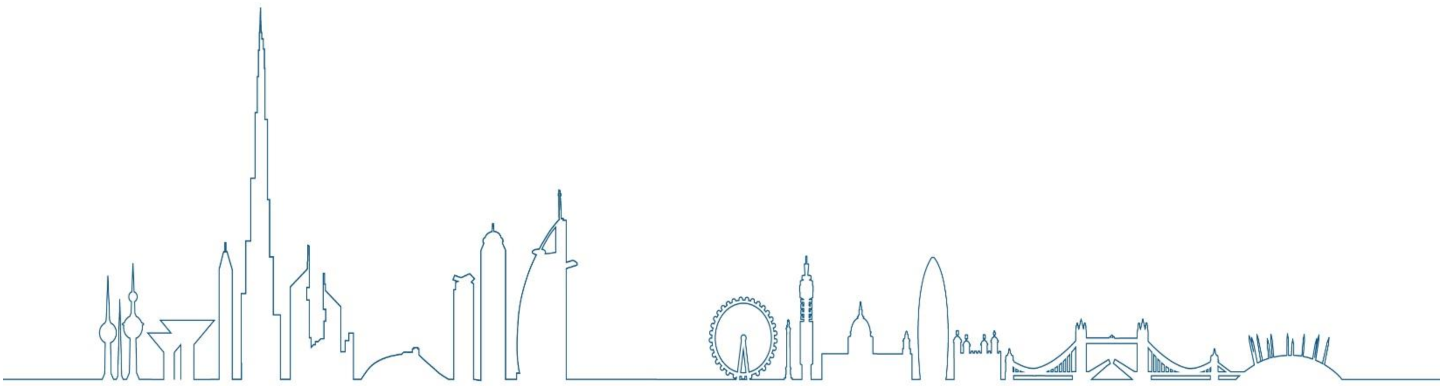
# Bank of London and The Middle East plc
# Annual Report and Financial Statements
# For the year ended 31 December 2017

Registered number 05897786



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## GLOSSARY OF ABBREVIATIONS

| | |
|---|---|
| AED | Arab Emirate Dirham |
| AFS | Available-for-Sale |
| AGM | Annual General Meeting |
| ALCO | Assets & Liabilities Committee |
| AMIC | Asset Management Investment Committee |
| AML | Anti-Money Laundering |
| ASOP | Approved Share Option Plan |
| Basel | Basel Accord or Basel Standards |
| BCC | Board Credit Committee |
| BLME | Bank of London and The Middle East plc |
| BLMEH | BLME Holdings plc |
| BREEAM | Building Research Establishment Environmental Assessment Method |
| BRC | Board Risk Committee |
| CCR | Counterparty Credit Risk |
| CCRC | Counterparty Credit Risk Committee |
| CEO | Chief Executive Officer |
| CET1 | Common Equity Tier 1 |
| CFO | Chief Financial Officer |
| CGs | Commercial Guidelines |
| CIC | Change Implementation Committee |
| COO | Chief Operating Officer |
| CRD IV | Capital Requirements Directive IV |
| CRO | Chief Risk Officer |
| DABS | Deferred Annual Bonus Scheme |
| DFSA | Dubai Financial Services Authority |
| DIFC | Dubai International Finance Centre |
| DIPs | Deferred Incentive Planned Scheme |
| EBT | Employee Benefit Trust |
| ECAI | External Credit Assessment Institutions |
| ECL | Expected Credit Loss |
| EPS | Earnings Per Share |
| EU | European Union |
| EXCO | Executive Committee |
| EY | Ernst & Young LLP |
| FCA | Financial Conduct Authority |
| FRC | Financial Reporting Council |
| FVOCI | Fair Value Through Other Comprehensive Income |
| FVTPL | Fair Value Through Profit or Loss |
| FX | Foreign Exchange |
| GCC | Gulf Cooperation Council |
| GDPR | General Data Protection Regulation |
| HTM | Held to Maturity |
| IAS | International Accounting Standard |
| IASB | International Accounting Standard Board |
| ICAAP | Internal Capital Adequacy Assessment Process |

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|---|---|
| ICG | Individual Capital Guidance |
| IFRIC | International Financial Reporting Interpretations Committee of the IASB |
| IFRS | International Financial Reporting Standard |
| ILAAP | Individual Liquidity Adequacy Assessment Process |
| INED | Independent Non-Executive Director |
| ISA | International Standards on Auditing |
| KYC | Know Your Customers |
| LAB | Liquid Asset Buffer |
| LGD | Loss Given Default |
| LLP | Limited Liability Partnership |
| LOD | Lines of Defence |
| MBA | Master of Business Administration |
| MCOBs | Mortgage and Home Finance Conduct of Business rules |
| MENA | Middle East and North Africa |
| MIFID | Markets in Financial Instruments Directive |
| MLRO | Money Laundering Reporting Officer |
| NCI | Non-Controlling Interest |
| NEDs | Non-executive Directors |
| OCI | Other Comprehensive Income |
| ORC | Operational Risk Committee |
| PC | Product Committee |
| PDA | Premier Deposit Account |
| PIFSS | Public Institution for Social Security |
| PRA | Prudential Regulation Authority |
| PRR | Position Risk Requirement |
| PRS | Profit Rate Swap |
| PVO1 | Present Value to 1 basis point |
| RAF | Renaissance Asset Finance |
| RMF | Risk Management Framework |
| RRP | Recovery Resolution Plan |
| RSCA | Risk Control Self-Assessment |
| SE | Structured Entities |
| SIC | Standard Interpretations Committee of the IASB |
| SICAV | Société d'Investissement À Capital Variable |
| SID | Senior Independent Director |
| SIF | Special Investment Fund |
| SM&CR | Senior Managers and Certification Regime |
| SMR | Senior Managers Regime |
| SSB | Sharia’a Supervisory Board |
| UAE | United Arab Emirates |
| UK | United Kingdom |
| USA | United States of America |
| USOP | Unapproved Share Option Plan |
| WMIC | Wealth Management Investment Committee |

## GLOSSARY OF ISLAMIC FINANCE TERMINOLOGY

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|---|---|
| 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 whilst 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 (also 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 Structured Entities (“SE”) 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. |

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| 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 providing a means of exchanging fixed rate profit rate risk for floating rate risk – or vice versa. |
| Participation agreement | A participation agreement is an agreement executed between the relevant Structured Entity (SE) and the Bank. The main objective of this agreement is to facilitate the required funding to enable the SE to acquire leased assets or investment property and to convey the beneficial ownership of the asset to the Bank. Under this agreement the risks and rewards are transferred to the Bank and the SE is indemnified against actual losses that arise as a result of any lease transaction it enters into except in cases where it misappropriates any funds. |
| Zakat | Zakat is an a legitimate obligation to donate a proportion on certain kinds of wealth each year to certain deserving classes of recipients prescribed for in accordance with the principles of Sharia'a. The purpose of zakat is to make society coherent so that the rich feel the suffering of the poor and the needy in society. Zakat is paid by Muslims who have wealth above a certain threshold. Zakat is paid on "shares" and shareholders of BLME are responsible for paying zakat on their shareholding. |
| Fatwa | Islamic law given by a recognized authority |

# STRATEGIC REPORT

## THE BUSINESS MODEL

The Bank of London and the Middle East plc ("BLME") is one of the largest Islamic banks in Europe specialising in Wealth Management with complementary Real Estate, Lease Finance and Trade Finance offerings focussed on the UK and Gulf Cooperation Council (GCC) markets. We are led by a strong management team, which brings together experienced international bankers, product specialists and leading experts in Islamic finance. We are fully in compliance with the principles of Sharia'a and pride ourselves in providing Sharia'a compliant financing solutions to our clients be they individuals, commercial or small businesses.

The Bank is authorised by the Prudential Regulatory Authority (PRA) and regulated by the PRA and the Financial Conduct Authority (FCA), and possesses a full UK banking licence. The Bank operates in three strategic divisions:

### Wealth Management

Wealth Management includes the Bank's complementary businesses of Private Banking, Investment Solutions and Real Estate Finance.

The Private Banking business focuses on providing private banking services leveraging our Real Estate and Leasing capabilities. It provides deposit products, banking services and residential and investment property finance targeted towards GCC and Middle-East and North Africa (MENA) based High Net Worth Individuals and also offer business jet and superyacht finance.

Investment Solutions offers targeted Sharia 'a compliant investments through in-house capabilities or third parties.

Real Estate Finance provides finance to small and medium sized Real Estate developers, investors and High Net Worth Individuals looking to invest in UK property across all sectors.

### Commercial Finance

The Commercial Finance division specialises in providing competitive financing solutions to the UK mid-market and particularly supports those companies that have links to the GCC region. The clients range from multinational corporations to family businesses generally earning a minimum operating profit of £1 million across a variety of business sectors. The facilities offered typically range in size from £1 million - £20 million and the credit approval process is centralised in the London office.

Commercial Finance, has particular expertise in the following sectors: transportation, healthcare and energy and can offer companies a comprehensive package of facilities. The business is relationship focussed so the same team remains with the transaction from origination to repayment. The Commercial Finance division is organised into three departments:

- Leasing solutions for the UK mid-market, including international facilities and wholesale finance through on balance sheet and joint venture investments.
- Corporate and Asset Finance for the GCC including vendor programmes.
- Trade Finance offering inventory finance, structured trade transactions and letters of credit

### Treasury

The Treasury division manages the Bank's capital, liquidity and funding, ensuring that the Bank operates within its market and liquidity risk appetites. To this end Treasury ensures funding sources are diversified and at cost effective rates. In alignment with the strategy objective to achieve wider and diversified funding, Treasury has launched a new savings product, the Notice Account, which provides shorter term savings opportunities.

**STRATEGY AND OBJECTIVES**

The Bank aims to become the UK's leading provider of Sharia'a compliant wealth management solutions for GCC nationals. We provide a bridge between the UK and the GCC, leveraging our established business areas such as Real Estate and Leasing where we have expertise and credibility.

In delivering the strategy, we have a number of aspirations:

- To build a strong, established and respected Wealth Management brand across the GCC.
- To become the UK partner of choice for GCC Islamic banks.
- To deliver sustainable profitability and stable returns.
- To provide excellent service to clients, demonstrated by long-term relationships and recommendations.
- To create a culture that drives a well-governed, innovative and client-centric Sharia'a Bank.

Over the course of 2017 we have launched new products including mortgages (outside of Mortgage Conduct of Business (MCOB) rules) and debit cards for our private banking clients, built a balanced and experienced wealth management team and upgraded our DIFC license from a representative office to a branch, which has now been approved in principle by the DFSA and will improve our distribution capabilities.

**FINANCIAL RESULTS**

The financial statements for the year ended 31 December 2017 are shown on pages 23 to 28 . The profit after tax for the year amounted to £3.5 million (2016: loss of £21.4 million). Below are the highlights of the financial performance and the position as at 31 December 2017.

| **Key performance indicators** | **2017** | **2016** |
|---|---|---|
| Profit/ (loss) after tax | £3.5m | £(21.4)m |
| Post-tax return on equity | 1.6% | (9.9)% |
| Cost income ratio | 98.1% | 104.7% |
| Net fee income / total income | 3.9% | 5.7% |
| Non-performing Financing Assets to overall Financial Assets | 5.5% | 7.8% |
| Number of depositors | 3,204 | 2,485 |

The efficiencies identified in late 2016 have been implemented and as a result our cost income ratio is on a downward trajectory.

**BANK NON-FINANCIAL INFORMATION STATEMENT**

BLME is committed building a bank that drives positive change not only for individuals but for society as a whole. We are committed to acting in a socially responsible manner and promoting this approach in the market in which we operate. We recognise our social, civic, economic and environmental responsibilities across all areas of our business and operations.

During 2017 we continued to develop a culture that inspires staff to deliver excellent client service in line with our strategy and risk appetite. This will continue in 2018 as we get closer to our clients and meet their needs with relevant products. The Bank continues to monitor its key risks, and as part of this we continue to reduce our concentration risk and are focussed on continuing to diversify our funding and financing streams.

**Social Responsibility**

BLME expects a high and consistent standard of conduct from all of our employees. Respect and compliance with the law, regulations, BLME policies and Sharia'a principles are the highest priority for BLME. Our values position integrity, consistency and fairness at the heart of BLME's operations. It is central to BLME's culture that all stakeholders are valued, and treated with dignity and transparency. BLME approaches clients, business and product development with a strong attention to risk. Our corporate values have become part of our everyday working life and influence all aspects of our operations from customer service to recruitment.

**The Environment**

BLME complies with relevant environmental laws and regulations. Our head office has a 'Very Good' BREEAM (Building Research Establishment Environmental Assessment Method) Rating.

BLME Corporate Social Responsibility includes our commitment to the environment. We implement operational efficiencies to ensure that our environmental impact is reduced or limited. For example; providing extensive recycling facilities in our offices and managing travel plans to maximise the number of clients and events as possible in one journey.

**Health and Wellbeing**

BLME takes the health and wellbeing of our employees seriously. We encourage safe and healthy working conditions through our Health and Safety policy and through a range of benefits which include Private Medical Insurance, gym membership, a generous holiday allowance and training and development. Our new employee wellbeing programme is in the midst of being launched by the end of first quarter of 2018.

To support a safe working environment BLME has fire wardens and trained first aiders on site. We also have Disaster Recovery and Business Continuity plans. Our employee handbook and intranet also provide advice on Wellbeing and Health and Safety.

**Financial Crime and Anti-Corruption and Anti-Bribery**

Over the past two years BLME has heavily invested in building a robust financial crime risk management team with supporting policies and processes alongside regular financial crime training and communications to all staff.

All BLME staff receive annual training on anti-corruption and anti-bribery matters. BLME's three core financial crime policies; Anti-Bribery and Corruption Policy, Anti-Money Laundering, Counter Terrorism Financing and Sanctions policy. Additional policies further support our robust approach to financial crime which include our Charitable Donations Policy, Conflicts of Interest Policy and Employee Handbook.

**Human Rights**

Our statement on modern slavery can be found on our website. When appointing suppliers we take into account the Modern Slavery Act.

**Whistleblowing**

BLME has a Whistleblowing Policy. A whistleblower is a person who raises a genuine concern related to suspected wrong doing or dangers at work. We support staff who have genuine concerns related to suspected wrongdoing or danger affecting any of BLME's activities to report should report their concerns to our Whistleblowing Champion.

## PRINCIPAL RISKS AND UNCERTAINTIES

The Bank's principal risks and uncertainties have been highlighted and discussed in detail in Note 33.

## FUTURE

2017 has been a breakthrough year for BLME. The Bank drew a line under the legacy issues that have cast a long shadow over the bank in recent years. We have built strong foundations, and can now focus on growing the Bank as we continue the implementation of our focused strategy.

We have a strong team that are fully aligned with our goals and who drive the culture and success of the Bank. I want to thank them for their amazing commitment and resilience in 2017. I would also like to thank the Chairman and the Board for their ongoing support, and the Sharia'a Supervisory Board for their continued guidance.

On behalf of the Board

Giles Cunningham
**Chief Executive Officer**
20 March 2018

**Naming convention and abbreviations:**
The expression "the Company" or "BLME" or "the Bank" refers to Bank of London and The Middle East plc which is the principal subsidiary of BLME Holdings plc ("the Group"), the ultimate parent company which is listed on Nasdaq Dubai.

# DIRECTORS' REPORT

The Directors present their annual report and audited financial statements for the year ended 31 December 2017.

**Principal activities**

Bank of London and The Middle East plc ("the Bank" or "BLME") 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 is an independent, wholly Sharia'a compliant bank authorised by the UK's Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA. The Bank provides a range of Sharia'a compliant banking services to businesses and individuals with a strong focus on the UK and the Middle East. BLME has three strategic business divisions – Commercial Finance, Wealth Management and Treasury - offering competitive financial products and services. BLME Holdings plc is the parent company of BLME. This was effected pursuant to a Scheme of Arrangement in 2013 which is explained in more detail in Note 30.

**Financial results and dividends**

The financial statements for the year ended 31 December 2017 are shown on pages 23 to 28. The Bank's profit for the year after taxation amounts to £3.5 million (2016: loss of £21.4 million). The Directors do not recommend the payment of a dividend for the year ended 31 December 2017 (2016: £Nil). The results for the year are discussed further in the Bank's strategic report.

**Directors**

There were some significant changes to the Board during 2017. The Directors who held office during the year, and their Committee memberships and functions as at 31 December 2017, were as follows:

| **Name and Board/Committee Chairmanships** (as at 31 December 2017) | **Date of Appointment** | **Date of Resignation** | **Committee Memberships** (as at 31 December 2017) |
|---|---|---|---|
| Adel Abdul Wahab Al-Majed<br>*Chairman of the Board* | 6 December 2012 | | |
| Sheikh Abdullah Jaber Al-Ahmed Al-Sabah<br>*Vice Chairman of the Board* | 22 October 2007 | | Audit<br>Risk<br>Remuneration |
| Giles Cunningham<br>*Chief Executive Officer* | 17 November 2016 | | Executive<br>Credit |
| Chris Power<br>*Chief Financial Officer* | 26 September 2016 | | Executive |
| Michael Williams (Senior Independent Director)<br>*Chairman of the Nominations Committee* | 2 March 2012 | | Nominations<br>Remuneration<br>Risk<br>Credit |
| Neil Holden (Independent)<br>*Chairman of the Remuneration Committee* | 1 November 2006 | | Nominations<br>Remuneration<br>Audit<br>Risk<br>Credit |
| Calum Thomson (Independent)<br>*Chairman of the Audit Committee* | 1 April 2017 | | Audit<br>Risk<br>Nominations<br>Credit |
| David Williams (Independent)<br>*Chairman of the Board Risk Committee* | 15 October 2015 | | Nominations<br>Remuneration<br>Risk<br>Credit |

| | | | |
|---|---|---|---|
| Jabra Ghandour | 25 March 2016 | | |
| Zeyad Al-Mukhaizeem | 18 October 2013 | 31 March 2017 | |
| Frank Vermeulen (Independent) | 1 January 2007 | 31 March 2017 | |
| Abdullah Al-Mejhem (Independent) | 1 April 2017 | 18 April 2017 | |

Michael Williams became Senior Independent Director and Chairman of the Nominations Committee on 27 February 2017.

Zeyad Al-Mukhaizeem stepped down from the Board on 31 March 2017 with Abdullah Al-Mejhem appointed to the Board as a Non-executive Director on 1 April 2017.

Frank Vermeulen stood down from the Board on 31 March 2017, with Calum Thomson appointed to the Board on 1 April 2017 taking over as Chairman of the Audit Committee.

In accordance with the Articles of Association Michael Williams, Jabra Ghandour and David Williams will retire by rotation at the next Annual General Meeting (AGM). They will offer themselves for re-appointment at the next Annual General Meeting.

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

**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

**Financial Risk Management**

The Bank has exposure to the following risk categories:

- Credit risk
- Liquidity risk
- Market risk
- Operational risk
- Capital risk
- Conduct risk

A description of how the Bank manages these risks is provided in Note 33.

The result of the UK's referendum on EU membership remains an area of risk and potential opportunity for the Bank. However, given the current state of the negotiations as we enter into 2018, management has assessed and stress-tested a number of scenarios that may result from a "Hard Brexit" . This is being monitored on a regular basis and the Bank is in a position to withstand any significant UK macroeconomic and political risk impact from the result of the Brexit negotiations.

**Political contributions**

The Bank made no political contributions during the year (2016: £nil).

**Going concern**

The Directors have reviewed the business activities and financial position of the Bank 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 Bank including the strategic direction, activities and risks that affect the financial position.

For these reasons the financial statements of the Bank have been prepared on a going concern basis.

**Disclosure of information to auditor**

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 Auditor is 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 Auditor is aware of that information.

**Auditor**

The Board undertook an audit tender in 2017 in accordance with auditor tender rules and best practice, having engaged KPMG LLP as Auditors for almost 10 years. Following the tender process the Board proposed the appointment of Ernst & Young LLP as Bank's Auditor and were appointed by resolution on 19th May 2017 at the Annual General Meeting.

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

By order of the Board

Peter Bulkeley
**Company Secretary**
20 March 2018

# 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 2017 to 31 December 2017 and have reviewed the BLME Annual Report and Financial Statements for the year ended 31 December 2017. 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 2017 to 31 December 2017 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 profit generated by BLME during the year 1 January 2017 to 31 December 2017 has been derived from Sharia'a compliant sources.
4. The Sharia'a Supervisory Board has reviewed all income received from non-Sharia'a compliant sources during the year 1 January 2017 to 31 December 2017 and will oversee BLME's dealings in the disposal of this income in a Sharia'a compliant manner.

BLME will provide shareholders with a calculation of the zakat payable on their shareholdings but it is the sole responsibility of shareholders to pay the zakat.

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**
20 March 2018

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

**In respect of the annual report and financial statements**

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

Company law requires the Directors to prepare the Company financial statements for each financial year. Under that law the Directors have elected to prepare the Bank's financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union (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 Company and of their profit or loss for that period.

In preparing each of the 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
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the 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 Bank 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**

**Opinion**

We have audited the financial statements of Bank of London and the Middle East plc (the "Bank") for the year ended 31 December 2017 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash flows and the Statement of Changes in Equity and the related notes 1 to 33, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU").

In our opinion, the financial statements:

- give a true and fair view of the Bank's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's ("FRC") Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Use of our report**

This report is made solely to the Bank'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 Bank's members those matters we are required to state to them in an auditor's 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 Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Conclusions relating to going concern**

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Bank's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

**Overview of our audit approach**

| | |
|---|---|
| Key audit matters | • Improper revenue recognition<br>• Adequacy and appropriateness of provisions made in relation to credit facilities |
| Materiality | • Overall materiality of £2.2m which represents 1% of total equity. |

**Performing a first year audit**

In preparation for our first year audit of the 31 December 2017 financial statements, we undertook procedures to establish our independence of the Bank. This involved ceasing commercial relationships and ensuring that all staff who work on the audit were independent of the Bank. We used the time prior to commencing any audit work to gain an understanding of the business issues and meet with key management and non-executive directors. We reviewed the predecessor auditor's working papers while identifying and assessing the risks, judgements and potential audit and accounting issues documented by the predecessor auditors. We used the understanding that we had formed to establish our audit base and assist in the formalisation of our audit strategy for the 2017 audit. This involved gaining an understanding of the key processes and controls over financial reporting.

**Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the 2017 financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters include those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

| **Risk** | **Our response to the risk** | **Key observations communicated to the Audit Committee** |
|---|---|---|
| **Improper revenue recognition**<br><br>Income from financing activities is £39.7 million (2016 £52.4 million).<br><br>Income from fees and commissions is £1.8 million (2016 £2.8 million).<br><br>*Refer to the Accounting policies (page 34); and Note 5 of the Financial Statements (page 46)*<br><br>The key risks of improper recognition of income arises from:<br><br>(i) Income recorded from financing and investing activities might not be complete and accurate, and<br><br>(ii) Fees and commissions can require judgment as to the amount and timing of recognition. | Our approach focussed on:<br><br>• Understanding processes and controls related to revenue recognition and testing the design and operating effectiveness of these controls with the assistance, where required, of EY IT audit professionals.<br>• Performing analytical procedures to identify trends and corroborating movements not in line with our expectations.<br>• Recalculating, on a sample basis, the income recognised across different product classes to ensure it has been calculated in accordance with the underlying transaction documentation.<br>• Agreeing, on a sample basis, transactions to supporting transaction documentation and cash receipts for fees and commissions.<br>• Performing year end cut-off testing to ensure that revenue was recognised in the correct period.<br>• Checking to supporting evidence any adjustments to the accounting records that we have identified that have characteristics that could indicate unusual or inappropriate adjustments.<br>• Assessing the appropriateness of the revenue recognition accounting policies adopted in accordance with IAS 18. | As a result of the procedures performed, we did not identify any evidence of material misstatement in the recognition of revenue. |

| Risk | Our response to the risk | Key observations communicated to the Audit Committee |
|---|---|---|
| **Adequacy and appropriateness of provisions made in relation to credit facilities**<br><br>**Financing arrangements**<br>**2017: £556,642k** *(specific provision £9,558k, collective provision £1,674k)*<br>**2016: £474,637k** *(specific provision £14,000k, collective provision £1,827k)*<br><br>**Finance lease receivables**<br>**2017: £170,546k** *(specific provision £3,190k, collective provision £1,492k)*<br>**2016: £232,701k** *(specific provision £4,674k, collective provision £2,318k)*<br><br>*Refer to the Accounting policies (page 34); and Note 14 of the Financial Statements (page 53)*<br><br>Impairment allowances represent management's best estimate of the losses incurred within the loan portfolios at the balance sheet date. They are calculated on (i) a collective basis for losses incurred but not yet recognised in the performing loan portfolios with a similar credit nature, and (ii) on an individual basis for loans where a loss event has occurred. The calculation of both collective and individual impairment allowances is inherently judgemental.<br><br>Given the subjective nature of the calculation of credit impairment provisions there is heightened risk that the timing and extent of this could be subject to error or to management bias. | Our approach focused on:<br>• Assessing, with the assistance of IT audit professionals, the design effectiveness and testing the operating effectiveness of controls over the credit arrears monitoring and impairment processes for identifying credit events.<br><br>**Specific provision**<br>• Reviewing financing arrangement annual credit review files, watch list, monitoring reports and, where relevant, collateral valuation documentation along with publically available information to identify any potential indicators of impairment. Testing a sample of credit exposures from the performing financing portfolio to determine whether any indicators of impairment exist.<br>• Analysing the files in the Asset Recovery Unit to assess that all non performing credit exposures are appropriately provided for.<br>• Challenging the decisions made by management to ensure that the provision booked against each impaired exposure, has been booked in accordance with IAS 39 and related assumptions are supported by corroborative evidence.<br>• With the assistance, where required, of EY valuation specialists, reviewing and challenging the third party valuation reports used by management in their assessment of credit exposures.<br>• Checking that exposures falling into arrears were monitored effectively and where appropriate had been included in the watchlist and provided for.<br>**Collective provision**<br>• Using EY risk modelling specialists to assess the design of the collective impairment provision model.<br>• Checking that the inputs to the model agreed to the underlying data that reconciles to the general ledger.<br>• Challenging the internal ratings applied to facilities within the collective impairment provision model and obtaining documentation that supported their classification within a specific risk category and subsequently reconciling the risk rating per the supporting documentation to the model.<br>• Performing a sensitivity analysis to corroborate that the Collective Impairment Provision is not materially understated based on the current | As a result of the procedures performed, we are satisfied that management's judgements are reasonable and that there is no evidence of material misstatement in the provision for impaired credit facilities. |

| Risk | Our response to the risk | Key observations communicated to the Audit Committee |
|---|---|---|
| . | Probability of Default ("PD") and Loss Given Default ("LGD") data.<br>• Reviewing and challenging a sample of annual credit reviews of performing financing arrangements to ensure they were carried out effectively and any deteriorations in the quality of credit were captured through an update to the risk ratings input to the collective provision model.<br>• Preparing a benchmark analysis comparing the PD rates used in the model to third party market data.<br>• For a sample of new credit facilities advanced during the period, obtaining a copy of the underlying collateral valuation and ensuring that this was effectively captured in the LGD calculation. | |

**An overview of the scope of our audit**

**Tailoring the scope**

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine the extent of our audit work. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Bank and effectiveness of controls, changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

**Our application of materiality**

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of any misstatements identified on the audit and in forming our audit opinion.

**Materiality**
*The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.*

We determined materiality for the purposes of our audit of the financial statements to be £2.2 million, which is 1% of equity. We determined our materiality based on equity rather than on profits or revenues because the Bank's profitability is low relative to the balance sheet size, and also our expectation is that the main users of the financial statements, such as the Prudential Regulatory Authority and the immediate and ultimate parent company, view capital preservation as a key consideration.

**Performance materiality**
*The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.*

On the basis of our risk assessments, together with our assessment of the Bank's overall control environment, our judgement was that an appropriate performance materiality was 75% of our planning materiality, namely £1.7m.

**Reporting threshold**
*An amount below which identified misstatements are considered as being clearly trivial.*

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.1m, which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluated any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

**Other information**

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

**Opinions on other matters prescribed by the Companies Act 2006**

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and

- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

**Matters on which we are required to report by exception**

In the light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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

**Responsibilities of directors**

As explained more fully in the directors' responsibilities statement set out on page 15, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

**Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

**Explanation as to what extent the audit was considered capable of detecting irregularities including fraud**

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Bank and management.

Our approach in respect of irregularities, including fraud, was as follows

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are Companies Act 2006, Financial Services and Markets Act 2000, Financial Services Act 2012, Capital Requirements Regulation, and relevant Prudential Regulation Authority and Financial Conduct Authority regulations.

- We understood how the Bank complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also reviewed correspondence between the Bank and UK regulatory bodies, reviewed minutes of the Board, the Executive Committee, the Audit Committee and the Board Risk Committee; and gained an understanding of the Bank's approach to governance demonstrated by the Board's approval of the Bank's risk management framework and governance framework and the internal controls processes.

- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Bank has established to address risks identified by the Bank, or that otherwise seek to prevent, deter, or detect fraud. We also considered performance incentives and their potential to influence management to manage earnings.

- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures included inquiries of management, internal audit, and those responsible for legal and compliance matters; as well as focused testing as referred to in the Key Audit Matters section above. In addition we performed procedures to identify any significant items inappropriately held in suspense and also any significant inappropriate adjustments made to the accounting records.

- As the audit of banks requires specialised audit skills, the senior statutory auditor considered the experience and expertise of the audit team to ensure that the team had the appropriate competence and capabilities, and included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

**Other matters we are required to address**

- We were appointed as auditors by the Bank at the annual general meeting on 19 May 2017 and our engagement letter was signed on 14 August 2017.

- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank and we remain independent of the Bank in conducting the audit.

The audit opinion is consistent with the additional report to the audit committee

**Kenneth Eglinton**
**Senior Statutory Auditor**
**For and on behalf of EY LLP, Statutory Auditor**
Chartered Accountants
London
20 March 2018

Notes:

1. The maintenance and integrity of the Bank of London and the Middle East plc web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# INCOME STATEMENT

**For the year 1 January 2017 to 31 December 2017**

| | Note | 2017 £000 | 2016 £000 |
|---|---|---|---|
| **Income** | | | |
| Income from financing and investing activities | 5 | 39,650 | 52,449 |
| Returns to financial institutions and customers | 6 | (16,285) | (19,530) |
| Net margin | | 23,365 | 32,919 |
| | | | |
| Fee and commission income | | 1,816 | 2,777 |
| Fee and commission expense | | (494) | (553) |
| Net fee income | | 1,322 | 2,224 |
| | | | |
| Net fair value losses on investments | 7 | (2,330) | (3,043) |
| Operating lease income | | 5,312 | 5,440 |
| Other operating income | 8 | 6,580 | 1,774 |
| **Total operating income** | | **34,249** | **39,314** |
| | | | |
| **Expenses** | | | |
| Personnel expenses | 10 | (15,239) | (14,597) |
| Operating lease depreciation | 21 | (4,318) | (3,684) |
| Other depreciation and amortisation | 20, 22 | (1,515) | (1,515) |
| Other operating expenses | 12 | (12,549) | (21,395) |
| **Total operating expenses** | | **(33,621)** | **(41,191)** |
| | | | |
| **Operating profit/(loss) before impairment charges** | | **628** | **(1,877)** |
| | | | |
| Net impairment credit/(charge) on financial assets | 14 | 2,734 | (15,791) |
| | | | |
| Loss on disposal | | - | (1,353) |
| | | | |
| **Net operating profit/(loss) before tax** | | **3,362** | **(19,021)** |
| | | | |
| Tax credit / (expense) | 15 | 105 | (2,437) |
| | | | |
| **Profit/(loss) for the year** | | **3,467** | **(21,458)** |

All of the profit for the financial year and the loss in the prior year were derived from continuing activities.

The notes on pages 29 to 89 are an integral part of these financial statements.

## STATEMENT OF COMPREHENSIVE INCOME

**For the year 1 January 2017 to 31 December 2017**

| | Note | 2017 £000 | 2016 £000 |
|---|---|---|---|
| **Income** | | | |
| Profit/(loss) for the year | | 3,467 | (21,458) |
| | | | |
| **Other comprehensive income** | | | |
| **Items that may be reclassified subsequently to profit or loss if specific conditions are met:** | | | |
| Foreign currency translation differences for cash flow hedging reserve | | - | (347) |
| Foreign currency translation differences for fair value reserve | | - | 94 |
| Fair value reserve recycled to the income statement | | 507 | - |
| Cashflow hedging reserve recycled to the income statement | | - | 2,138 |
| Unrealised (loss)/ gain in fair value of available-for-sale financial assets taken to equity | | (451) | 231 |
| Re-classification of fair value hedging instruments | | - | (1,193) |
| Income tax on other comprehensive income | *15* | (105) | (625) |
| **Other comprehensive (expense) / income for the year net of income tax** | | **(49)** | **298** |
| | | | |
| **Total comprehensive income/ (loss) for the year attributable to equity holders of the Parent company** | | **3,418** | **(21,160)** |

The notes on pages 29 to 89 are an integral part of these financial statements.

# STATEMENT OF FINANCIAL POSITION

**As at 31 December 2017**

| | Note | 2017<br>£000 | 2016<br>£000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks | | 94,931 | 68,560 |
| Due from financial institutions | *16* | 28,544 | 107,182 |
| Due from customers | *16* | 9,027 | - |
| Investment securities | *17* | 126,250 | 112,422 |
| Financing arrangements | *18* | 556,642 | 474,637 |
| Finance lease receivables | *19* | 170,546 | 232,701 |
| Operating lease assets | *21* | 34,205 | 21,977 |
| Property and equipment | *20* | 986 | 1,521 |
| Intangible assets | *22* | 837 | 1,693 |
| Other assets | *23* | 3,920 | 8,238 |
| **Total assets** | | **1,025,888** | **1,028,931** |
| **Liabilities** | | | |
| Due to financial institutions | *24* | 514,392 | 586,964 |
| Due to customers | *25* | 277,341 | 213,804 |
| Profit rate swaps | *9* | 636 | 1,305 |
| Other liabilities | *26* | 12,998 | 10,062 |
| **Total liabilities** | | **805,367** | **812,135** |
| **Equity** | | | |
| Share capital | *29* | 48,933 | 48,933 |
| Share premium | *29* | 180,623 | 180,623 |
| Capital contribution | *30* | 1,911 | 1,604 |
| Fair value reserve | | (380) | (331) |
| Retained earnings / (losses) | | (10,566) | (14,033) |
| **Total equity attributable to equity holders of the Bank** | | **220,521** | **216,796** |
| **Total liabilities and equity** | | **1,025,888** | **1,028,931** |

These financial statements were approved by the Board of Directors on 20 March 2018 and were signed on its behalf by:

Giles Cunningham
**Chief Executive Officer**

Chris Power
**Chief Financial Officer**

Company Registration Number: 05897786

The notes on pages 29 to 89 are an integral part of these financial statements

## STATEMENT OF CASH FLOWS

**For the year 1 January 2017 to 31 December 2017**

| | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| **Cash flows from operating activities** | | |
| Profit/ (loss) for the year before tax | 3,362 | (19,021) |
| Adjusted for: | | |
| Exchange differences | (1,745) | 722 |
| Fair value losses / (gains) on investments | 2,359 | 202 |
| Adjustments to cash flow hedge reserve | - | 2,053 |
| Provision for impairment | (2,734) | 15,791 |
| Depreciation and amortisation | 5,833 | 5,199 |
| Share-based payment awards | 307 | 186 |
| Mark to market movement in profit rate swaps | 114 | (250) |
| Amortisation of fair value reserve | 26 | - |
| Loss on disposal of investment | - | 1,353 |
| | 7,522 | 6,235 |
| **Net decrease / (increase) in operating assets:** | | |
| Due from financial institutions | 77,139 | (81,752) |
| Due from customers | (9,027) | - |
| Financing arrangements | (75,068) | 137,129 |
| Finance lease receivables | 65,383 | 41,956 |
| Operating lease assets | (16,439) | 3,045 |
| Other assets | 4,138 | 3,022 |
| | 46,126 | 103,400 |
| **Net (decrease) / increase in operating liabilities:** | | |
| Due to financial institutions | (67,650) | (122,778) |
| Due to customers | 63,683 | (108,712) |
| Other liabilities | 1,190 | 8,658 |
| | (2,777) | (222,832) |
| Corporation tax received / (paid) | - | 700 |
| **Net cash outflow from operating activities** | **50,871** | **(112,497)** |
| **Cash flows from investing activities** | | |
| Purchase of property and equipment | (7) | (25) |
| Purchase of intangible assets | (118) | (372) |
| Purchase of investments | (89,021) | (54,919) |
| Sale of investments | 62,565 | 158,447 |
| **Net cash intflow from investing activities** | **(26,581)** | **103,131** |
| **Net change in cash and cash equivalents** | 24,290 | **(9,366)** |
| Cash and cash equivalents at the beginning of the year | 68,560 | 72,813 |
| Exchange differences in respect of cash and cash equivalents | 2,081 | 5,113 |
| **Cash and cash equivalents at the end of the year** | **94,931** | **68,560** |

The notes on pages 29 to 89 are an integral part of these financial statements.

## BANK STATEMENT OF CHANGES IN EQUITY

| For the year ended 31 December 2017 | Share capital £000 | Share premium £000 | Capital contribution £000 | Fair value reserve £000 | Cash flow hedging reserve £000 | Retained earnings / (losses) £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| Balance at 31 December 2016 | 48,933 | 180,623 | 1,604 | (331) | - | (14,033) | 216,796 |
| **Profit for the year** | **-** | **-** | **-** | **-** | **-** | **3,467** | **3,467** |
| **Other comprehensive income /(expense)** | | | | | | | |
| Foreign currency translation | - | - | - | - | - | - | - |
| Fair value reserve recyled through income statement | - | - | - | 507 | - | - | 507 |
| Change in fair value of AFS financial assets | - | - | - | (451) | - | - | (451) |
| Reclassification of the fair value of hedging instruments | - | - | - | - | - | - | - |
| Tax on change in fair value of AFS financial assets | - | - | - | (105) | - | - | (105) |
| **Total other comprehensive expense** | **-** | **-** | **-** | **(49)** | **-** | **-** | **(49)** |
| **Total comprehensive income/(expense) for the year** | **-** | **-** | **-** | **(49)** | **-** | **3,467** | **3,418** |
| **Contributions by and distributions to owners** | | | | | | | |
| Equity-settled share-based payment awards | - | - | 307 | - | - | - | 307 |
| **Total transactions with owners** | **-** | **-** | **307** | **-** | **-** | **-** | **307** |
| **Balance at 31 December 2017** | **48,933** | **180,623** | **1,911** | **(380)** | **-** | **(10,566)** | **220,521** |

**AFS** – Available for Sale

**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. The change in fair value of AFS financial assets includes a £0.5 million adjustment relating to fair value hedging.

**Capital contribution**

This is the share-based payment reserve in prior years representing the amortised portion of the fair value of equity instruments issued under the BLME share incentive schemes and accounted for as equity-settled share-based payments. During 2013, the Deferred Annual Bonus Scheme (DABS) was reclassified back from cash-settled to equity-settled accounting and the obligations under all the BLME share incentive schemes were assumed by BLME Holdings plc for no consideration. This assumption of liability was treated as an injection of equity and is recognised as a **Capital contribution** in 2013**.** Certain vested DABS obligations were settled by BLME in cash during 2014 therefore reducing the capital contribution.

The notes on pages 29 to 89 are an integral part of these financial statements.

# BANK STATEMENT OF CHANGES IN EQUITY

**For the year ended 31 December 2016**

| | Share capital | Share premium | Capital contribution | Fair value reserve | Cash flow hedging reserve | Retained earnings / (losses) | Total |
|---|---|---|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** |
| Balance at 31 December 2015 | 48,933 | 180,623 | 1,484 | 537 | (1,166) | 7,361 | 237,772 |
| **Loss for the year** | **-** | **-** | **-** | **-** | **-** | **(21,458)** | **(21,458)** |
| **Other comprehensive income / (expense)** | | | | | | | |
| Foreign currency translation | - | - | - | 94 | (347) | - | (253) |
| Cashflow hedging reserve recycled to income statement | - | - | - | - | 2,138 | - | 2,138 |
| De-Recognition of tax asset on cash flow hedge reserve | - | - | - | - | (625) | - | (625) |
| Change in fair value of AFS financial assets | - | - | - | 231 | - | - | 231 |
| Reclassification of the fair value of hedging instruments | - | - | - | (1,193) | - | - | (1,193) |
| Tax on change in fair value of AFS financial assets | - | - | - | - | - | - | - |
| **Total other comprehensive income/ (expense)** | **-** | **-** | **-** | **(868)** | **1,166** | **-** | **298** |
| **Total comprehensive income/ (expense) for the year** | **-** | **-** | **-** | **(868)** | **1,166** | **(21,458)** | **(21,160)** |
| **Contributions by and distributions to owners** | | | | | | | |
| Equity-settled share-based payment awards | - | - | 171 | - | - | - | 171 |
| Transfer to Retained Earnings | - | - | (51) | - | - | 51 | - |
| Purchase of own shares | - | - | - | - | - | 13 | 13 |
| **Total transactions with owners** | **-** | **-** | **120** | **-** | **-** | **64** | **184** |
| **Balance at 31 December 2016** | **48,933** | **180,623** | **1,604** | **(331)** | **-** | **(14,033)** | **216,796** |

The notes on pages 29 to 89 are an integral part of these financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

## 1. 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 Company's registered office is Cannon Place, 78 Cannon Street, London, EC4N 6HL. BLME is an independent wholesale bank involved in investment, commercial finance, private client banking and wealth management. The financial statements of the Bank are presented as at and for the year ended 31 December 2017.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

### a. Presentation of financial statements

The Bank have prepared its financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and effective for the Bank's reporting for the year ended 31 December 2017.

The Bank has not produced consolidated financial statements as under Section 401 of the Companies Act 2006 consolidated financial statements are not required, the Bank being a wholly owned subsidiary of BLME Holdings plc which consolidates the financial statements of the Bank as detailed in note 32. Accordingly these financial statements present information about the Company as an individual undertaking and not about its consolidated group. The Parent's Annual report and financial statements are prepared in accordance with IFRS as adopted by the EU in order to qualify for the exemption.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

### b. Use of estimates and judgements

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.

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 36.

### c. Going concern

Accounting standards require the Directors to assess the Bank's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the Directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them. The Directors have reviewed the business activities, financial position and future forecast of the Bank and have a reasonable expectation that it has adequate resources to continue in operational existence for the foreseeable future.

In light of the above, the Directors continue to adopt the going concern basis in preparing these financial statements.

## d. Adoption of new and amended accounting standards in 2017

The following new amendments or interpretations were required to be applied for an annual period beginning on 1 January 2017 however none had a significant impact to the Bank:

- IAS 7 Statement of Cashflows – Amendments as a result of Disclosure Initiative
- IAS 12 Income Taxes - Amendments regarding the recognition of Deferred Tax Assets for Unrealised Losses
- IFRS 12 Disclosure of Interest in Other Entities – Amendments resulting from Annual Improvements 2014-2016 Cycle

## e. 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 2018, and have not been applied in preparing these financial statements. Those that may be relevant to the Bank are set out below. The Bank does not plan to adopt any of these standards early, where adopted by the EU and permitted, however will adopt as per the required deadlines.

### i. IFRS 9 Financial Instruments

IFRS 9 will replace the existing standard on the recognition and measurement of financial instruments (IAS 39) and is effective for annual periods beginning on or after 1 January 2018. The Bank plans to adopt IFRS 9 on 1 January 2018.

***Classification and Measurement***

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

An assessment by Management has confirmed:

- The 'Financing Arrangements', 'Due from financial institutions' and 'Due from customers' that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9
- Investment Securities that are classified as held to maturity or loans and receivables under IAS 39 are expected to measured at amortised cost under IFRS 9
- Investment Securities that are classified as available for sale under IAS 39 are expected to be measured at Fair Value through other comprehensive Income (FVOCI) under IFRS 9.
- Financial assets held for trading are expected to continue to be measured at fair value through profit and loss (FVTPL)

IFRS 9 largely retains the existing requirements of IAS 39 for the classification of financial liabilities. However, under IAS 39 all fair value changes of liabilities designated at FVTPL are recognised in profit or loss, whereas under IFRS 9 these fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

The Bank has not designated any financial liabilities at FVTPL and the Bank has no current intention to do so; consequently management does not expect this to have a material impact on the Bank's financial statements when transitioning to IFRS 9.

***Impairment***

IFRS 9 replaces the 'incurred loss model' under IAS 39 with a forward-looking expected credit loss ("ECL") model. This will require significant judgement as to how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis. The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments, and to contract assets. It will also apply to finance lease receivables, trade receivables and off-balance sheet commitments.

Under IFRS 9, the Bank expects to c its loss allowances into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology as described below:

- Stage 1: 12-month ECLs. These are ECLs that result from possible default events within the 12-months after the reporting date; and
- Stage 2: Lifetime ECLs. When an instrument shows significant increase in credit risk, these are ECLs that result from all possible default events over the expected life of a financial instrument; and
- Stage 3: Lifetime ECLs. These are the impaired instruments and lifetime ECLs will be recognised

Lifetime ECL measurement applies if the credit risk of a financial asset at the reporting date has increased significantly since initial recognition and 12-month ECL measurement applies if it has not. An entity may determine that a financial asset's credit risk has not increased significantly if the asset has low credit risk at the reporting date.

An assessment by Management has confirmed that provision for impairment is predicted to decrease by £0.1m under the new IFRS 9 model if applied to the portfolio held as at 31 December 2017. The Management believes that these losses will become more volatile for assets in the scope of the IFRS 9 impairment model, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39 as applied in our current impairment assessment.

***Transition and disclosure***

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, except as described below:

- the Bank plans to adopt the option of allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 will be recognised in retained earnings as at 1 January 2018;
- new hedge accounting requirements should generally be applied prospectively however the Bank may elect to apply the expected change in accounting for forward points retrospectively. The Bank has not made a decision in relation to this election.
- the following assessments have to be made on the basis of facts and circumstances that exist at the date of initial application:
    - the determination of the business model within which a financial asset is held;
    - the designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL (if any); and
    - the designation of certain debt securities and equity investments not held for trading as at FVOCI.

### ii. IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue from customers is recognised (except for contracts that are within the scope of the accounting standards on leases, insurance contracts and financial instruments). The standard introduces a five-step model to determine when to recognise revenue and at what amount; the model specifies that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled.

The Bank will adopt this standard from its mandatory effective date of 1 January 2018. Management is performing a detailed assessment of the impact resulting from the application of IFRS 15 and expects to make appropriate disclosures in 2018, however does not expect the impact to be material.

### iii. IFRS 16 Leases

The new standard on leasing was issued in January 2016 with an effective date of 1 January 2019. The full impact of this standard is being assessed however the two most significant areas are likely to be the following:

- Lessee accounting model: there will be a single accounting model with no lease classification test. All leases will be on-balance sheet and will result in the recognition of a right of use of asset representing the lessees right to use the underlying asset together with a lease liability representing the lessee's obligation to make payments.

- Lessor accounting model: the lease classification test will be based on existing IAS 17 criteria.

The Bank has started an initial assessment of the potential impact on its financial statements. So far, the most significant impact identified is that the Bank will recognise new assets and liabilities for its operating leases in relation to office premises. In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces straight-line operating lease expense with a depreciation charge for right-of-use assets and financing expense on lease liabilities. Furthermore, the Bank will need to consider the impact of its leases in relation to company cars and any leased computer/office equipment although there are optional exemptions for short-term leases and leases of low value items. An element of the full impact analysis will consider which transition approach to apply (retrospective or modified retrospective with optional practical expedients).

IFRS 16 replaces existing leases guidance including IAS 17, IFRIC 4, SIC-15 and SIC-27. The Bank does not plan to adopt this standard early but will adopt from 1 January 2019.

**The following are not yet adopted and are deemed not material to the Bank and will be adopted from the effective date:**

iv. IAS 28 Investments in Associates and Joint Ventures, effective 1 January 2018
v. IAS 40 Investment Property, effective 1 January 2018
vi. Annual Improvements to IFRSs 2014-2016 Cycle – various standards, effective 1 January 2018

### f. Basis of measurement

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

All amounts have been rounded to the nearest thousand except when otherwise indicated.

**g. Functional and presentation currency**

The financial statements are presented in Sterling, which is also the Bank's functional currency. The method of translation is explained below.

**h. 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, which are measured at historical cost, 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 non-monetary assets and liabilities go to other comprehensive income or the income statement, depending where the underlying fair value movement of asset or liability was recognised initially.

**i. 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. When calculating the effective profit rate, BLME estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The Bank has an available-for-sale Sukuk portfolio. Any fair value gain or loss is accounted for in the statement of comprehensive income.

**ii. Fees and commission**

Fees and commission which are not recognised on an effective profit rate 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.

**iii. Financial assets and financial liabilities**

The Bank classifies its financial assets in the following categories: 'due from financial institutions'; 'due from customers'; 'financing arrangements'; and 'investment securities'. Investment securities can be either financial assets at fair value through profit and loss, available-for-sale or held to maturity 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.

**iv. Due from financial institutions and customers and financing arrangements**

Due from financial institutions and customers 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.

**v. 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 Bank's documented risk management or investment strategy.

- **Available-for-sale**

Available-for-sale ("AFS") assets are either debt or equity non-derivative financial assets that are designated as available-for-sale. 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 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 Bank's right to receive payment is established.

- **Held to maturity**

Held to maturity assets are initially measured at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at amortised cost less impairment losses.

**vi. Offsetting financial assets and financial liabilities**

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.

**vii. Derecognition of financial assets**

Financial assets are derecognised when the rights to receive cash flows from the assets have expired; or where the Bank 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.

**viii. Impairment of financial assets and forbearance**

The Bank 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 Bank about the following loss events:

- significant financial difficulty of the issuer or obligor
- a breach of contract, such as default or delinquency in profit or principal payments
- the Bank 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
- it becoming probable that the client will enter bankruptcy or other financial reorganisation
- the disappearance of an active market for that financial asset because of financial difficulties
- 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 Bank first assesses whether objective evidence of impairment exists for financial assets that are individually significant, and collectively where they are not. If the Bank 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.

In assessing collective impairment, the Bank uses historical information on the timing of recoveries, the amount of loss incurred and an estimated emergence period. The emergence period is assessed using historical information as a proxy together with an assessment of current factors that may affect our customers. The emergence period used also considers the maturity profiles of each financial asset within the collective impairment portfolio. Management also estimates a probability of default and loss given default across the business divisions using external ratings companies and data. Note 3a provides further information on the areas of estimation uncertainty inherent in calculating a collective impairment charge.

The Bank writes off a facility or an investment security, either partially or in full, and any related allowance for impairment losses, when management (including the relevant Board Committees) determines that there is no realistic prospect of recovery.

- **Forbearance**

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the customer, then an assessment is made of whether the financial asset should be derecognised. If the cash flows of the renegotiated asset are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and the new financial asset is recognised at fair value. The impairment loss before an expected restructuring is measured as follows.

- if the expected restructuring will not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective profit rate of the existing financial asset; or
- if the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition.

This amount is discounted from the expected date of derecognition to the reporting date using the original effective profit rate of the existing financial asset.

Further disclosures on forbearance can be found on pages 77 to 78 in Note 33.

- **Assets carried at amortised cost**

If there is objective evidence that an impairment loss on exposures 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 facility balance has a variable profit rate, the discount rate for measuring any impairment loss is the effective profit rate as at 31 December 2017.

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 Bank 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 greater than 20% or over nine months, in the fair value of the security below its cost is considered evidence of impairment. 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 36. 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. There were no reversals in 2017 (2016: none).

**ix. Financial liabilities**

Financial liabilities that create and obligation 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.

**x. Determining fair value**

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities at an ask price. Where no active market exists for the particular asset or liability, the Bank uses another 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).

### xi. 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 and foreign exchange forward deals) 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 Bank 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 Bank 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 Bank thereof that are attributable to the hedged risk. Any gain or loss in fair value relating to the hedged item and instrument is recognised in “Net fair value gains / losses on investment securities”.

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.

- **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; BLME assesses this at inception (prospective effectiveness) and on a monthly basis (retrospective effectiveness). 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.

**j. Collateral and netting**

The Bank enters into master agreements with counterparties whenever possible and obtains collateral in respect of customer advances where it is considered appropriate. 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. 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.

**k. 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**

Property and equipment are depreciated down to their estimated residual value. Depreciation is recognised in the income statement on a straight-line basis over the estimated useful life of each part of the an item of property and equipment. Assets leased out under operating leases are depreciated over the shorter of the lease term and their useful lives.

**Useful Lives:**
- Computer equipment – 3 years
- Fixtures and fittings – 4 years
- Office equipment – 3 years
- Motor vehicles – 4 years
- Leasehold improvements – 4 years

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

**l. 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.

**m. Impairment of property and equipment, intangible assets and assets leased out under operating leases**

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 higher of value in use or fair value less cost to sell. 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.

**n. 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. The depreciable amount is the cost of the asset less the estimated residual value. Lease 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 by the Bank 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. The onerous lease provision is recognised in the income statement in the year it arises.

Residual value exposure occurs in the leasing portfolio due to the uncertain nature of the value of the underlying asset at the end of the lease. Throughout the life of an asset, its residual value will fluctuate due to changes in asset usage, uncertainty of the future market for that asset and general economic conditions. Residual values are set at the commencement of the lease based upon management's expectation of future sale proceeds. During the course of the lease, these values are monitored and compared to past history and future projections.

**o. 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.

**p. Employee benefits**

The Bank operates a defined contribution pension scheme for all staff. A defined contribution plan is a pension plan under which the Bank pays fixed contributions into a separate entity, and where the Bank 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 Bank pays contributions to Standard Life. The Bank 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.

**q. Share-based payments**

The Bank operates equity-settled share-based incentive schemes for employees in conjunction with its ultimate parent undertaking, BLME Holdings plc. 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. 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.

**r. Own shares**

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

**s. Provisions**

A provision is recognised if, as a result of a past event, the Bank 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.

**t. Income tax (current and deferred tax)**

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in Other comprehensive income.

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.

**u. Cash and cash equivalents**

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

**v. Other receivables**

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

**w. Segmental information**

Segment results that are reported to the Bank's Executive Committee (being the chief operating decision maker) include items that are directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly head office and back office expenses, and other assets.

**x. Investment in subsidiary undertaking**

The investment in subsidiary undertaking in the Company's financial statements is stated at the historical cost of investment less impairment. The investment in subsidiary undertaking is assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement.

## 3. USE OF CRITICAL ACCOUNTING ESTIMATES, JUDGEMENTS IN APPLYING ACCOUNTING POLICIES AND ESTIMATION UNCERTAINTY

**a. Allowance for credit losses**

Assets accounted for at amortised cost are evaluated monthly for impairment on a basis described in Note 2i (viii). In determining whether an impairment loss should be recorded in the income statement, the Bank 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 items with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired items, 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 set out in Note 2i (viii) , based on historical experience and current economic conditions.
The Bank considers its leasing, real estate, trade finance and corporate & structured finance portfolios to be individually significant.

**b. Determining fair values**

The Bank's accounting policy on fair value measurements is in accordance with IFRS 13 Fair Value Measurement and is discussed in Note 36.

The Bank measures fair values using the following fair value hierarchy that reflects the significance and observability 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 foreign exchange forward deals held at fair value through profit and loss and Sukuk held at fair value designated as available-for-sale.

Level 2: Valuation techniques are primarily based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Valuation techniques are also based on unobservable inputs if they do not have a significant impact on the fair value measurement in its entirety. This category comprises profit rate swaps, which are valued using reference to observable 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 Bank determines fair values using other 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 that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Bank 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.

**c. Effective profit rate adjustments**

IAS 39 requires financial instruments to be recognised at the effective profit rate of the asset, which is considered to be the rate that exactly discounts estimated future cash flows through the expected life of the instrument. As the timing of certain cash flows is uncertain, judgement has been applied in estimating all contractual cash flows (profit rate income and fees).

**4. SEGMENTAL INFORMATION**

The Bank has three operating segments as described strategic report on page 7, which are based on the Bank's strategic business divisions. The strategic business divisions offer different products and services and are managed separately based on the Bank's management and internal reporting structure.

Information regarding the results of the Bank's three reportable segments is included in the following three pages. Performance is measured based on net segment contribution as included in the internally generated management information of the Bank utilised by the Executive Committee. Segment contribution is stated after charging (or crediting) funding costs between the segments in respect of the segment assets or liabilities which either require or generate funding. There are no other significant transactions between segments.

The following summary describes the operations of each of the Bank's reportable segments during the year:

**For the year ended 31 December 2017**

| | **Treasury Division £000** | **Commercial Finance £000** | **Wealth Management £000** | **Unallocated items £000** | **Total £000** |
|---|---|---|---|---|---|
| Net margin from financing and investing activities | 459 | 10,769 | 12,137 | - | 23,365 |
| Operating lease income | 857 | 4,455 | - | - | 5,312 |
| Net fee income | 37 | 964 | 321 | - | 1,322 |
| Net fair value losses on investments | (2,330) | - | - | - | (2,330) |
| Other operating income | 1,745 | 4,835 | - | - | 6,580 |
| **Total operating income** | **768** | **21,023** | **12,458** | **-** | **34,249** |
| Directly attributable segment expenses | (1,832) | (3,626) | (2,171) | - | (7,629) |
| Operating lease depreciation | - | (4,318) | - | - | (4,318) |
| Net impairment gain/(charge) on financial assets and operating leases | 11 | 2,895 | (172) | - | 2,734 |
| **Net segment contribution** | **(1,053)** | **15,974** | **10,115** | **-** | **25,036** |
| Common costs not directly attributable to segments | | | | | (21,674) |
| **Net operating profit before tax** | | | | | **3,362** |
| **Reportable segment assets** | **240,701** | **532,012** | **249,137** | **4,038** | **1,025,888** |

The Treasury Division manages the Bank's liquidity as a whole and the Bank's liabilities are not analysed by operating segment within the internally generated management information.

**For the year ended 31 December 2016**

| | Treasury Division £000 | Commercial Finance* £000 | Wealth Management* £000 | Unallocated items £000 | Total £000 |
|---|---|---|---|---|---|
| Net margin from financing and investing activities | 682 | 30,736 | 1,501 | - | 32,919 |
| Operating lease income | 880 | 4,560 | - | - | 5,440 |
| Net fee income | 381 | 1,675 | 168 | - | 2,224 |
| Net fair value losses on investments | (3,109) | - | 66 | - | (3,043) |
| Other operating income | 977 | 799 | (2) | - | 1,774 |
| **Total operating income** | **(189)** | **37,770** | **1,733** | **-** | **39,314** |
| Directly attributable segment expenses | (2,150) | (8,238) | (2,025) | - | (12,413) |
| Operating lease depreciation | - | (3,684) | - | - | (3,684) |
| Net impairment gain/(charge) on financial assets and operating leases | 608 | (15,816) | (583) | - | (15,791) |
| Loss on disposal of group company | - | (1,353) | - | - | (1,353) |
| **Net segment contribution** | **(1,731)** | **8,679** | **(875)** | **-** | **6,073** |
| Common costs not directly attributable to segments | | | | | (25,094) |
| **Net operating loss before tax** | | | | | **(19,021)** |
| **Reportable segment assets** | **290,779** | **707,979** | **25,644** | **4,529** | **1,028,931** |

*During the year ended 31 December 2017, the Real Estate business moved from the Commercial Finance division to the Wealth Management division and therefore the comparatives have been re-presented to reflect the move.

**Entity wide disclosures**

**Geographical analysis of non-current assets**

| | 31 December 2017 £000 | 31 December 2016 £000 |
|---|---|---|
| United Arab Emirates | 32 | 155 |
| United Kingdom | 39,676 | 32,915 |
| USA | 240 | 329 |
| Others | - | 31 |
| **Total** | **39,948** | **33,430** |

Non-current assets include operating lease assets, investment properties, property and equipment, intangible assets, goodwill and other assets.

## 5. INCOME FROM FINANCING AND INVESTING ACTIVITIES

| | 2017 | 2016 |
|---|---|---|
| **Income from:** | **£000** | **£000** |
| Due from financial institutions: | | |
| Murabaha income | 386 | 193 |
| Wakala income | 330 | 194 |
| Finance lease receivables: | | |
| Finance lease income | 4,246 | 6,040 |
| Hire Purchase income | 3,775 | 7,300 |
| Istisna and Ijara income | 184 | 140 |
| Financing arrangements: | | |
| Mudaraba income | - | 22 |
| Murabaha income | 26,986 | 35,109 |
| Musharaka income | 19 | 46 |
| Wakala income | 285 | - |
| Participation Agreements | 24 | 560 |
| Investment securities: | | |
| Sukuk income | 3,415 | 2,845 |
| | **39,650** | **52,449** |

## 6. RETURNS TO FINANCIAL INSTITUTIONS AND CUSTOMERS

| | 2017 | 2016 |
|---|---|---|
| | **£000** | **£000** |
| Customer deposits | 5,288 | 6,501 |
| Murabaha | 9,604 | 11,431 |
| Wakala | 1,393 | 1,598 |
| | **16,285** | **19,530** |

## 7. NET FAIR VALUE LOSSES ON INVESTMENTS

| | 2017 | 2016 |
|---|---|---|
| | **£000** | **£000** |
| Net realised losses on investments | (29) | (788) |
| Net unrealised losses on investments | (1,880) | (202) |
| Realised gain/(loss) on hedge | (421) | (2,053) |
| | **(2,330)** | **(3,043)** |

## 8. OTHER OPERATING INCOME

| | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Gain on foreign exchange transactions | 1,745 | 722 |
| Gain on leased asset sales | 962 | 801 |
| Other | 3,873 | 251 |
| | **6,580** | **1,774** |

In the other income line above, £3.3m out of £3.8m relates to a receipt from an insurance claim in respect of an earlier year.

## 9. PROFIT RATE SWAPS

The Bank uses Sharia'a compliant derivatives, profit rate swaps(PRS), for hedging purposes in the management of its own asset and liability portfolios. This enables the Bank 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. If they do not qualify as hedges, they are classified FVTPL and the Mark to Market movement is recognised in the profit and loss. The Bank had one PRS as at 31 December 2017 which is not used for hedging purposes and is fair valued through profit and loss. These are described under the relevant headings below:

All PRSs are over-the-counter derivatives, none of which are settled through a central counterparty. There are no collateral arrangements.

Notional contract amounts of PRSs held by product type:

**Bank**

| | 2017 FVTPL | 2017 FVTPL | 2017 Fair value hedges | 2017 Fair value hedges |
|---|---|---|---|---|
| | $000 | £000 | $000 | £000 |
| **Profit rate swaps - USD** | 10,000 | - | 75,000 | - |
| **Profit rate swaps - GBP** | - | - | - | 20,000 |
| | **10,000** | **-** | **75,000** | **20,000** |

**Bank**

| | 2016 FVTPL | 2016 FVTPL | 2016 Fair value hedges | 2016 Fair value hedges |
|---|---|---|---|---|
| | $000 | £000 | $000 | £000 |
| **Profit rate swaps - USD** | 10,000 | - | 75,000 | - |
| **Profit rate swaps - GBP** | - | - | - | 20,000 |
| | **10,000** | **-** | **75,000** | **20,000** |

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.

**Fair value of PRSs designated as fair value hedges:**

| **Bank** | **2017 Fair value assets £000** | **2017 Fair value liabilities £000** | **2016 Fair value assets £000** | **2016 Fair value liabilities £000** |
|---|---|---|---|---|
| **Profit rate swaps** | **-** | **638** | **-** | **1,254** |

**Movement in the fair value of PRSs used for fair value hedging:**

| **Bank** | **2017 £000** | **2016 £000** |
|---|---|---|
| Net profit rate swap liability as at 1 January | (1,254) | (1,100) |
| Gains / (losses): | | |
| Exchange translation | 30 | (79) |
| On hedging instruments through the income statement | 80 | 141 |
| On effective hedges | 506 | (216) |
| **Net profit rate swap liability as at 31 December** | **(638)** | **(1,254)** |
| Unhedged Profit Rate Swap Asset/(Liability) recognised as Fair Value through Profit and Loss: | 2 | (51) |
| | **(636)** | **(1,305)** |

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 2017 a loss of £0.1 million (2016: £0.1 million) was recognised due to hedge ineffectiveness.

## 10. PERSONNEL EXPENSES

| | **2017 £000** | **2016 £000** |
|---|---|---|
| Wages and salaries | 11,710 | 10,788 |
| Social security costs | 1,653 | 1,157 |
| Defined contribution pension scheme costs | 1,044 | 1,066 |
| Recruitment costs | 398 | 951 |
| Other staff costs | 434 | 635 |
| | **15,239** | **14,597** |

Sharia's Supervisory Board fees recognised under personnel expenses has been reclassified to other operating expense in the comparative to reflect the appropriate nature of the expense and to be consistent with the treatment in 2017.

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

| | 2017 Number | 2016 Number |
|---|---|---|
| Period end | 112 | 118 |
| Average for the period - management | 10 | 8 |
| Average for the period - non-management | 104 | 113 |

**11. DIRECTORS' EMOLUMENTS**

| | 2017 £000 | 2016 £000 |
|---|---|---|
| Directors' emoluments | 1,962 | 1,123 |
| Pension contributions | 65 | 10 |
| | **2,027** | **1,133** |

The aggregate emoluments of the highest paid Director was £0.8 million (2016: £0.3 million), and pension contributions of £0.06 million (2016: £0.01) were made on his behalf. During 2016, compensation for loss of office amounting to £0.1 million was expensed in relation to a Director who resigned during that year. During the year, one Director exercised share options and this is disclosed in more detail in note 31. (2016: none).

**12. OTHER OPERATING EXPENSES**

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

| | 2017 £000 | 2016 £000 |
|---|---|---|
| Advertising and market development | 91 | 228 |
| Board and SSB related expenses | 409 | 618 |
| Communications and IT costs | 1,768 | 1,852 |
| Consultancy | 1,673 | 2,627 |
| Legal and professional fees | 3,972 | 8,482 |
| Other operating charges | 2,921 | 4,109 |
| Rent and other occupancy costs | 1,715 | 3,479 |
| | **12,549** | **21,395** |

| | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Auditor's remuneration | | |
| Audit of financial statements pursuant to the legislation | | |
| - Ernst & Young LLP (Current Auditors) | 500 | - |
| - KPMG (Previous Auditors) | - | 479 |
| Tax Advisory and Compliance Services | | |
| - KPMG (Previous Auditors) | - | 49 |
| Other advisory and assurance services | | |
| - Ernst & Young LLP (Current Auditors) | 27 | 15 |
| - KPMG (Previous Auditors) | - | 48 |
| | **527** | **591** |

EY's current year audit fee of £0.5 million, includes a one-off fee of £0.06 million for the audit of IFRS 9 implementation.

## 13. SHARE-BASED PAYMENTS

During the year £0.5 million (2016: £0.1 million) was charged to the income statement in respect of share-based payment transactions arising under the following employee share schemes in accordance with the Bank's reward structures:

| | 2017 | 2016 |
|---|---|---|
| **Equity settled schemes** | **£000** | **£000** |
| Approved Share Option Plan ("ASOP") | 25 | 22 |
| Unapproved Share Option Plan ("USOP") | 287 | 136 |
| Executive Share Option Scheme ("ESOP") | - | 3 |
| Deferred Incentive Plan Scheme ("DIPS") | (5) | 10 |
| | **307** | **171** |
| **Cash settled schemes** | | |
| Deferred Annual Bonus Scheme ("DABS") | 199 | (105) |
| | **506** | **66** |

A corporate reorganisation was implemented on 2 October 2013 by means of a Court-approved Scheme of Arrangement under sections 895 to 899 of the UK Companies Act, whereby BLME Holding plc became the new holding company of the Group.

All existing options under the Bank of London and The Middle East plc share incentive plans lapsed as a result of the BLME Scheme of Arrangement and replacement options were offered by BLME Holdings plc on substantially the same terms and conditions. The replacement options shall be treated as granted at the same time as the original options and the exercise of the replacement options shall be exercisable in the same manner as the existing options. The issue of these replacement options has been accounted for under IFRS 2 as a modification with no incremental fair value arising that would require amortisation to the income statement over the remaining vesting period.

**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 following tables list the weighted average inputs to the model at the measurement dates for the options granted during 2017 and 2016.

| Options issued in 2017 and 2016 | ASOP | USOP | ASOP | USOP |
|---|---|---|---|---|
| | 2017 | 2017 | 2016 | 2016 |
| Fair value (cents) * | 5.23 | 5.55 | 11.98 | 10.84 |
| Share price (cents) * | 40.15 | 40.66 | 51.20 | 48.29 |
| Exercise price (cents) * | 50.58 | 50.25 | 51.20 | 50.19 |
| Expected volatility (% p.a.) | 19.03 | 19.01 | 20.00 | 20.19 |
| Expected option life (years) | 6.80 | 6.79 | 6.50 | 6.78 |
| Expected dividends (% p.a.) | Nil | Nil | Nil | Nil |
| Risk free interest rate (%) | 0.72 | 0.72 | 1.23 | 0.99 |

* The values per share disclosed in the above table are expressed in US Dollars because options were issued to employees with US Dollar strike prices given that the shares are listed on Nasdaq Dubai and traded in US Dollars. This is based on ordinary shares which have a sterling nominal value of 25 pence each. The Black-Scholes fair value of the options has been translated into sterling using the exchange rate ruling at the date of grant, for the purpose of amortising the share-based payment expense.

The expected volatility was determined by reference to the historical volatility of the FTSE 350 Banks Index.

***Equity-settled schemes***

**Approved share options ("ASOPs")**

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 2017 | Weighted average excercise price (pence) 2017 | Number of options 2016 | Weighted average excercise price (pence) 2016 |
|---|---|---|---|---|
| Outstanding at 1 January | 1,627,892 | 66.1 | 1,222,865 | 106.0 |
| Granted in the year | 1,832,676 | 39.2 | 1,032,867 | 36.0 |
| Forfeited in the year | (597,224) | 64.7 | (627,840) | 92.6 |
| **Outstanding at 31 December** | **2,863,344** | **49.5** | **1,627,892** | **66.1** |
| **Exercisable at 31 December** | **339,493** | | **286,113** | |

The weighted average remaining contractual life of the above ASOPs outstanding at the balance sheet date was 8.5 years (2016: 7.9 years). The weighted average exercise price is 49.5 pence (2016: 66.1 pence).

1.6 million of the ASOPs granted in 2017 were issued with a longer vesting profile with 50% vesting after 3 years, 25% vesting after 4 years and 25% vesting after 5 years. (2016: None)

During 2010 options were issued in parallel to the then existing approved options that 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 equivalent to 125 pence per 25p ordinary share as against an exercise price of 162.5 pence per share for their original approved options. The old and new options 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 had two approved options, they will only be able to exercise one of them.

| **Parallel ASOPs** | **Number of options 2017** | **Number of options 2016** |
|---|---|---|
| Outstanding at 1 January | 52,298 | 73,832 |
| Granted in the year | - | - |
| Forfeited in the year | (12,306) | (21,534) |
| **Outstanding at 31 December** | **39,992** | **52,298** |
| **Exercisable at 31 December** | **39,992** | **52,298** |

The weighted average remaining contractual life of the above parallel options outstanding at the balance sheet date was 2.2 years (2016: 3.2 years). The weighted average exercise price is 125 pence (2016: 125 pence). All of these options were exercisable at the balance sheet date (2016: all). The issue of these approved parallel options in 2010 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 ("USOPs")**

Unapproved share options are granted under the "BLME Unapproved Share Option Plan" to employees who already have received approved share options up to their aggregate 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 2017** | **Weighted average excercise price (pence) 2017** | **Number of options 2016** | **Weighted average excercise price (pence) 2016** |
|---|---|---|---|---|
| Outstanding at 1 January | 11,092,251 | 44.3 | 4,473,522 | 57.6 |
| Granted in the year | 7,847,324 | 39.4 | 9,230,133 | 39.6 |
| Forfeited in the year | (1,287,091) | 48.6 | (2,611,404) | 50.2 |
| Exercised in the year | (333,333) | Nil | - | - |
| **Outstanding at 31 December** | **17,319,151** | **42.7** | **11,092,251** | **44.3** |
| **Exercisable at 31 December** | **795,504** | | **355,536** | |

The weighted average remaining contractual life of the above USOPs outstanding at the balance sheet date was 8.9 years (2016: 9.5 years). The weighted average exercise price is 42.7 pence (2016: 44.3 pence).

7.5 million of the USOPs granted in 2017 were issued with a longer vesting profile with 50% vesting after 3 years, 25% vesting after 4 years and 25% vesting after 5 years. (2016: 6.9 million).

**Executive share option scheme ("ESOPs")**

Share options were first granted to senior management under the BLME Unapproved Share Option Plan in 2009. The options granted in 2009 and 2010 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. The ESOP awards were 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.

| ESOPs | Number of options 2017 | Number of options 2016 |
|---|---|---|
| Outstanding at 1 January | 1,832,427 | 2,288,409 |
| Granted in the year | - | - |
| Forfeited in the year | (1,077,236) | (455,982) |
| **Outstanding at 31 December** | **755,191** | **1,832,427** |
| **Exercisable at 31 December** | **755,191** | **1,832,427** |

The weighted average remaining contractual life of the executive share options outstanding at the balance sheet date was 2.0 years (2016: 2.9 years). The weighted average exercise price is 162.5 pence (2016: 162.5 pence).

**Deferred Incentive Plan Scheme ("DIPs")**

The DIPs is a five-year plan introduced by the Bank in 2015 with participation open to all Bank employees. Under the Plan, employees sacrifice a portion of their salary in exchange for being granted options to acquire shares in BLME Holdings plc with a maximum market value limit of £30,000 at grant date. The options are granted under BLME Holding plc's existing ASOP and USOP schemes.

| DIPs | Number of options 2017 | Number of options 2016 |
|---|---|---|
| Outstanding at 1 January | 601,549 | 941,306 |
| Granted in the year | - | - |
| Forfeited in the year | (271,802) | (339,757) |
| **Outstanding at 31 December** | **329,747** | **601,549** |
| **Exercisable at 31 December** | **-** | **-** |

The weighted average remaining contractual life of the above DIPS options outstanding at the balance sheet date was 7.2 years (2016: 8.2 years). The weighted average exercise price was 45.0 pence (2016: 45.0 pence).

***Cash-settled schemes***

**Deferred annual bonus scheme ("DABs")**

DABs are granted under the "BLME Deferred Annual Bonus Scheme" which was introduced to ensure that the long term interests of certain employees were aligned with the interests of Shareholders. DABs awards entitle 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 take the form of nil cost options but can be settled in cash at the discretion of the company.

The DABs scheme rules were amended in March 2015 to introduce employees' awards being subject to forfeiture on leaving employment, unless the Remuneration Committee determines that the staff member concerned is a good leaver, and for awards to be cash settled at the discretion of the Company.

| DABs | Number of nil cost options 2017 | Number of nil cost options* 2016 |
|---|---|---|
| Outstanding at 1 January | 1,236,592 | 1,115,194 |
| Awarded and deferred | - | 1,559,160 |
| Awarded under matched award | 321,529 | - |
| Forfeited in the year | - | (931,075) |
| Exercised in the year | - | (9,230) |
| Settled in the year | (42,600) | (497,457) |
| **Outstanding at 31 December** | **1,515,521** | **1,236,592** |
| **Exercisable at 31 December** | **181,511** | **104,923** |

The weighted average remaining contractual life of the above nil cost options outstanding at the balance sheet date was 7.7 years (2016: 8.5 years). The weighted average exercise price was nil (2016: nil).

*prior period figures of “awarded and deferred” and “total outstanding” at 31 December have been re-presented using weighted average price.

## 14. IMPAIRMENTS OF FINANCIAL ASSETS

The table below sets out a reconciliation of changes in impairment provisions against financial assets:

| **Bank** | | | **2017** |
|---|---|---|---|
| | **Specific** | **Collective** | **Total** |
| **Impairments of financial assets:** | **£000** | **£000** | **£000** |
| Balance at 1 January 2017 | 19,018 | 4,145 | 23,163 |
| Exchange translation and other movements | (549) | - | (549) |
| **Income statement:** | | | |
| Gross impairment charge for the year | 8,240 | - | 8,240 |
| Amount recovered during the year | (9,995) | (979) | (10,974) |
| **Net impairment (credit) / charge for the year** | **(1,755)** | **(979)** | **(2,734)** |
| Amounts written off during the year | (3,893) | - | (3,893) |
| **Balance as at 31 December 2017** | **12,821** | **3,166** | **15,987** |
| Being impairments against: | | | |
| Financing arrangements | 9,558 | 1,674 | 11,232 |
| Finance lease receivables | 3,190 | 1,492 | 4,682 |
| Other Assets (Inventory) | 73 | - | 73 |
| **Balance as at 31 December 2017** | **12,821** | **3,166** | **15,987** |

| Bank | | | 2016 |
|---|---|---|---|
| | Specific | Collective | Total |
| **Impairments of financial assets:** | **£000** | **£000** | **£000** |
| Balance at 1 January 2016 | 35,741 | 3,346 | 39,087 |
| Exchange translation and other movements | 1,369 | - | 1,369 |
| **Income statement:** | | | |
| Gross impairment charge for the year | 17,369 | 799 | 18,168 |
| Amount recovered during the year | (2,377) | - | (2,377) |
| **Net impairment charge for the year** | **14,992** | **799** | **15,791** |
| Amounts written off during the year | (33,084) | - | (33,084) |
| **Balance as at 31 December 2016** | **19,018** | **4,145** | **23,163** |
| Being impairments against: | | | |
| Financing arrangements | 14,000 | 1,827 | 15,827 |
| Finance lease receivables | 4,674 | 2,318 | 6,992 |
| Operating lease assets | 344 | - | 344 |
| **Balance as at 31 December 2016** | **19,018** | **4,145** | **23,163** |

There were no collective and specific impairments against Cash and balances with banks, Due from financial institutions and customers, Investment securities or Other assets. (2016:Nil)

Refer to Note 2i (viii) and Note 3a for the factors considered in deriving the collective impairment charge for the year.

**15. TAXATION**

| Bank | 2017 | 2016 |
|---|---|---|
| | **£000** | **£000** |
| UK Corporation Tax | | |
| - current tax for the year | (72) | (625) |
| - adjustments in respect of prior years | (33) | |
| | (105) | (625) |
| Overseas tax for the year | - | - |
| Deferred tax for the year | - | 3,062 |
| **Tax (credit) / charge in income statement** | **(105)** | **2,437** |

The tax charge for the year is lower (2016: higher) than the standard rate of corporation tax which is explained as follows:

| Bank | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| **Reconciliation of effective tax rate** | | |
| Profit / (Loss) for the year before tax | 3,362 | (19,021) |
| Profit / (Loss) for the year multiplied by standard rate of corporation tax in the UK of 19.25% (2016: 20%) | 647 | (3,804) |
| De-recognition of deferred tax asset | - | 3,062 |
| Deferred tax on cash flow hedge de-recognised | - | 625 |
| Movement in unrecognised deferred tax | (669) | 2,460 |
| Expenses not deductible for tax purposes | 54 | 222 |
| Tax exempt income | (104) | (50) |
| Others | - | 274 |
| Prior year adjustment | (33) | (352) |
| **Tax (credit) / charge in income statement** | **(105)** | **2,437** |

The headline rate of UK corporation tax reduced from 20% to 19% on 1 April 2017, and following the enactment of the 2016 Finance Act on 15 September 2016, this will reduce further to 17% from 1 April 2020. As these changes were enacted before the balance sheet date, relevant deferred tax balances have been calculated with reference to these rates.

**Tax recognised in other comprehensive income**

| Bank | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Cash flow hedging reserve | - | 625 |
| Fair value reserve | 105 | - |
| | **105** | **625** |

**Deferred tax**

As at 31 December 2017, the Bank has not recognised a deferred tax asset on the total trading losses carried forward of £24.5m (2016: £26.7m), accelerated depreciation of £15.2m (2016: £17.2m) and other short term timing differences of £4.1m (2016: £4.1m).

Deferred tax assets in relation to tax losses should only be recognised when it is probable that sufficient taxable profits will be available against which the unused tax losses can be utilised. Judgement has been applied in estimating the future profitability of the business and when considering whether these will be generated in a timely manner. During 2016, management derecognised the deferred tax asset, which had primarily arisen as a result of tax losses carried forward from prior years. In prior year, the management deemed it appropriate to de-recognise this asset on the basis of current and prior year losses and after an assessment of the timeliness of generating sufficient taxable profits against which the carried forward tax losses could be utilised. Management considered the recognition for the current year and made a judgement of not to recognise any deferred tax asset.

## 16. DUE FROM FINANCIAL INSTITUTIONS AND CUSTOMERS

**Due from Institutions**

| | 0 - 3 months | 4 - 12 months | 1 - 5 years | 2017 |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Murabaha | 14,787 | 10,057 | - | 24,844 |
| Wakala | 3,700 | - | - | 3,700 |
| | **18,487** | **10,057** | **-** | **28,544** |
| Provision for impairment | | | | - |
| | | | | **28,544** |

**Due from Institutions**

| | 0 - 3 months | 4 - 12 months | 1 - 5 years | 2016 |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Murabaha | 52,640 | - | 10,012 | 62,652 |
| Wakala | 44,530 | - | - | 44,530 |
| | **97,170** | **-** | **10,012** | **107,182** |
| Provision for impairment | | | | - |
| | | | | **107,182** |

**Due from Customers**

| | 0 - 3 months | 4 - 12 months | 1 - 5 years | 2017 |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Wakala | 9,027 | - | - | 9,027 |
| | **9,027** | **-** | **-** | **9,027** |
| Provision for impairment | | | | - |
| | | | | **9,027** |

**Due from Customers**

| | 0 - 3 months | 4 - 12 months | 1 - 5 years | 2016 |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Wakala | - | - | - | - |
| | **-** | **-** | **-** | **-** |
| Provision for impairment | | | | - |
| | | | | **-** |

## 17. INVESTMENT SECURITIES

| Bank | Listed | Unlisted | 2017 Total |
|---|---|---|---|
| | £000 | £000 | £000 |
| **Fair value through profit and loss** | | | |
| Sharia'a compliant funds | - | - | - |
| **Available-for-sale** | | | |
| Equity | - | 973 | 973 |
| Sukuk | 104,883 | - | 104,883 |
| **Investment in subsidiaries** | - | 11,319 | 11,319 |
| **Held to maturity** | | | |
| Sukuk | 9,075 | - | 9,075 |
| | **113,958** | **12,292** | **126,250** |

| Bank | Listed | Unlisted | 2016 Total |
|---|---|---|---|
| | £000 | £000 | £000 |
| **Fair value through profit and loss** | | | |
| Sharia'a compliant funds | - | 240 | 240 |
| **Available-for-sale** | | | |
| Equity | - | 3,170 | 3,170 |
| Sukuk | 90,171 | 820 | 90,991 |
| **Investment in subsidiaries** | - | 21 | 21 |
| **Held to maturity** | | | |
| Sukuk | - | 18,000 | 18,000 |
| | **90,171** | **22,251** | **112,422** |

Investment in subsidiaries includes $25,000 invested in BLME Umbrella Fund Management Sarl and, £11.3m in Aspenway Limited.(2016: BLME Umbrella Fund Management Sarl $25,000; Aspenway Limited £Nil)

## 18. FINANCING ARRANGEMENTS

These tables represent contractual maturities.

| Bank | Less than 1 year £000 | 1 - 5 years £000 | Over 5 years £000 | 2017 Total £000 |
|---|---|---|---|---|
| Murabaha | 486,184 | 74,070 | - | 560,254 |
| Mudaraba | 3,425 | - | - | 3,425 |
| Musharaka | - | - | - | - |
| Participation agreements | 714 | - | - | 714 |
| Sukuk | 944 | 2,537 | - | 3,481 |
| | **491,267** | **76,607** | **-** | **567,874** |
| Provision for impairment | | | | (11,232) |
| | | | | **556,642** |
| Collective Impairment | | | | (1,674) |
| Specific Impairment | | | | (9,558) |
| | | | | **(11,232)** |

| Bank | Less than 1 year £000 | 1 - 5 years £000 | Over 5 years £000 | 2016 Total £000 |
|---|---|---|---|---|
| Murabaha | 417,319 | 59,895 | - | 477,214 |
| Mudaraba | - | 3,798 | - | 3,798 |
| Musharaka | 1,133 | - | - | 1,133 |
| Participation agreements | 1,822 | - | - | 1,822 |
| Sukuk | - | 6,497 | - | 6,497 |
| | **420,274** | **70,190** | **-** | **490,464** |
| Provision for impairment | | | | (15,827) |
| | | | | **474,637** |
| Collective Impairment | | | | (1,827) |
| Specific Impairment | | | | (14,000) |
| | | | | **(15,827)** |

**19. FINANCE LEASE RECEIVABLES**

| Bank | 2017 | 2016 |
|---|---|---|
| | **£000** | **£000** |
| **Gross investment in finance lease receivables** | | |
| Within one year | 32,256 | 56,136 |
| One to five years | 43,338 | 49,953 |
| Over five years | 6,547 | 9,281 |
| | 82,141 | 115,370 |
| | | |
| **Hire purchase** | | |
| Within one year | 54,124 | 64,133 |
| One to five years | 52,277 | 80,403 |
| Over five years | - | 37 |
| | 106,401 | 144,573 |
| | | |
| Unearned future income on finance leases | (7,868) | (10,745) |
| Unearned future income on hire purchase | (5,446) | (9,505) |
| Collective Impairment | (1,492) | (2,318) |
| Specific Impairment | (3,190) | (4,674) |
| **Net investment in finance leases and hire purchase** | **170,546** | **232,701** |
| | | |
| **The net investment in finance leases comprises:** | | |
| Within one year | 24,444 | 46,610 |
| One to five years | 39,209 | 44,393 |
| Over five years | 6,273 | 8,769 |
| | **69,926** | **99,772** |
| | | |
| **The net investment in hire purchase comprises:** | | |
| Within one year | 50,577 | 56,630 |
| One to five years | 50,043 | 76,262 |
| Over five years | - | 37 |
| | **100,620** | **132,929** |

These tables represent contractual maturities.

The Bank’s investment in finance lease receivables covers a wide range of equipment types including transport, construction, mining and heavy machinery equipment.

## 20. PROPERTY AND EQUIPMENT

| Bank | Computer Equipment £000 | Office Equipment £000 | Fixtures & Fittings £000 | Total £000 |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 January 2017 | 525 | 69 | 2,184 | 2,778 |
| Additions | 7 | - | - | 7 |
| Disposals | - | - | - | - |
| **At 31 December 2017** | 532 | 69 | 2,184 | **2,785** |
| At 1 January 2016 | 500 | 57 | 2,830 | 3,387 |
| Additions | 25 | 12 | 95 | 132 |
| Disposals | - | - | (741) | (741) |
| **At 31 December 2016** | **525** | **69** | **2,184** | **2,778** |
| **Depreciation** | | | | |
| At 1 January 2017 | 473 | 56 | 728 | 1,257 |
| Charge for the year | 36 | 6 | 500 | 542 |
| Disposals | - | - | - | - |
| **At 31 December 2017** | 509 | 62 | 1,228 | **1,799** |
| At 1 January 2016 | 433 | 49 | 836 | 1,318 |
| Charge for the year | 40 | 7 | 525 | 572 |
| Disposals | - | - | (633) | (633) |
| **At 31 December 2016** | **473** | **56** | **728** | **1,257** |
| | | | | |
| **Net Book Value** | | | | |
| At 1 January 2017 | 52 | 13 | 1,456 | 1,521 |
| **At 31 December 2017** | 23 | 7 | 956 | **986** |
| **At 31 December 2016** | **52** | **13** | **1,456** | **1,521** |

## 21. OPERATING LEASE ASSETS

| Bank | At 31 December 2016 £000 | Additions 2017 £000 | Disposals 2017 £000 | Depreciation 2017 £000 | At 31 December 2017 £000 |
|---|---|---|---|---|---|
| Gross carrying amount | 29,268 | 27,830 | (14,764) | - | 42,334 |
| Less depreciation | (6,947) | - | 3,136 | (4,318) | (8,129) |
| | **22,321** | **27,830** | **(11,628)** | **(4,318)** | **34,205** |

| Bank | At 31 December 2015 £000 | Additions 2016 £000 | Disposals 2016 £000 | Depreciation 2016 £000 | At 31 December 2016 £000 |
|---|---|---|---|---|---|
| Gross carrying amount | 42,980 | 501 | (14,213) | - | 29,268 |
| Less depreciation | (13,869) | - | 10,606 | (3,684) | (6,947) |
| | **29,111** | **501** | **(3,607)** | **(3,684)** | **22,321** |
| Provision for impairment | | | | | (344) |
| | | | | | **21,977** |
| | | | | | |
| Specific Impairment | | | | | (344) |
| | | | | | **(344)** |

| **Rental receipts under operating leases** | **2017** | **2016** |
|---|---|---|
| Future rentals are as follows: | **£000** | **£000** |
| Less than one year | 3,270 | 4,591 |
| Between one and five years | 13,815 | 6,150 |
| More than five years | 1,971 | 32 |
| | **19,056** | **10,773** |

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

## 22. INTANGIBLE ASSETS

| **Bank** | **2017** | **2016** |
|---|---|---|
| **Cost** | **£000** | **£000** |
| Opening balance | 5,528 | 5,166 |
| Additions | 115 | 373 |
| Disposals | 0 | (11) |
| **Closing balance** | **5,643** | **5,528** |
| | | |
| **Amortisation and impairment losses** | | |
| Opening balance | 3,835 | 2,904 |
| Charge for the year | 971 | 942 |
| Disposals | 0 | (11) |
| **Closing balance** | **4,806** | **3,835** |
| | | |
| **Net Book Value** | **837** | **1,693** |

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

**23. OTHER ASSETS**

| Bank | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| VAT recoverable | 1,105 | - |
| Accrued income | 145 | 99 |
| Collateral deposits* | 487 | 482 |
| Prepayments | 723 | 1,238 |
| Other receivables and assets** | 1,460 | 6,419 |
| | **3,920** | **8,238** |

* The Bank has pledged cash collateral deposits of £0.5 million (2016: £0.5 million) as security against rental payments on its premises.

**Other receivables and asset line above include foreign exchange forward deal balance of £Nil (2016:£3.8 million).

**24. DUE TO FINANCIAL INSTITUTIONS**

| Bank | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Reverse Murabaha | 391,186 | 511,239 |
| Wakala | 123,206 | 75,725 |
| | **514,392** | **586,964** |

**25. DUE TO CUSTOMERS**

| Bank | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Customer deposits | 270,645 | 206,110 |
| Security deposits | 6,696 | 7,694 |
| | **277,341** | **213,804** |

**26. OTHER LIABILITIES**

| Bank | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Trade payables | 175 | 257 |
| VAT payable | - | 1,284 |
| Deferred income | 48 | 48 |
| Social security and income tax | 354 | 352 |
| Accruals | 8,160 | 7,512 |
| Other creditors | 4,261 | 609 |
| | **12,998** | **10,062** |

*Other creditors line above include foreign exchange forward deal balance of £0.9 million (2016:£Nil).

## 27. COMMITMENTS UNDER OPERATING LEASES

| Cannon Place | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Future minimum rentals are as follows: | | |
| Lease expiring in more than five years | 12,130 | 13,085 |
| | **12,130** | **13,085** |

There is a commitment at year-end under a non-cancellable operating lease for the Bank's main office premises at Cannon Place, 78 Cannon Street, London EC4N 6HL for a fifteen year period (with a ten year break clause) from 11 September 2015 to 10 September 2030, at an annual rental of £0.95 million with an initial rent free period.

During the year £0.8 million was recognised as an expense in the income statement in respect of this operating lease (2016: £0.8 million).

| Manchester Square | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Future minimum rentals are as follows: | | |
| Lease expiring between one and five years | 215 | 679 |
| Lease expiring in more than five years | - | - |
| | **215** | **679** |

There is a commitment at the year-end under a non-cancellable operating lease for the Bank's Wealth Management Division's former 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 £0.5 million with an initial rent free period (2016: £0.5 million).

The Manchester Square premise during 2017 was not in use due to employees relocating from Manchester Square to the Bank's primary office Cannon place in 2016. In 2016, the bank had exercised an exit from lease in line with break clause dated June 2018 and recognised an onerous lease provision of £1.2m in the income statement comprising the contractual rent and reliable estimate of the future maintenance costs. The remaining commitment of the lease is £0.2m (2016: £0.6m) which has been fully provided in the onerous lease provision.

| Dubai office | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Future minimum rentals are as follows: | | |
| Lease expiring in less than five years | 117 | 276 |
| | **117** | **276** |

There is a commitment at the year-end under a non-cancellable operating lease for the Bank's representative office in Dubai for a three year period from 15 November 2015 to 14 November 2018, at an annual rental of AED 0.7 million, which was equivalent to £0.1 million at the balance sheet date (2016: AED 0.7 million / £0.1 million), with an initial rent free period.

During the year £0.1 million was recognised as an expense in the income statement in respect of this operating lease (2016: £0.1 million).

In addition to above, the Bank has two more non-cancellable operating lease agreements in relation to two other UK office premises. The future minimum lease rental for these two premises is £0.019 million (2016: £0.025m). During the year an expense of £0.037 million (2016: £0.037 million) was recognised in the income statement in respect of these operating leases.

**28. CHANGES IN LIABILITIES FROM FINANCING ACTIVITIES**

| Bank | 1 January 2017 | Cashflows | FX Movement | Changes in Fair Value | Other | 31 December 2017 |
|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Due to Financial Institutions | (586,964) | 67,650 | 4,922 | - | - | (514,392) |
| Due to Customers | (213,804) | (63,683) | 146 | - | - | (277,341) |
| Profit Rate Swaps | (1,305) | | 29 | 589 | 51 | (636) |
| **Total** | (802,073) | 3,967 | 5,097 | 589 | 51 | (792,369) |

| Bank | 1 January 2016 | Cashflows | FX Movement | Changes in Fair Value | Other | 31 December 2016 |
|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Due to Financial Institutions | (669,849) | 122,778 | (39,893) | - | - | (586,964) |
| Due to Customers | (321,473) | 108,712 | (1,043) | - | - | (213,804) |
| Profit Rate Swaps | (1,104) | | (79) | (90) | (32) | (1,305) |
| **Total** | (992,426) | 231,490 | (41,015) | (90) | (32) | (802,073) |

**29. SHARE CAPITAL AND SHARE PREMIUM**

| Bank | Number of shares | Share capital £000 | Share premium £000 |
|---|---|---|---|
| **Allotted, called up and fully paid 25p per ordinary share** | | | |
| **At 31 December 2016** | 195,733,691 | 48,933 | 180,623 |
| **At 31 December 2017** | **195,733,691** | **48,933** | **180,623** |

In 2015 the Bank reduced its Share Premium account by £25 million with the resulting credit balance being transferred into Retained Earnings. This was conducted by way of a Special Resolution of BLME passed in accordance with section 283 of the Companies Act 2006 at a general meeting of BLME duly convened and held on 24 November 2015. This process was formally approved by the High Court of Justice in London and became effective on 16 December 2015.

In 2013, as part of the preparation of the BLME Bank for Admission to the Official List of Securities of Dubai Financial Services Authority and Admission to Trading on NASDAQ Dubai, a corporate reorganisation was implemented by means of a Court-approved scheme of arrangement under sections 895 to 899 of the UK Companies Act. Pursuant to the Scheme of Arrangement, BLME's Shareholders exchanged their ordinary shares in Bank of London and The Middle East plc for a beneficial interest in the ordinary shares of BLME Holdings plc.

The effects of the implementation of the BLME Scheme of Arrangement were as follows:

i. instead of having its issued share capital owned by BLME's Shareholders, Bank of London and The Middle East plc is now a wholly-owned subsidiary of BLME Holdings plc

ii. instead of owning a given number of Bank of London and The Middle East plc shares, each BLME Shareholder now beneficially owns approximately one BLME Holdings plc share for every 25 Bank of London and The Middle East plc shares that it held prior to the BLME Scheme of Arrangement becoming effective

iii. BLME Holdings plc became the new holding company of the BLME Bank.

Pursuant to the BLME Scheme of Arrangement, the issued share capital of Bank of London and The Middle East plc was reduced by cancelling and extinguishing the ordinary shares of Bank of London and The Middle East plc in issue immediately prior to the BLME Scheme of Arrangement becoming effective (the "Scheme shares"), following which the credit arising in the books of Bank of London and The Middle East plc as a result of the cancellation was applied in paying up in full new ordinary shares of Bank of London and The Middle East plc, such that the aggregate nominal value of such new ordinary shares equalled the aggregate nominal value of the Scheme shares cancelled. The Bank of London and The Middle East plc new ordinary shares were issued to BLME Holdings plc which, as a result, became the holding company of Bank of London and The Middle East plc and the BLME Bank.

In consideration for the cancellation of the Scheme shares, the BLME Shareholders were entitled to a beneficial interest in one BLME Holdings plc share for every 25 Scheme shares held. The principal purpose of the consolidation was to enable a price to be established for the BLME Holdings plc shares at Admission which the Directors considered to be at an appropriate level for effective and orderly market dealings in BLME Holdings plc shares to commence on NASDAQ Dubai.

A meeting of the holders of Bank of London and The Middle East plc shares convened by an order of the Court pursuant to section 896 of the UK Companies Act was held on 10 June 2013 at which the BLME Scheme of Arrangement was approved by a majority in number, representing not less than 75 per cent. in value of shareholders present and voting, either in person or by proxy.

A general meeting of the Bank of London and The Middle East plc Shareholders, to approve amongst other things:

i. the BLME Scheme of Arrangement

ii. the cancellation of the Scheme shares

iii. the application of the reserve arising as a result of the cancellation of the Scheme shares to paying up the new Bank of London and The Middle East plc shares and the allotment of the new Bank of London and The Middle East plc shares to BLME Holdings plc

was also held on 10 June 2013 and the above proposals were approved as special resolutions by not less than 75 per cent. in value of the votes cast.

The Court hearing at which the BLME Scheme of Arrangement was sanctioned was held on 2 October 2013 and the BLME Scheme of Arrangement became effective on that date.

## 30. CAPITAL CONTRIBUTION

| **Bank** | **2017** | **2016** |
|---|---|---|
| | **£000** | **£000** |
| Assumption of share incentive scheme liabilities by parent company: | | |
| Opening balance | 1,604 | 1,484 |
| Transfer to Retained Earnings | - | (51) |
| Equity-settled share-based payment awards | 307 | 171 |
| **Closing balance at 31 December** | **1,911** | **1,604** |

Pursuant to a scheme of arrangement under sections 895 to 899 of the UK Companies Act that was implemented on 2 October 2013, and as explained in Note 13, all existing options under the Bank of London and The Middle East plc share incentive plans lapsed and replacement options were offered by BLME Holdings plc on substantially the same terms and conditions.

Furthermore, Bank of London and The Middle East plc was relieved of its obligations under the share incentive plans and those responsibilities were assumed by BLME Holdings plc for no consideration.

As this transaction was a non-monetary transaction for no consideration with a parent company, it is in effect additional investment in Bank of London and The Middle East plc by BLME Holdings plc. Therefore Bank of London and The Middle East plc has derecognised its Share-based payment reserve and recognised a corresponding increase in equity as a contribution from its parent company.

**31. RELATED PARTIES**

During the year the Bank entered into transactions on an arm's length basis with related counterparties as detailed below.

| | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Boubyan Bank K.S.C.P | | |
| Wakala placement | 826,850 | 490,532 |
| Wakala deposit taking | 168,176 | 304,049 |
| Foreign exchange transactions | - | 249 |
| The Public Institution for Social Security | | |
| Reverse Murabaha | 238,155 | 505,294 |

The amounts outstanding with Boubyan Bank K.S.C.P as at 31 December were as follows:

| Included within: | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Cash and balances with banks | | |
| Nostros | 2,720 | 1,941 |
| Due from financial institutions | | |
| Wakala placement | - | - |
| Due to financial institutions | | |
| Wakala deposit taking | 31,893 | - |

As at 31 December 2017, Boubyan Bank K.S.C.P held an economic interest of 26.39% of the Parent Company's shares (2016: 26.39%). A Non-executive Director who joined the Board on 6 December 2012, and was appointed Chairman on 31 March 2014, is the current Chief Executive Officer and Vice-Chairman of Boubyan Bank K.S.C.P.

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

| Included within: | 2017 | 2016 |
|---|---|---|
| | £000 | £000 |
| Reverse Murabaha | 381,185 | 522,812 |

As at 31 December 2017, The Public Institution for Social Security held 7.67% (2016: 7.67%) of the Bank's shares. The Bank's Vice Chairman holds the position of Deputy Director General for Investment and Operations of The Public Institution for Social Security.

The key management of the Bank are the Executive Directors. The compensation of key management personnel for the year was as follows:

| | 2017 | 2016 |
|---|---|---|
| | **£000** | **£000** |
| Key management emoluments * | 1,429 | 827 |
| Bank contributions to pension plans | 65 | 10 |
| | **1,494** | **837** |

* Key management emoluments includes share-based payments of £0.15 million (2016: £0.09 million).

During the year, the Company received notification of the following Directors' purchase of company shares on the following dates.

| No. | Director's Name | Date | No. of Shares | Value | % Cumulative holding of issued share capital |
|---|---|---|---|---|---|
| 1. | Michael Williams | 29 June 2017 | 30,000 | US$12,000 | 0.015% |
| 2. | Calum Thomson | 29 June 2017 | 30,000 | US$12,000 | 0.015% |
| 3. | David Williams | 29 June 2017 | 30,000 | US$12,000 | 0.015% |
| 4. | Jabra Ghandour | 29 June 2017 | 30,000 | US$12,000 | 0.015% |
| | | 5 September 2017 | 136,667 | US$54,667 | 0.255% |
| 5. | Giles Cunningham | 27 August 2017 | 675,917 | U$270,367 | |
| | | 28 August 2017 | 74,083 | U$29,633 | |
| | | 5 September 2017 | 63,120 | U$25,248 | 0.415% |
| 6. | Christopher Power | 27 August 2017 | 30,000 | U$11,990 | 0.015% |
| 7. | Adel Al-Majed | 7 September 2017 | 771,412 | U$308,564 | |
| | | 17 September 2017 | 228,588 | U$308,564 | 0.511% |

In addition to above purchase, Jabra Ghandour exercised options over 333,333 ordinary shares in the Company plc on 29 June 2017 at nil cost per share. He was granted these options in November 2015 when he was Head of Wealth Management.

On 17 October 2016 the Bank's Dubai Representative Office entered into a consultancy agreement with Jabra Ghandour (Director) to provide services to help build the Bank's Wealth Management brand and revenues. The agreement was made in the ordinary course of business and on an arms' length basis and can be terminated by either party giving to the other party not less than one month's notice in writing. The Bank recognised an expense of £0.24 million (31 December 2016: £0.03 million) in the income statement line "Other operating expenses" in relation to this agreement and this amount has been included in the Director's Emolument figures disclosed in Note 11. The amount outstanding as at 31 December 2017 is £0.045m (31 December 2016: £Nil).

**32. PARENT COMPANY AND SUBSIDIARIES**

As at 31 December 2017 the Bank's ultimate parent undertaking was BLME Holdings plc, a limited liability company incorporated in the UK and domiciled in England & Wales, which is also the parent undertaking of the largest and the smallest group of undertakings for which Group consolidated financial statements are drawn up and of which the Bank is a member. Copies of the Consolidated Group financial statements of BLME Holdings plc can be obtained from the Company Secretary, BLME Holdings plc, Cannon Place, 78 Cannon Street, London EC4N 6HL.

Below is the list of the subsidiaries directly held by the Bank of London and The Middle East plc.

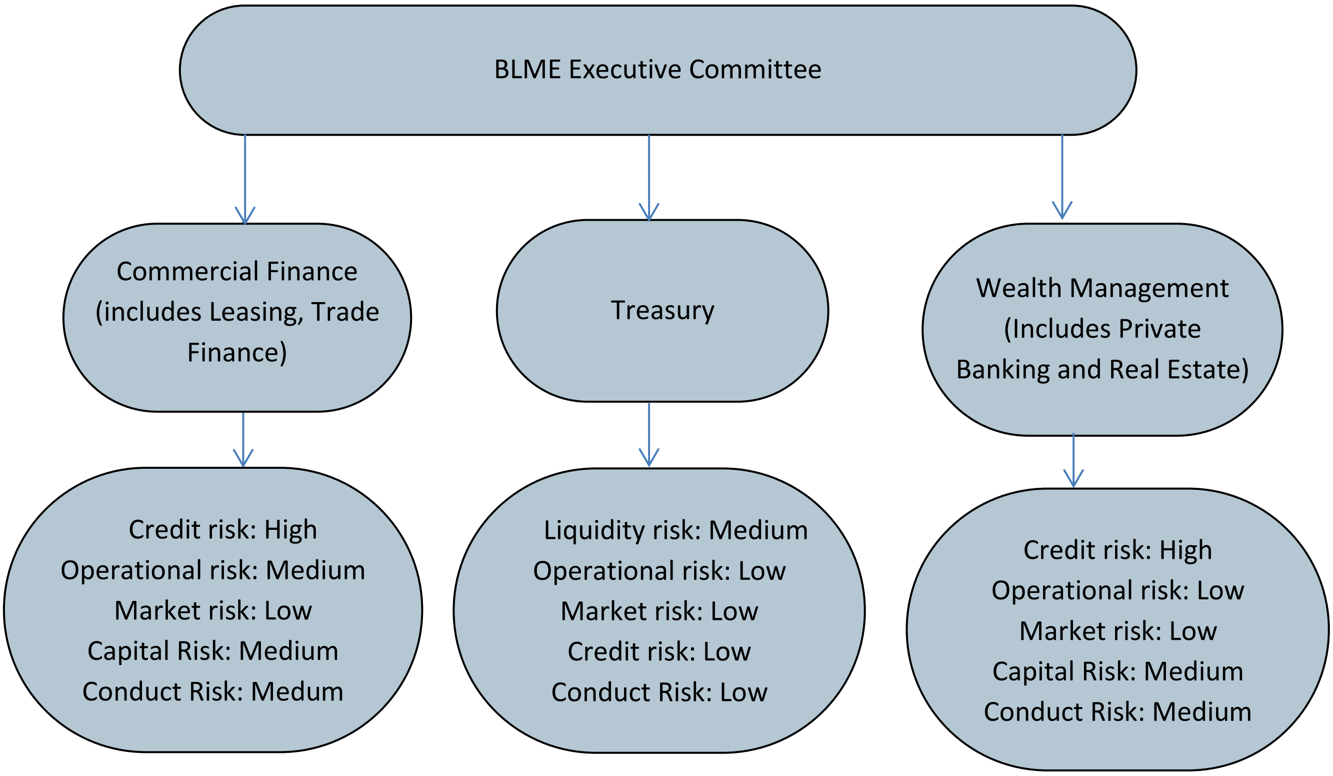
| Principal Subsidiaries | Country of incorporation and principal operations | BLME interest in equity capital | Issued equity capital | Principal business activity | Ultimate parent undertaking | Immediate parent undertaking | Registered office |
|---|---|---|---|---|---|---|---|
| **Directly held:** | | | | | | | |
| BLME Asset Management Limited | United Kingdom | 100% | £2 | Dormant | BLME Holdings plc | BLME plc | 78 Cannon Street, London EC4N 6HL |
| BLME Holdco Limited | United Kingdom | 100% | £102 | Dormant | BLME Holdings plc | BLME plc | 78 Cannon Street, London EC4N 6HL |
| BLME Holdings EBT | Jersey | 100% | £100 | Employee benefit trust | BLME Holdings plc | BLME plc | n/a |
| BLME Limited | United Kingdom | 100% | £2 | Dormant | BLME Holdings plc | BLME plc | 78 Cannon Street, London EC4N 6HL |
| BLME Umbrella Fund Management Sarl | Luxembourg | 100% | US$ 25,000 | Holding Company | BLME Holdings plc | BLME plc | n/a |
| Global Liquidity Solutions Limited | United Kingdom | 100% | £1 | Dormant | BLME Holdings plc | BLME plc | 78 Cannon Street, London EC4N 6HL |
| MKL Construction Equipment Finance Limited | United Kingdom | 60% | £1,000 | Leasing | BLME Holdings plc | BLME plc | Padgets Lane, Redditch, B98 0RT |
| Renaissance Property Finance Limited | United Kingdom | 100% | £2 | Dormant | BLME Holdings plc | BLME plc | 78 Cannon Street, London EC4N 6HL |
| Renaissance Trade Finance Limited | United Kingdom | 100% | £2 | Dormant | BLME Holdings plc | BLME plc | 78 Cannon Street, London EC4N 6HL |
| Aspenway Limited | Jersey | 100% | £11,300,000 | Investment Holding Company | BLME Holdings plc | BLME plc | 26 New Street, St Helier, Jersey JE2 3RA |

## 33. FINANCIAL RISK MANAGEMENT

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

- credit risk
- liquidity risk
- market risk
- operational risk (includes cyber risk)
- capital risk
- conduct risk

The chart below provides a link between the Bank's business units and the principal risks that they are exposed to. The significance of risk is assessed within the context of the Bank as a whole and is measured based on allocation of the regulatory capital within the Bank.




The following presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing these risks, and the management of capital.
Following a review of the Bank's business strategy last year, the following objectives have been identified:

- Continue to reduce exposure to capital intensive and less profitable business lines;
- Expansion of its presence in the Gulf Cooperation Council (GCC) states and the Middle East;
- Reduced wholesale funding concentration. This has been achieved by attracting more deposits through BLME's Premier Deposit Account (PDA) and will continue into 2018.

As referred to in the Chairman and CEO statements, the Bank has undergone significant changes in 2017 which included a refinement of the Bank's risk management framework and Board Risk Appetite.

**Risk management framework**

The Bank's risk management framework ("RMF") provides the foundation for ensuring risk-taking activity is consistent with the Bank's strategy and risk appetite, and that the Bank delivers good service and good outcomes for customers from its products. The RMF establishes an appropriate balance between risks and reward and ensuring robust controls and management of risk.

The Bank's method of managing risk begins with the definition of the Risk Appetite, which when combined with the Bank's strategy articulates its willingness to be exposed to risk events and losses.

The RMF is subject to regular evaluation to ensure that it meets the challenges and requirements of the market in which the Bank operates, including regulatory standards and industry best practices. The Bank requires a strong and proactive RMF, in order to:

- Manage the Bank in line with the Board's approved Risk Appetite;
- Achieve the Bank's strategic objectives whilst adhering to its Risk Tolerance levels;
- Empower and equip the Bank's staff to make decisions in a risk-aware manner; with roles, responsibilities, and delegated authorities clearly defined; and
- Embed a culture of treating customers fairly and ensuring Sharia 'a compliant products in order to mitigate all principal risks.

The RMF lays out systematic processes to identify, evaluate, mitigate, report, and manage risk:

- Risk identification – ensure there is a clear definition of each risk entered into by the Bank with an identified Risk Owner;
- Risk assessment – agree and implement appropriate, effective risk measurement and reporting standards for each identified risk. Set metrics together with reporting monitoring controls, processes and standards;
- Risk mitigation – establish key control processes and practices, including limit structures, impairment allowance criteria and reporting requirements. Ensure all frameworks and policies are regularly reviewed and kept relevant and up to date;
- Execution and monitoring – separate control functions independent of business lines are responsible for monitoring the operation of the controls and adherence to risk direction and limits;
- Manage and challenge – review and challenge all aspects of the Bank's risk profile; and
- To identify and evaluate the roles of three lines of defence.

The Bank's RMF requires the following principles to be adhered to:

- All risks assessed as being principal risks to be covered by a Risk Appetite Statement, Policy and operating process to mitigate the risk;
- The Board retains overall responsibility for approving business strategy, understanding major risks and ensuring that the risks are adequately controlled and monitored;
- The Board Risk Committee provides oversight and assurance of the RMF, with independent reporting lines for the Chief Risk Officer and Head of Credit Risk respectively to enable this; and
- Adoption of a "4 eyes" maker / checker control system throughout the Bank, with independent review / approval of key risk decisions in a three lines of defence model.

**Board Risk Appetite**

The Board defines its appetite and tolerance for risk expressed in terms of qualitative and quantitative metrics which are measured on a stressed and unstressed basis.

The BLME Risk Appetite Statement is set by the BLME Board and reviewed at least semi-annually.

The Board has set risk appetite within the context of projected financial earnings and balance sheet over the short and medium term. The risk appetite will be set to clearly articulate the Board's objectives under a stress event, and to align to the Board's stated strategy.

The Board's appetite for risk is stated as an appetite for potential loss under stressed and normal market scenarios which drives the business to focus on business that has adequate rewards for the risks taken, and to reduce the overall level of risk undertaken.

The principal risks faced by the Bank are described below, together with details of how these risks are managed. 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 year

**a. Credit risk**

Credit risk is the risk of financial loss to the Bank 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 Bank's Credit Risk Management Policy. The Bank has a credit review 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 as is the amount of credit that can be made available to the risk counterparty.

**i. Management of credit risk**

The Bank manages credit risk by the use of Portfolio Limits and Commercial Guidelines ("CGs") within the Bank'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 monitored on a daily basis and regularly re-assessed for creditworthiness.

The Board Credit Committee is a sub-committee of BRC established to review and agree decisions made by the Counterparty Credit Risk Committee (CCRC) that are outside of stated risk appetite and/or meet other escalation criteria. 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 Bank also employs a credit grading system, to facilitate monitoring of the quality of the overall portfolio and individual segments.

### ii. Exposure

The tables below present the Bank's exposure to credit risk on their balance sheet financial instruments as at 31 December 2017, before taking account of any collateral held or other credit enhancements. The amounts at the current reporting date reflect the continued de-risking of the Bank's lending portfolio. This has resulted in a decrease in the overall gross exposures as a consequence of the Bank exiting non-core business such Islamic Capital Markets and US Leasing, and higher risk products which includes ABL Finance.

| **Bank** | **2017** | **2016** |
|---|---|---|
| | **£000** | **£000** |
| Cash and balances with banks | 94,931 | 68,560 |
| Due from financial institutions | | |
| Murabaha | 24,844 | 62,652 |
| Wakala | 3,700 | 44,530 |
| Due from customers | 9,027 | - |
| Investment securities | 126,250 | 112,422 |
| Financing arrangements | 556,642 | 474,637 |
| Finance lease receivables | 170,546 | 232,701 |
| Other assets (Foreign exchange forward deals) | - | 3,888 |
| **Total credit exposure** | **985,940** | **999,390** |

The Bank had 12 off balance sheet letters of guarantee outstanding at 31 December 2017 (2016: 40) with a total exposure of £18 million (2016: £24.8 million). These letters of guarantee mainly relate to short dated Trade Finance and ABL Finance facilities with a maturity of less than six months.

### iii. Exposure by country of incorporation of the borrower

The Bank's exposure to credit risk at balance sheet date were dispersed across the following countries:

| Bank | 2017<br>£000 | 2016<br>£000 |
|---|---|---|
| **GCC countries** | | |
| Bahrain | 8,464 | 7,747 |
| Kuwait | 94,017 | 16,112 |
| Qatar | 14,008 | 42,779 |
| Saudi Arabia | 92,570 | 119,577 |
| United Arab Emirates | 16,064 | 28,157 |
| | | |
| **EEA countries** | | |
| France | - | 8,094 |
| Ireland | - | 3,295 |
| Luxembourg | - | 241 |
| United Kingdom | 673,061 | 662,227 |
| | | |
| **Other countries** | | |
| British Virgin Islands | - | 1,118 |
| Cayman Islands | 6,097 | 16,954 |
| Djibouti | - | 1,133 |
| Guernsey | 15,491 | 12,927 |
| Jordan | 1,369 | - |
| Isle of Man | 16,234 | 15,540 |
| Jersey | 11,300 | 15,080 |
| South Korea | - | 1,240 |
| Switzerland | 866 | - |
| USA | 36,399 | 47,169 |
| **Total credit exposure** | **985,940** | **999,390** |

### iv. Exposure by economic sector

The Bank’s exposure to credit risk at balance sheet date were dispersed across the following economic sectors:

| **Bank** | **2017** | **2016** |
|---|---|---|
| | **£000** | **£000** |
| Financial services | | |
| GCC financial institutions | 141,042 | 126,773 |
| UK financial institutions | 124,387 | 159,777 |
| European financial institutions | - | 8,094 |
| Other financial institutions | 45,652 | 39,712 |
| Mining and quarrying | 4,146 | 5,413 |
| Manufacturing | 31,100 | 37,437 |
| Real estate | 295,181 | 290,195 |
| Transportation and storage | 38,447 | 83,839 |
| Government | 40,788 | 37,047 |
| Sharia'a compliant funds | - | 241 |
| Wholesale / Retail | 84,701 | 74,348 |
| Oil and Gas | - | 14,232 |
| Commodities | 66,886 | 54,974 |
| Energy | 14,072 | - |
| Construction | 45,151 | 26,935 |
| Others | 54,387 | 40,373 |
| **Total credit exposure** | **985,940** | **999,390** |

### v. Credit risk quality

The Bank’s credit quality and direct investments are managed by CCRC and the Assets and Liabilities Committee (ALCO) respectively, under the oversight of the Executive Committee and, in the case of CCRC under the oversight of BCC. Credit quality is assessed using techniques that include information from the major External Credit Assessment Institutions (ECAI) as well as internal ratings for customers who are not externally rated. The latter are mapped to the ratings of the ECAI. Of the total portfolio 24% (31 December 2016: 27%) was directly rated by at least one of the ECAI, with 76% (31 December 2016: 73%) using internal ratings.

For counterparties not rated by the major ECAI the Bank determine 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 rating is allocated.

## Bank

| At 31 December 2017 | Neither Past Due Nor Impaired | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | ECAI Rating | | BLME Internal Rating | | | | | |
| | Investment Grade | Sub-Investment Grade | Investment Grade equivalent | Sub-Investment Grade | Ungraded | Past due but not impaired | Individually Impaired | Total |
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| Cash and balances with banks | 94,931 | - | - | - | - | - | - | 94,931 |
| Due from financial institutions | 14,787 | - | 3,700 | 10,057 | - | - | - | 28,544 |
| Due from customers | - | - | 9,027 | - | - | - | - | 9,027 |
| **Investment securities** | | | | | | | | |
| **Available for sale** | | | | | | | | |
| Government debt securities | 31,713 | - | - | - | | - | - | 31,713 |
| Other Investment securities | 73,170 | - | - | 973 | 11,319 | - | - | 85,462 |
| **Investment Hold to Maturity (HTM)** | | | | | | | | |
| Government debt securities | 3,718 | 5,357 | - | - | | - | - | 9,075 |
| Other Investment securities | - | - | - | - | | - | - | - |
| Financing arrangements | 4,762 | - | 301,907 | 184,126 | 964 | 40,256 | 24,627 | 556,642 |
| Finance lease receivables | 10,157 | - | 63,856 | 75,975 | 4,461 | 479 | 15,618 | 170,546 |
| Other assets (Foreign exchange forward deals) | - | - | - | - | - | - | - | - |
| **Total credit exposure** | **233,238** | **5,357** | **378,490** | **271,131** | **16,744** | **40,735** | **40,245** | **985,940** |

## Bank

| At 31 December 2016 | Neither Past Due Nor Impaired | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | ECAI Rating | | BLME Internal Rating | | | | | |
| | Investment Grade | Sub-Investment Grade | Investment Grade equivalent | Sub-Investment Grade | Ungraded | Past due but not impaired | Individually Impaired | Total |
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| Cash and balances with banks | 68,560 | - | - | - | - | - | - | 68,560 |
| Due from financial institutions | 89,075 | - | 8,095 | 10,012 | - | - | - | 107,182 |
| Due from customers | - | - | - | - | - | - | - | - |
| **Investment securities** | | | | | | | | |
| **Available for sale** | | | | | | | | |
| Government debt securities | 21,095 | - | - | - | | - | - | 21,095 |
| Other Investment securities | 69,896 | - | - | 611 | 2,556 | - | - | 73,063 |
| **Investment Hold to Maturity (HTM)** | | | | | | | | |
| Government debt securities | 5,824 | - | - | - | | - | - | 5,824 |
| Other Investment securities | - | - | 12,178 | - | 262 | - | - | 12,440 |
| Financing arrangements | - | - | 177,004 | 224,150 | 4,493 | 23,758 | 45,232 | 474,637 |
| Finance lease receivables | 13,498 | - | 46,512 | 153,181 | 1,103 | 6,596 | 11,811 | 232,701 |
| Other assets (Foreign exchange forward deals) | - | - | 2,054 | 506 | 1,328 | - | - | 3,888 |
| **Total credit exposure** | **267,948** | **-** | **245,843** | **388,460** | **9,742** | **30,354** | **57,043** | **999,390** |

The Bank's cash balances, due from financial institutions and customers balances and investment securities were neither past due nor impaired as at 31 December 2017 and as at 31 December 2016.

**Analysis of past due amounts and impairments**

| Bank | Financing arrangements | | Finance Leases | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | £000 | £000 | £000 | £000 |
| Neither past due nor impaired | 501,318 | 411,975 | 157,639 | 221,286 |
| Past due but not impaired | 40,255 | 33,257 | 479 | 6,596 |
| Gross exposure associated with impairment provision | 24,627 | 45,232 | 15,618 | 11,811 |
| Less: allowance for impairments | (9,558) | (15,827) | (3,190) | (6,992) |
| **Total** | **556,642** | **474,637** | **170,546** | **232,701** |

| **Past due but not impaired** | **£000** | **£000** | **£000** | **£000** |
|---|---|---|---|---|
| Past due up to 30 days | - | 8,980 | 367 | 5,030 |
| Past due 30 to 60 days | 374 | 24,277 | 33 | 403 |
| Past due 60 to 90 days | 34,659 | - | 33 | 609 |
| Past due over 90 days | 5,222 | - | 46 | 554 |
| **Total** | **40,255** | **33,257** | **479** | **6,596** |

The past due but not impaired balances as at 31 December 2017 include £39.2 million (2016: £21.4 million) relating to two transactions (2016: four) where collateral value exceeds the facility balance. The Bank believes that impairment is not appropriate on the basis of the level of security or collateral available and/or the stage of collection of amounts owed to the Bank. An analysis of impairments is provided in Note 14 “Impairment of financial assets”.

Subsequent to 31 December 2017 £34.6 million out of £40.2 million of Financing arrangements past due but not impaired became current.

**Forbearance**

BLME assist customers in financial difficulty through modification of terms or agreements to accept less than contractual amounts due where financial distress could otherwise prevent satisfactory repayment. Such agreements may be initiated by the customer, but may be initiated by BLME or a third party.

Forbearance is considered to occur when, BLME, for reasons pertaining to the actual, imminent or perceived financial stress of a customer, allows, grants, or restructures facilities on terms that are outside of its current lending appetite when considered against the credit risk of the customer. To note, while guidance is provided by commercial guidelines, this does not necessarily mean that any granting of facilities that fall outside of these guidelines constitutes forbearance.

Forbearance would typically be evident where the concession(s) agreed impact the ability to repay debt or avoid recognising a default and risk mitigation/structural enhancement of benefit to the Bank in return for that concession.

A concession refers to either of the following actions:

- A modification of the previous terms and conditions of a contract, that the debtor is considered unable to comply with, due to its financial difficulties (“troubled debt”) in order to allow for sufficient debt serviceability that would not have been granted had the debtor not been in financial difficulty.
- A total or partial refinancing of a troubled debt contract that would not have been granted had the debtor not been in financial difficulty.

Evidence of a concession includes:

- A difference in favour of the debtor between the modified and the previous terms of the contract.
- Cases where a modified contract includes more favourable terms than other debtors with a similar risk profile could have obtained from the Bank.

The revised terms may include a reduction of current contractual profit rate or other fees, amending the terms of exposure covenants, extending the maturity and/or changing the timing of profit rate payments. All exposures are subject to the forbearance policy. The Bank's forbearance register is maintained by the Credit department and is subject to monthly oversight by the Bank's CCRC. The Audit Committee also reviews reports on forbearance activities.

Agreement to forbearance does not necessarily result in an impairment of that facility. All impairments will be individually assessed by the Credit Risk department and CCRC on a case-by-case basis.

The forbearance classification and reporting will be discontinued when all of the following conditions are met:

1) The contract is considered as performing after an analysis of the financial condition of the debtor showed it no longer met the conditions to be considered as non-performing.
2) A minimum 2 year probation period has passed from the date the forborne exposure was considered as performing.
3) Regular payments of more than an insignificant aggregate amount of principal and profit have been made during at least half of the probation period.
4) None of the exposure to the debtor is more than 30 days past due at the end of the probation period.

The exposure continues to be reported as forborne until such time as all of the conditions are met. The conditions are assessed on a monthly basis.

Based on the credit exposures existing as at 31 December 2017 there had been seventeen instances (2016: thirteen):

- 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; and/or
- where the Bank agreed to extend facilities beyond their contractual term outside of its normal credit criteria.

The carrying value as at 31 December 2017 of exposures relating to forborne counterparties with no specific impairment charge was £37.2 million, which represents 4% of the Bank's total assets (2016: £60.1 million and 6%).

- **Allowance for impairment**

The Bank 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 Banks 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 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**

The Bank monitors the market value of its collateral on an on-going basis which, dependent upon the collateral type, can vary from monthly to yearly. The Bank uses external valuers to perform independent valuations of assets. These valuations are reviewed and challenged by management and, where applicable, corroborated with internal estimations. In calculating collateral value, the Bank considers factors such as asset condition, market environment, ease of liquidation and the interdependency between the borrower and collateral.

Financial assets and non-financial assets obtained by the Bank by taking possession of collateral held as security against financing arrangements and finance leases and held at the year-end are shown below:

| **Assets obtained by taking possession of collateral** | **2017** | **2016** |
|---|---|---|
| | **£000** | **£000** |
| Murabaha | 8,125 | - |
| Real estate | - | 3,596 |
| **Total** | **8,125** | **3,596** |

The Murabaha collateral relates to a yatch that has been arrested by the receiver as at 31 December 2017. The real estate collateral balance reported above relates to a property that was under the appointment of an LPA receiver at 31 December 2016. In February 2017, the Bank concluded an exit having realised the collateral at a value that did not require further impairment charges.

In addition, the Bank holds financial guarantees of £107.6 million (2016: £60.9 million) against financing arrangements.

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** | **2017 On balance sheet exposure** | **2017 Collateral** | **2016 On balance sheet exposure** | **2016 Collateral** |
|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** |
| Cash and balances with banks | 94,931 | - | 68,560 | - |
| Due from financial institutions | 28,544 | - | 107,182 | - |
| Due from customers | 9,027 | - | | |
| Investment securities | 126,250 | - | 112,422 | - |
| Financing arrangements | 556,642 | 405,535 | 474,637 | 367,092 |
| Finance lease receivables | 170,546 | 131,339 | 232,701 | 226,514 |
| Other assets (Foreign exchange forward deals) | - | - | 3,888 | - |
| **Total credit exposure** | **985,940** | **536,874** | **999,390** | **593,606** |

As at 31 December 2017, collateral represented 55% (2016: 60%) of the Bank’s total credit exposure.

| **Bank analysis of collateral** | **2017** | **2016** |
|---|---|---|
| | **£000** | **£000** |
| Plant and equipment | 146,433 | 245,291 |
| Property | 246,173 | 234,222 |
| Raw materials/ finished stock | 144,268 | 114,093 |
| **Total credit exposure** | **536,874** | **593,606** |

As at 31 December 2017, 94% (2016: 94%) of the Bank’s property financing exposure had a financing-to-value ratio equal to or less than 70%.

### vii. Offsetting financial assets and liabilities

Whilst the Bank has entered into Master Agreements with counterparties that allow the Bank to obtain collateral which, if an event of default occurs, permits settlement of all outstanding transactions with each counterparty on a net basis; no such commercial arrangements have been transacted and accordingly there are no offsetting financial assets and liabilities which require disclosure.

**Financial asset and liabilities subject to offsetting, netting arrangements:**

| 2017 | Offsetting recognised on the Statement of Financial Position | | |
|---|---|---|---|
| | Gross Amount of financial instrument before offsetting | Amounts subject to an enforceable master netting agreement | Net Amount presented in statement of financial poistion |
| | £'000 | £'000 | £'000 |
| Profit Rate Swap (Asset) | 132 | (132) | - |
| Profit Rate Swap (Liabilities) | 768 | (132) | 636 |
| Foreign exchange forward deals (Asset) | 88 | (88) | - |
| Foreign exchange forward deals (Liabilities) | 1,070 | (88) | 982 |
| **2016** | | | |
| Profit Rate Swap (Asset) | - | - | - |
| Profit Rate Swap (Liabilities) | 1,305 | - | 1,305 |
| Foreign exchange forward deals (Asset) | 4,889 | (1,001) | 3,888 |
| Foreign exchange forward deals (Liabilities) | 1,001 | (1,001) | - |

### viii. Fair value of financial assets and liabilities

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

| Bank | | | 2017 | 2017 | 2016 | 2016 |
|---|---|---|---|---|---|---|
| | | Fair value hierarchy | Carrying value | Fair value | Carrying value | Fair value |
| | Note | | £000 | £000 | £000 | £000 |
| Cash and balances wih banks | | 1 | 94,931 | * | 68,560 | * |
| Due from financial institutions | i | 2 | 28,544 | 28,498 | 107,182 | 106,973 |
| Due from customers | i | 2 | 9,027 | 9,016 | | |
| Investment securities | ii, iii | See next table** | 126,250 | 126,250 | 112,422 | 112,161 |
| Financing arrangements | iii | 3 | 556,642 | 550,021 | 474,637 | 467,506 |
| Finance lease receivables | iii | 3 | 170,546 | 170,262 | 232,701 | 222,956 |
| Other assets (Foreign exchange forward deals) | iv | 2 | - | - | 3,888 | 3,888 |
| Due to financial institutions | iii | 3 | 514,392 | 511,278 | 586,964 | 581,181 |
| Profit rate swaps liability | ii | 2 | 636 | 636 | 1,305 | 1,305 |
| Due to customers | iii | 3 | 277,341 | 275,261 | 213,804 | 212,357 |
| Other liabilities (Foreign exchange forward deals) | iv | 2 | 982 | 982 | - | - |

*   the carrying amount of these financial assets and financial liabilities are representative of their fair values.
** Investment securities not included in the table below are held to maturity (HTM) security.

**Notes**

i. These assets represent short term liquidity; the majority of these assets have an average residual life of 2 weeks and a maximum individual residual maturity of 6 weeks. The assets are placed with banks with an average credit rating of A. On this basis, carrying value reflects fair value.

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

iii. For financial assets and financial liabilities measured at amortised cost, the fair value has been estimated by calculating the present value of future cash flows associated with each deal using a risk-adjusted discount rate, which is the unobservable input.

iv. For other assets and liabilities held at amortised cost, fair value is approximately equal to carrying value.

**Valuation of Financial Instruments**

Level 1: Valuation is based upon quoted market price in an active market for an identical instrument.
Level 2: Valuation techniques are primarily based upon observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
Level 3: Valuation techniques using significant unobservable inputs.

The Bank's fair value measurement techniques can be found in Note 3b.

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

| **Bank** | **2017 Level 1 £000** | **2017 Level 2 £000** | **2017 Level 3 £000** | **2017 Total £000** |
|---|---|---|---|---|
| Investment securities | 104,882 | - | 12,293 | 117,175 |
| Profit rate swaps liability | - | 636 | - | 636 |
| Foreign exchange forward deals (liabilities) | - | 982 | - | 982 |

| **Bank** | **2016 Level 1 £000** | **2016 Level 2 £000** | **2016 Level 3 £000** | **2016 Total £000** |
|---|---|---|---|---|
| Investment securities | 90,413 | 820 | 3,189 | 94,422 |
| Profit rate swaps liability | - | 1,305 | - | 1,305 |
| Foreign exchange forward deals (Assets) | - | 3,888 | - | 3,888 |

During the year, there were no transfers between Level 1 and Level 2 fair value measurements (2016: none) and no transfers into or out of Level 3 fair value measurements (2016: none). Transfers between levels occur at the date of the event or change in circumstances that caused the transfer.

The level 3 investment securities are valued by an independent professional firm of corporate finance and capital markets advisors who use a market approach to value the portfolio. Market value is determined by using prices and other relevant information generated by market transactions involving the individual security and/or identical or comparable securities.

There have been no changes to the methodologies used in valuing the level 2 and 3 assets (2016: none).
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.

| **Bank** | **2017** | **2016** |
|---|---|---|
| Investment securities | **£000** | **£000** |
| Balance at 1 January | 3,189 | 7,365 |
| | | |
| Total gains / (losses) recognised in: | | |
| - profit or loss* | (1,769) | (4,028) |
| - other comprehensive income** | (427) | 32 |
| | | |
| Purchases | 26,000 | - |
| Sales | (14,700) | (180) |
| | | |
| Balance at 31 December | **12,293** | **3,189** |

** this amount is included in "net fair value losses on investment securities" in the income statement*
*** this amount is included in "changes in fair value of available-for-sale financial assets taken to equity" in the statement of comprehensive income*

The reconciliation for investment securities is included in Note 17.

For the fair values of available-for-sale equity securities, reasonably possible changes at the reporting date to one of the significant unobservable inputs, holding the other inputs constant, would have the following effects:

| **Bank** | | | | **31 December 2017** |
|---|---|---|---|---|
| | **Income statement** | | **Other comprehensive income** | |
| | **Increase** | **Decrease** | **Increase** | **Decrease** |
| | **£000** | **£000** | **£000** | **£000** |
| Valuation adjustment +30% | - | - | 3,688 | - |
| Valuation adjustment -30% | - | (3,403) | - | (285) |

| **Bank** | | | | **31 December 2016** |
|---|---|---|---|---|
| | **Income statement** | | **Other comprehensive income** | |
| | **Increase** | **Decrease** | **Increase** | **Decrease** |
| | **£000** | **£000** | **£000** | **£000** |
| Valuation adjustment +30% | - | - | 951 | - |
| Valuation adjustment -30% | - | (239) | - | (712) |

### ix. Financial assets and liabilities

The following table details the carrying value by category of financial assets and liabilities as at 31 December 2017.

| Bank | 2017 Fair value through profit and loss | 2017 Designated at fair value through profit and loss upon initial recognition | 2017 Available-for-sale | 2017 Financial assets at amortised cost | 2017 Total |
|---|---|---|---|---|---|
| **Assets** | **£000** | **£000** | **£000** | **£000** | **£000** |
| Cash and balances with banks | - | - | - | 94,931 | 94,931 |
| Due from financial institutions | - | - | - | 28,544 | 28,544 |
| Due from customers | | | | 9,027 | 9,027 |
| Investment securities: | | | | | |
| Sukuk | - | - | 104,883 | 9,075 | 113,958 |
| Equity | - | - | 973 | - | 973 |
| Investment in subsidiaries | - | - | - | 11,319 | 11,319 |
| Financing arrangements | - | - | - | 556,642 | 556,642 |
| Finance lease receivables | - | - | - | 170,546 | 170,546 |
| **Total financial assets** | **-** | **-** | **105,856** | **880,084** | **985,940** |

| | Fair value through profit and loss | Other Profit Rate Swaps | Financial liabilities at amortised cost | 2017 Total |
|---|---|---|---|---|
| **Liabilities** | **£000** | **£000** | **£000** | **£000** |
| Due to financial institutions | - | - | 514,392 | 514,392 |
| Due to customers | - | - | 277,341 | 277,341 |
| Profit rate swaps | 636 | - | - | 636 |
| Other liabilities (Foreign exchange forward deals) | 982 | - | - | 982 |
| **Total financial liabilities** | **1,618** | **-** | **791,733** | **793,351** |

| Bank | 2016 Fair value through profit and loss | 2016 Designated at fair value through profit and loss upon initial recognition | 2016 Available-for-sale | 2016 Financial assets at amortised cost | 2016 Total |
|---|---|---|---|---|---|
| **Assets** | **£000** | **£000** | **£000** | **£000** | **£000** |
| Cash and balances with banks | - | - | - | 68,560 | 68,560 |
| Due from financial institutions | - | - | - | 107,182 | 107,182 |
| Investment securities: | | | | | |
| Sukuk | - | - | 90,970 | 18,000 | 108,970 |
| Unlisted sharia'a compliant funds | - | 242 | - | - | 242 |
| Equity | - | - | 3,189 | - | 3,189 |
| Investment in subsidiaries | - | - | - | 21 | 21 |
| Financing arrangements | - | - | - | 474,637 | 474,637 |
| Finance lease receivables | - | - | - | 232,701 | 232,701 |
| Other assets (Foreign exchange forward deals) | 3,888 | - | - | - | 3,888 |
| **Total financial assets** | **3,888** | **242** | **94,159** | **901,101** | **999,390** |

| | Fair value through profit and loss | Other Profit Rate Swaps | Financial liabilities at amortised cost | 2016 Total |
|---|---|---|---|---|
| **Liabilities** | **£000** | **£000** | **£000** | **£000** |
| Due to financial institutions | - | - | 586,964 | 586,964 |
| Due to customers | - | - | 213,804 | 213,804 |
| Profit rate swaps | 1,254 | 51 | - | 1,305 |
| **Total financial liabilities** | **1,254** | **51** | **800,768** | **802,073** |

### b. Liquidity risk

Liquidity risk is the risk that the Bank 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 Bank has sufficient liquidity to meet its liabilities when due.

The Treasury Division 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 and seeks to ensure that sufficient liquidity is maintained. The liquidity position is monitored on a daily basis in accordance with guidelines issued by ALCO and approved by Board Risk Committee. Overall, the management of liquidity risk is conducted in accordance with the Bank's Liquidity Risk Management Policy and its annual Individual Liquidity Adequacy Assessment Process (ILAAP), as required by the PRA. Included in the ILAAP is BLME's Contingency Funding Plan that details actions during a liquidity stress.

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 2017, the Bank held £765 million (2016: £777 million) of term deposits and held £0.9 million (2016: £2.0m)of secondary market assets.

**Residual contractual maturities of financial assets**

| Bank | Less than 1 month £000 | 1-3 months £000 | 3 - 12 months £000 | 1-5 years £000 | 5+ years £000 | 2017 Total £000 |
|---|---|---|---|---|---|---|
| Cash and balances with banks | 94,931 | - | - | - | - | 94,931 |
| Due from financial institutions | 18,489 | - | 10,090 | - | - | 28,579 |
| Due from Customers | 9,042 | - | - | - | - | 9,042 |
| Investment securities | 13,285 | 745 | 19,506 | 93,924 | 5,498 | 132,958 |
| Financing arrangements | 316,182 | 131,351 | 37,034 | 83,455 | - | 568,022 |
| Finance lease receivables | 12,941 | 16,151 | 52,524 | 95,615 | 6,547 | 183,778 |
| Other assets (Foreign exchange forward deals) | - | - | - | - | - | - |
| | **464,870** | **148,247** | **119,154** | **272,994** | **12,045** | **1,017,310** |

| Bank | Less than 1 month £000 | 1-3 months £000 | 3 - 12 months £000 | 1-5 years £000 | 5+ years £000 | 2016 Total £000 |
|---|---|---|---|---|---|---|
| Cash and balances with banks | 68,560 | - | - | - | - | 68,560 |
| Due from financial institutions | 68,845 | 28,388 | - | 10,090 | - | 107,323 |
| Investment securities | 3,603 | 496 | 1,560 | 109,006 | 6,455 | 121,120 |
| Financing arrangements | 304,394 | 63,355 | 70,651 | 81,028 | - | 519,428 |
| Finance lease receivables | 3,755 | 22,134 | 87,387 | 130,356 | 9,318 | 252,950 |
| Other assets (Foreign exchange forward deals) | 2,818 | 1,070 | - | - | - | 3,888 |
| | **451,975** | **115,443** | **159,598** | **330,480** | **15,773** | **1,073,269** |

The tables above show the contractual, undiscounted cash flows of the Bank's financial assets. The Bank are the senior lender in all of their lending exposures.

None of the Bank's assets have been pledged as collateral apart from cash collateral deposits of £0.5 million (2016: £0.5 million) as security against rental payments on the Bank's premises. Consequently, all of the Bank's assets are unencumbered.

**Residual contractual maturities of financial liabilities**

| **Bank** | **Less than 1 month £000** | **1-3 months £000** | **3 - 12 months £000** | **1-5 years £000** | **5+ years £** | **2017 Total £000** |
|---|---|---|---|---|---|---|
| Due to financial institutions | 138,025 | 143,186 | 236,654 | - | - | 517,865 |
| Due to customers | 31,712 | 10,662 | 130,261 | 114,816 | 1,808 | 289,259 |
| Profit rate swaps | - | - | - | 636 | - | 636 |
| Other liabilities (Foreign exchange forward deals) | 752 | 259 | (29) | - | - | 982 |
| | **170,489** | **154,107** | **366,886** | **115,452** | **1,808** | **808,742** |

| **Bank** | **Less than 1 month £000** | **1-3 months £000** | **3 - 12 months £000** | **1-5 years £000** | **5+ years £** | **2016 Total £000** |
|---|---|---|---|---|---|---|
| Due to financial institutions | - | 153,820 | 292,767 | 154,808 | - | 601,395 |
| Due to customers | 21,751 | 10,736 | 100,339 | 100,384 | 1,256 | 234,466 |
| Profit rate swaps | - | - | - | 1,305 | - | 1,305 |
| Other liabilities (Foreign exchange forward deals) | - | - | - | - | - | - |
| | **21,751** | **164,556** | **393,106** | **256,497** | **1,256** | **837,166** |

The tables above show the contractual, undiscounted cash flows of the Bank's financial liabilities apart from profit rate swaps which are showed using discounted cash flows.

Whilst BLME has sufficient assets in the short dated time buckets to cover its short dated liabilities as they become due, it also holds a significant Liquid Asset Buffer (in line with the PRA rules) of £91.1 million as at 31 December 2017 (2016: £89.7 million). These LAB holdings have been greater than the regulatory liquidity requirement throughout the year (unaudited).

The following table sets out components of the Bank's liquidity reserve:

| **Bank** | **2017 £000** | **2016 £000** |
|---|---|---|
| Cash and cash equivalents | 94,931 | 68,560 |
| Highly liquid securities (including LAB) | 104,882 | 90,413 |
| **Total** | **199,813** | **158,973** |

As at 31 December 2017, there are no limitations on the use of the liquidity reserve held by the Bank (2016: none).

## c. Market risk

Market risk is the risk that changes in market prices will affect income. It covers profit rate risk, credit spread risk, equity price risk and foreign exchange risk. The credit spread risk only pertains to the part that is not related to the issuer’s / obligor’s credit standing as that part is already covered in credit risk. In accordance with the Bank’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 foreign exchange 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 Bank 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 2017, the Bank’s net profit rate sensitivity to profit and loss on its fixed and variable rate assets as measured by the discounted value of a one basis point change in market rates, was £7,951 (2016: £24,853 ). The impact of an increase / decrease of 100 basis points in profit rates at the statement of financial position date, subject to a minimum rate of 0%, would be as follows:

| | **At 31 December 2017** | | **At 31 December 2016** | |
|---|---|---|---|---|
| | **Increase of 100 bp £000** | **Decrease of 100 bp £000** | **Increase of 100 bp £000** | **Decrease of 100 bp £000** |
| Increase in profit & loss | 4,153 | - | 4,575 | - |
| Decrease in profit & loss | - | 3,761 | - | 5,228 |
| Increase in equity | 3,983 | - | 3,160 | - |
| Decrease in equity | - | 3,579 | - | 3,739 |

### ii. Foreign exchange risk

Foreign exchange risk is the risk that the value of 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.

| | At 31 December 2017<br>£000 | At 31 December 2016<br>£000 |
|---|---|---|
| Resultant foreign exchange revaluation gain from a 10% strengthening or weakening of the net foreign currency positions against Sterling | 30 | 68 |

| | Year to 31 December 2017<br>£000 | Year to 31 December 2016<br>£000 |
|---|---|---|
| Net foreign exchange gain / (loss) for the period | 1,746 | 756 |

### iii. Equity price risk

Equity prices are monitored by the Bank's Assets and Liabilities Committee, but the sensitivity risk is not currently significant in relation to the overall results and financial position of the Bank.

## d. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The responsibility for the operating framework for risk governance rests with the Board. This extends to determining risk appetite in line with the Bank's strategy 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 Operational Risk Framework is built around the three lines of defence model. This Framework has been approved and is periodically reviewed by the Board through the Board Risk Committee.

Senior Management ensures the identification and assessment of operational risk through a Risk and Control Self-Assessment ("RCSA") process. Technology risk (including CyberSecurity and Information Risk) surrounding core banking systems is perceived to be the area of risk that concerns most business areas and is compounded by a high inherent End User Computing risk. Operational risk events are reported through a centralised risk management system accessible to all staff; the resolution of an event is monitored by a network of operational risk 'champions' located within each business unit and support function.

Basel III requires capital to be retained for operational risk, which the Bank has calculated to be £7.0 million using the Basic Indicator Approach (2016: £6.9 million) (unaudited).

## e. Capital adequacy

At 31 December 2017 and throughout the year the Bank complied with the capital requirements that were in force as set out by the Prudential Regulation Authority ("the PRA") (unaudited). The PRA adopted the Basel III requirements with effect from 1 January 2014.

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

| | 2017 | 2016 |
|---|---|---|
| **Audited** | **£000** | **£000** |
| **Tier 1 Capital - CET1** | | |
| Ordinary share capital | 48,933 | 48,933 |
| Share premium | 180,623 | 180,623 |
| Retained (losses) / earnings | (10,566) | (14,033) |
| **Total Tier 1 capital** | **218,990** | **215,523** |
| | | |
| **Unaudited** | | |
| **Deductions from Tier 1 capital** | | |
| Intangible assets | (837) | (1,708) |
| Others | 1,640 | 847 |
| **Total Tier 1 capital after deductions** | **219,793** | **214,662** |
| | | |
| **Tier 2 capital** | 3,915 | 4,398 |
| **Total Tier 2 capital** | **3,915** | **4,398** |
| | | |
| **Total Tier 1 and Tier 2 capital** | **223,708** | **219,060** |
| | | |
| **Deductions from Tier 1 and Tier 2 capital:** | | |
| Investment in BLME Sharia'a Umbrella Fund SICAV SIF | - | - |
| Investment in DMJ II LLC | - | - |
| Investment in group companies | - | - |
| | | |
| **Total regulatory capital** | **223,708** | **219,060** |

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

Under the capital adequacy rules applicable from 1 January 2008, the Bank 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 CCR.

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

| | 2017 £000 (unaudited) | 2016 £000 (unaudited) |
|---|---|---|
| **Pillar 1 capital requirements** | | |
| Credit risk | 75,456 | 76,759 |
| Market risk - foreign currency PRR | 110 | 596 |
| Counterparty risk capital component | 13 | 74 |
| Operational risk | 7,018 | 6,993 |
| **Total Pillar 1 capital requirement** | **82,597** | **84,422** |
| | | |
| **Total regulatory capital in place** | **223,708** | **219,060** |

The Bank 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 Bank which do not explicitly attract a capital requirement under the Pillar 1 rules. The Bank allocates additional capital for these Pillar 2 risks ("the Pillar 2 capital requirement"). The total capital requirement of the Bank is determined as the sum of the Pillar 1 and the Pillar 2 capital requirements.

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

The Bank 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 Bank'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 .

The Bank will continue to prudently employ capital and maintain appropriate capital adequacy, liquidity and leverage ratios. BLME reported to the PRA ratios above the minimum requirement throughout 2017. The capital planning process continues to incorporate these measures.

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