty Credit Risk Committee (CCRC). Where available, the counterparty credit ratings of the 3 major External Credit Assessment Institutions (Fitch, Moody's and Standard and Pools) are used.

Exposure by Rating Band 31 December 2010

RATING BAND	GBP mn
AAA TO AA-	109
A+ TO A-	170
BBB+ TO BBB-	254
BB+ TO BB-	125
B+ TO B-	25
CCC+ and Below	7
Total Credit Exposure	690

Where more than one ECAI rating exists and the ratings differ (i.e. a split rating) BLME will assign the most conservative of the ratings. Where none of the three afore-mentioned ECAI ratings exist BLME assigns its own internal counterparty rating. Any such rating is subject to "no objection" being raised by the CCRC. Overall, 77% of BLME's credit exposure is investment grade or equivalent. Within this, 63% of the portfolio was directly rated by at least one of the ECAI, with the remaining 37% being mapped using internal ratings.

Risk weighted asset values under the Standardised Approach are calculated by reference to six credit quality steps under BIPRU 3. The table below shows the mapping from the ECAI ratings to the six credit quality steps:

Credit quality step	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<u>Fitch assessment</u>	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below
<u>Moody's assessment</u>	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to Ba3	B1 to B3	Caa1 and below
<u>S&P assessment</u>	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below

The credit quality steps are then mapped to their relevant risk weightings, as follows:

<u>Credit quality step</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<u>Corporate</u>	20%	50%	100%	100%	150%	150%
<u>Institution > 3 months</u>	20%	50%	50%	100%	100%	150%
<u>Institution Maturity 3 months or less</u>	20%	20%	20%	50%	50%	150%
<u>Sovereign</u>	0%	20%	50%	100%	100%	150%

8. Counterparty Credit Risk

Counterparty pre-settlement risk is very limited. It arises through a small number of Profit Rate Swaps (PRS) transacted to hedge the fixed rate exposures in Banking Book transactions. These PRS have been undertaken with ECAI investment grade rated banks, for which BLME allocates separate sub-limits. There is no collateral given or taken for PRS transactions. BLME's assessment of pre-settlement risk takes account of the daily mark-to-market of these positions plus a conservative volatility add-on. The latter manages the risk that adverse future changes in market rates could result in higher counterparty risks. The exposures from these transactions are deemed to be immaterial for the purposes of this disclosure.

9. Secondary Credit Exposure through Collateral

BLME has secondary credit exposure as the Corporate Banking and Private Banking financing transactions are secured on assets. The Bank monitors the composition of these portfolios, within which the collateral assets are subject to regular assessment and review by professional valuation agents.

10. Credit and Dilution Risk

10.1 Impairment of Credit Risks

For credit risk management purposes:

- a credit asset is considered to be past due where repayment is 90 days overdue and where Management is not aware of any specific event that might mitigate the impact of the non-payment.
- a credit asset is deemed to be impaired when repayment is more than 90 days in arrears, where collateral rights have been exercised or where Management considers the full and eventual repayment to the Bank to be at risk.

Every month Credit Risk Department meets with the Finance Department to assess the performance of the credit portfolio. As part of the Bank's Credit Impairment and Non-Accrual Policy, this assessment determines whether there is a need to reverse any accrued earnings; add the credit asset to the Credit Watch List; or establish specific impairment provisions. Such recommendations are subsequently referred to CCRC for a full review. Any recommendations for credit provisions or write-offs are reported to the Risk and Audit Committees before being presented to the Board for final approval. The portfolio is still of a limited size which allows all credits to be considered and assessed on an individual basis without reliance on portfolio modelling to assess impairment.

10.2 Impairment assessment and provision at year end, 31 December 2010

The Bank has established a Credit Impairment and Non-Accrual Policy to monitor impairment events that could lead to losses in its asset portfolio. This policy covers specific loss events for individual exposures, as well as events that relate to collective losses on groups of homogenous assets that have yet to be identified and assessed individually for impairment. The Bank writes off a balance and any related allowances for impairment when the Credit Risk Management department determines that the balance is uncollectable. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that the borrower's obligation can no longer be serviced, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The provision is recommended by the CCRC before being referred to the Audit Committee and the Board for ultimate approval. For the period ending 31 December 2010 BLME considered it prudent to take an impairment charge of £1,937,296 which was offset by recoveries of £2,985,273.

As at 31 December 2010

	GBP mn
Exposures past due	13
Exposures considered impaired	21
Impairment provision	8

11. Analysis of Credit Exposures and Impairment

All credit exposures are considered for impairment on a specific basis.

12. Credit Risk Mitigation

The Bank has entered into a small number of netting agreements for on and off-balance sheet activities. As legally enforceable contacts which comply with BIPRU standards, the Bank recognises such credit risk mitigation in its Pillar I capital requirement calculations. The effect of this credit risk mitigation is deemed to be immaterial.

The other area where credit risk mitigation techniques are applied is in relation to credit insurance contracts undertaken to enhance the credit risk of some of the Bank's finance receivables business. In all cases the credit insurers used are ECAI rated institutions.

13. Non-Trading Book Exposures in Equities

The Bank has only a small number of minor Private Equity and Venture Capital exposures. These exposures are treated as 100% deductions from capital as disclosed in Section 4.

14. Profit Rate Risk in the Banking Book

These risks principally emanate from the following sources:

- asset and liability rate reset mismatches from corporate and private banking lending.
- asset and liability rate reset mismatches from investment book activities.
- asset and liability rate reset mismatches from money market and liquidity management activities.
- strategies used to hedge the Bank's capital and reserves.

The 31 December 2010 sensitivity to a standard parallel 100 basis points change in the yield curve across all currencies for the Bank's transactional risks was a reduction in potential equity of £5,017,600 across all currencies over the seven year term of the Bank's asset and liability re-price risk profile.

Currency	100 Basis Points Move GBP thousands
GBP (£)	4,522
USD (\$)	744
EUR (€)	17
TOTAL (GBP)	(5,018)

15. Securitisation

To date the Bank has not entered into any securitisation activities.

16. Remuneration

In December 2010, the FSA issued its Policy Statement PS10/20 "Revising the Remuneration Code" ("the Code") which set out their requirements in respect of staff remuneration within the banking sector. The FSA also issued Policy Statement PS10/21 "Implementing CRD3 requirements on the disclosure of remuneration" in December 2010.

BLME qualifies as a Tier 2 firm under the Code and is required to provide disclosures of both quantitative information as well as qualitative information about decision-making policies for remuneration and links between pay and performance. The following sections of BLME’s Pillar 3 disclosures reflect the requirements of PS10/21. Comparative data have not been provided as this is the first year of disclosure.

The following table shows the remuneration awards in respect of Code Staff (as defined in SYSC 19A.3.4. R and 19A 3.6.G) made by BLME in respect of 2010.

Analysis of Code Staff remuneration	
	2010
	GBP 000s
Fixed remuneration	
Wages and salaries	1,423
Social security costs	182
Defined contribution pension scheme costs	198
Total fixed remuneration	1,803
Variable remuneration	2,954
Total Code Staff remuneration	4,757
Number of Code Staff	11

16.1 Decision Making Process for Remuneration Policy

BLME has an established Remuneration Committee (RemCo) which meets regularly to consider human resource issues with particular emphasis on the overall reward framework across the Bank. Within the authority delegated by the Board, RemCo is responsible for approving remuneration policy and in doing so takes into account the pay and conditions across the Bank. This includes the terms of bonus plans, share plans, other long-term incentive plans and the individual remuneration packages of executive Directors and other senior Bank employees, including all in positions of significant influence and those having an impact on our risk profile (Code Staff).

There were three meetings of the RemCo during 2010. During 2010 the terms of reference of RemCo were reviewed and revised in accordance with best practice. No Directors are involved in deciding their own remuneration.

i. Composition of the RemCo

The members of RemCo during 2010 were Neil Holden, Sheikh Abdullah Jaber Al-Ahmed Al-Sabah and Masood Akbar. Neil Holden is the appointed chairman of RemCo.

ii. Role of the relevant stakeholders

RemCo received independent advice on executive remuneration issues from Kepler Associates during 2010. Other reward consulting and benchmarking firms are also used from time to time to advise on specific issues.

16.2 Code Staff Criteria

The following groups of staff have been identified as meeting the FSA's criteria for Code Staff:-

- Senior Management whose roles are judged as falling within the FSA Code Staff definition (including executive board Directors).
- Staff performing a Significant Influence Function for the Bank.
- Specific roles whose professional activities either have a significant risk impact (e.g. front office roles) or cover control functions (e.g. Risk and Compliance).
- Any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile.

16.3 Link between Pay and Performance

Remuneration at BLME comprises fixed pay (salary) and variable pay (annual bonus and long-term incentives) designed to reward performance. In determining the level of award of any component of variable pay, the Bank has a discretionary policy to assess the extent to which performance has been achieved. BLME does not apply a formulaic approach on the grounds that this may encourage inappropriate risk taking. The annual bonus earned by an individual is dependent on the achievement of objectives. The payout levels depend on the performance of the Bank, of constituent businesses and of the individual.

The purpose of the bonus is to reflect the extent to which the Bank's annual objectives have been met against the annual budget, the risk appetite framework and competitive market practice. The purpose of the existing Long Term Incentives has been to reward the creation of sustained growth in shareholder value and to encourage alignment with the interests of shareholders.

16.4 Design and Structure of Remuneration

Reward is delivered via a combination of fixed and variable pay (salary, bonus and other long-term incentives). The variable pay element is differentiated by performance. Taking into account the expected value of awards, the performance related elements of pay make up a considerable proportion of the total remuneration package for Code Staff, whilst maintaining an appropriate balance between fixed and variable elements. Remuneration is structured to provide an opportunity for upper quartile total compensation only for higher levels of performance.

All Code Staff receive a salary to reflect their market value, responsibility and contribution to the Bank. BLME pays market competitive salaries with variable pay awards based on performance. All Code Staff are eligible to receive an annual bonus to reflect the extent to which the Bank's annual objectives have been met. This approach allows the Bank to not pay a bonus when appropriate. Employees (including Code Staff) with poor performance ratings will receive little or no bonus. The determination of the bonus pool is a fully discretionary process informed by various performance metrics (the key one being profit before tax), affordability and the commercial requirement to remain competitive in the market place.

The risk appetite framework of the Bank shapes the integrated approach to business, risk and capital management, and supports the Bank in its long-term value creation objectives. The risk appetite framework is agreed by the Board as part of the ICAAP process and provides an important input into the RemCo deliberations with regard to remuneration.

16.5 Deferral, Vesting and Claw Back

To ensure that the interests of BLME and its senior employees are aligned with those of BLME's shareholders, and that the Bank's approach to risk management supports the interests of all stakeholders, a proportion of variable pay awards above certain thresholds is required to be deferred into the BLME Deferred Annual Bonus Scheme ("DABS"). For Code Staff, up to 50% of variable remuneration is deferred for a period of 3 years in the form of nil cost share options. The delivered value will vary in accordance with the BLME share price.

Linked matching DABS awards are granted at the same time as the original award and are subject to forfeiture rules if corporate financial performance targets and personal performance objectives are not met in each year of the three year vesting period. Vesting of linked matched awards is subject to continued employment with BLME unless RemCo determines that the employee was a good leaver in accordance with the scheme rules. Both DABS awards and linked matching awards are subject to forfeiture in the case of a material breach of contract by employees.

16.6 Long Term Incentives

BLME has an Approved Share Option Plan and an Unapproved Share Option Plan. Grants made under the unapproved plan are generally limited to executive directors and senior management. They provide the main incentive tool, other than DABS, to align the long term interests of Code Staff with those of shareholders. Options granted under the Unapproved Plan vest over a four year period. Historically half of the awards granted to Code Staff under the Unapproved Plan have been subject to forfeiture due to the challenging corporate performance conditions not being met.