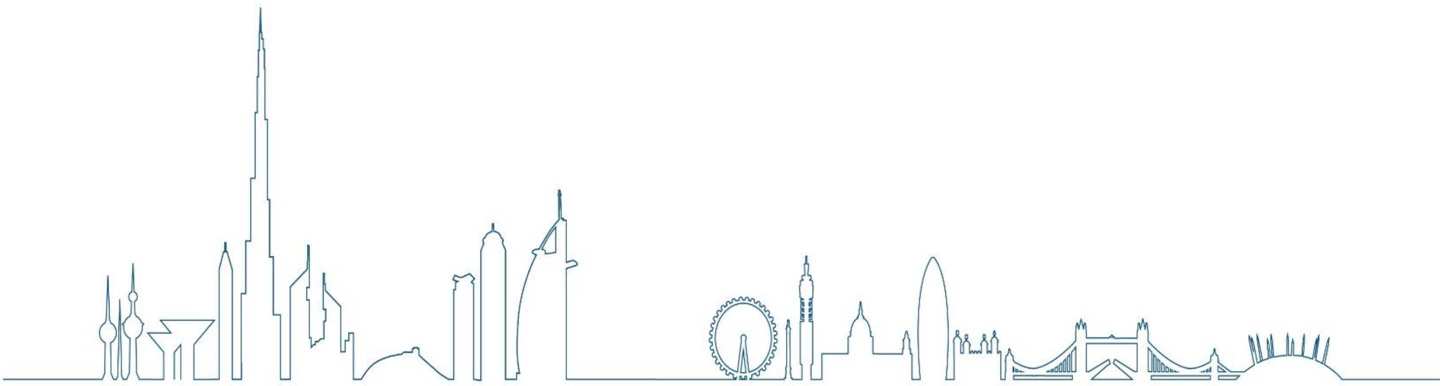
Bank of London and The Middle East plc
Annual Report and Financial Statements
For the year ended 31 December 2018

Registered number 05897786



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STRATEGIC REPORT

THE BUSINESS MODEL

The Bank of London and The Middle East plc ("BLME") is one of the largest wholly Islamic banks in Europe. BLME aims to become the leading UK provider of Wealth Management solutions to GCC nationals, complemented by market leading Real Estate, Lease Finance and Trade Finance offerings. BLME operates under the ethical principles of Islamic finance.

The Bank is authorised by the Prudential Regulatory Authority (PRA) and regulated by the PRA and the Financial Conduct Authority (FCA).

The Bank operates in three strategic divisions:

Wealth Management

BLME Private Banking leverages our Real Estate and Leasing capabilities to provide a range of solutions that meet the requirements of our High Net Worth Clients.

During 2018 the focus was on growing our client base and developing products in line with their requirements and investment appetite. As a result we have launched additional products including mortgages and a Premium Wakala. Our distribution capabilities have improved with the Dubai International Financial Centre office now a fully operational branch, providing the perfect base to connect with our clients in the GCC and MENA region.

Real Estate remains the asset class of choice for GCC Wealth Management clients and we have successfully executed two landmark transactions. In 2017 we acquired the B&Q building in Castleford which was sold down to our clients during 2018, we also acquired the £55m Atlantic Quay 1 (AQ1) building in Glasgow. Being primarily let to the UK government, AQ1 has been of particular interest to our clients.

The focus for 2019 is to identify suitable investment opportunities to deploy the bank's capital and also to expand the investment offering to include client mandates. A priority for Wealth Management is to generate more fee income.

Real Estate Finance continues to provide finance to small and medium sized Real Estate developers, investors and High Net Worth Individuals looking to invest in UK property across all sectors. We have rebalanced the portfolio and diversified across the UK. Our Real Estate Finance business has strong links to our GCC clients.

Commercial Finance

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

Leasing is a successful area of the Bank and is central to our Commercial Finance offering. Our team has an excellent reputation within the market, particularly in the northern UK region where our Manchester team has grown the wholesale finance aspect.

Over the past year we have grown Trade Finance and have added to our product offering. Late 2018 BLME launched Sharia'a compliant Corporate Trade Finance with the ultimate aim of diversifying the portfolio over the next few years.

Corporate Trade Finance focusses on supply chain financing, self-liquidating transactions for international companies and selected opportunities in the GCC.

Commodity Trade Finance also provides FX facilities to clients and hold cash balances on accounts of over US$10m across the portfolio. During 2019 Commodity Trade Finance will continue to manage and develop the current client base while selectively introducing new names and conservatively growing the portfolio.

Liabilities and Deposits

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.

A priority for Treasury is to continue to diversify our source of funding. With this in mind the minimum deposit amount for the Premier Deposit Account has been reduced from £10,000 to £1,000. The Bank has seen the benefits of the increased efficiency and improved customer experience in digitalising our successful savings products.

STRATEGY AND OBJECTIVES

The Bank has made good progress in the Wealth Management focussed strategy. The Bank has made improvements to our products and services and invested in our team in Dubai to establish our presence in the DIFC. This is positive progress which needs to continue as the Bank builds on its foundations.

The agreement with Al Baraka is a priority and solid start to our aim of becoming the UK partner of choice for GCC nationals. The agreement gives BLME the opportunity to provide targeted Al Baraka clients with investment opportunities in UK real estate and other UK sectors. Our strong relationship with Boubyan bank has provided us with much success in this area.

We are proud of our efforts in turning the Bank around having achieved profits for the second consecutive year. This is not something we take for granted and we continue to monitor and manage costs closely. We want to create sustainable returns for our shareholders.

As a customer centric bank we engage with our clients to ensure that we deliver a service in line with their standards. In 2018 we completed our first ever customer survey of our Leasing and Real Estate clients and the feedback was generally positive. Where improvements were identified we have taken steps to address them for example redesigning and improving all client facing application forms across the Bank.

BLME works hard to align our core values with our strategic objectives to ensure that our employees operate in accordance with our conservative risk appetite. Central to our values, we take measures to ensure that we are operating in accordance with Sharia'a, as a result we liaise with our Sharia'a Supervisory Board regularly.

FINANCIAL RESULTS

The financial statements for the year ended 31 December 2018 are shown on pages 20 to 25. The profit after tax for the year amounted to £10.7 million (2017: £3.5 million). Below are the highlights of the financial performance and the position as at 31 December 2018.

Key performance indicators	**2018**	**2017**
Post-tax return on equity	4.7%	1.6%
Cost income ratio	71%	98.1%
Net fee income / total income	4.8%	3.9%

Non-performing Financing Assets to overall Financial Assets	2.2%	5.5%
Number of depositors	4,857	3,204

BANK NON-FINANCIAL INFORMATION STATEMENT

BLME Employee Engagement

BLME is committed to being a great place to work. We take employee feedback very seriously, more importantly we ensure that our employees have a formal forum to share their views via an annual staff engagement survey. This annual survey is in addition to the monthly bank wide Question and Answer sessions and a half yearly 'pulse' survey.

As a result of some of the feedback we have initiated a CSR programme, created a 'Bite Size' series where employees can learn about the different functions of the bank and have introduced regular training programmes. An important part of the training programme has been the Islamic Finance Qualification which the Bank encourages all employees to take.

The Environment

BLME Corporate Social Responsibility includes our commitment to the environment. We take this into account when selecting our suppliers and try to ensure that our environmental impact is reduced or limited. For example, providing extensive recycling facilities in our offices and introducing a Cycle to Work Scheme to support our staff in making their commute healthier and greener.

Our head office has a 'Very Good' BREEAM (Building Research Establishment Environmental Assessment Method) Rating. We comply with the recycling methods instituted by the Cannon Place office and have also partnered with a company to recycle our coffee waste.

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 business continuity policy. We provide a range of benefits which include private medical insurance and a gym membership.

In 2018 we successfully launched an employee wellbeing programme and are in partnership with a leading healthcare provider for all employees to have an annual health assessment. Our employees also have access to a 'Wellbeing hub' which provides advice on healthy living, a counselling service and cognitive behavioural therapy.

Financial Crime and Anti-Corruption and Anti-Bribery

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.

All BLME staff including Board members receive annual training on anti-corruption and anti-bribery matters. BLME's core financial crime policies are the Anti-Bribery and Corruption Policy, the Fraud Prevention Policy and Anti-Money Laundering, Counter Terrorism Financing and Sanctions Policy.

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 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 36.

FUTURE

2018 has been a successful year for BLME. The Bank has been able to deliver the best results in its history. This year we will work even harder to ensure that our strategy remains successful and despite the economic and political strains, it is encouraging to see that our strategy is delivering.

We have a strong team that is 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 2018. 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 2019

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 2018.

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. The Dubai International Financial Centre (DIFC) branch became fully operational during 2018 and the growing team are now actively building our brand in the region. 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 29. The results for the year are discussed further in the Bank's strategic report.

Financial results and dividends

The financial statements for the year ended 31 December 2018 are shown on pages 20 to 25. The Bank's profit for the year after taxation amounts to £10.7 million (2017: £3.5 million). An interim dividend of £3.75 million, representing 1.91586 pence per share, was declared and paid from BLME to BLME Holdings plc on 19 December 2018 (2017: £Nil). The results for the year are discussed further in the Bank's strategic report. In addition, a dividend of £5.4m, representing 2.75885 pence per share, was declared and paid from BLME to BLME Holdings plc on 31 January 2019.

During the year, the Bank acquired a portfolio of existing leases with receivables from a third party UK lessor, specialising in writing small ticket leases to a variety of counterparty types including: schools, SMEs, government bodies. The underlying assets are mostly hard assets, in particular cars and commercial vehicles.

The acquisition of the Atlantic Quay One, an office building in Glasgow, 86% let to Government, was completed In October 2018 for a consideration of £54.75m. The Bank initially owned 100% of the equity of AQ1 Limited, the Jersey company which is financing the transaction. The Bank sold down part of its investment prior to the year end resulting in a remaining equity investment of 56%.

Directors

The Directors who held office during the year, and their Committee memberships and functions as at 31 December 2018, were as follows:

Name and Board/Committee Chairmanships (as at 31 December 2018)	**Date of Appointment**	**Date of Resignation**	**Board Committee Memberships** (as at 31 December 2018)
Adel Abdul Wahab Al-Majed *Chairman of the Board*	6 December 2012		
Sheikh Abdullah Jaber Al-Ahmed Al-Sabah *Vice Chairman of the Board*	22 October 2007		Audit Risk Remuneration
Giles Cunningham *Chief Executive Officer*	17 November 2016		Executive Credit
Chris Power *Chief Financial Officer*	26 September 2016		Executive
Michael Williams (Senior Independent Director) *Chairman of the Nominations Committee*	2 March 2012		Nominations Remuneration Risk

			Credit
Joanne Hindle (Independent) *Chairman of the Remuneration Committee*	1 July 2018		Nominations Remuneration Audit Risk Credit
Calum Thomson (Independent) *Chairman of the Audit Committee*	1 April 2017		Audit Risk Nominations Remuneration Credit
David Williams (Independent) *Chairman of the Board Risk Committee*	15 October 2015		Nominations Remuneration Risk Credit
Jabra Ghandour	25 March 2016		Credit
Neil Holden (Independent)	26 April 2013	14 May 2018	N/A

In accordance with the Articles of Association Giles Cunningham, Chris Power and Calum Thomson will retire and offer themselves up for rotation at the next Annual General Meeting. They will offer themselves for re-appointment at the next Annual General Meeting in 2019.

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

Reduction of Share Premium Account of BLME

On 25 September 2018 BLME reduced its Share Premium Account by £40 million by way of a Special Resolution confirmed by an Order of the High Court of Justice, Chancery Division ("the Reduction"). The resulting accounting entries were to debit the Share Premium account and credit Retained Earnings. There was no net reduction in equity or regulatory capital. The purpose of the Reduction was to create positive distributable reserves to enable BLME to pay dividends up to BLME Holdings plc. Accordingly, on 19 December 2018 a dividend of £3.75 million, representing 1.91586 pence per share was paid to BLME Holdings plc in order to facilitate a Share Repurchase Programme by BLME Holdings plc.

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 (Trading Book and Banking Book)
- Operational risk (including conduct and cyber risk)

- Capital risk

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

We continue to closely monitor and manage our positions in light of the ongoing Brexit negotiations to ensure we continue to maintain a strong capital and liquidity position. Certain foreign exchange hedges have also been entered into to help mitigate FX risk arising from any potential sterling volatility. 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 (2017: £nil).

Future developments

The business strategy and prospects for future financial years are included in the Strategic Report on pages 3 to 6. The material business risks are set out in Note 33 Financial Risk Management from page 71.

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 or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that the Bank's Auditor is aware of that information.

Auditor

A resolution concerning the re-appointment of Ernst & Young LLP as auditors 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 2019

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 through its offices in England and in the Dubai International Financial Centre 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 through its offices in England and in the Dubai International Financial Centre during the period 1 January 2018 to 31 December 2018 and have reviewed the BLME Annual Report and Accounts for the year ended 31 December 2018. 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 through its offices in England and in the Dubai International Financial Centre during the year 1 January 2018 to 31 December 2018 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 profits generated by BLME during the year 1 January 2018 to 31 December 2018 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 2018 to 31 December 2018 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 2019

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 2018 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 34, 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 2018 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.

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 recognition of income • Adequacy and appropriateness of the allowance for expected credit losses
Audit scope	• We performed an audit of the complete financial information of the Bank.
Materiality	• Materiality of £2.3 million which represents 1% of net assets

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the 2018 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.

The key audit matter *Adequacy and appropriateness of the allowance for expected credit losses* has been updated since last year to reflect the move from an incurred loss model under IAS 39 to an expected credit loss model under IFRS 9.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Improper revenue recognition **Income from financing and investing activities: £48.7 million (2017: £39.7 million).** **Income from fees and commissions: £1.9 million (2017 £1.3 million).** *Refer to the Accounting policies (page 35); and Note 5 of the Financial Statements* The key risks of improper recognition of income arises from: (i) Income recorded from financing and investing activities might not be complete and accurate, and (ii) Fees and commissions can require judgment as to the amount and timing of recognition. The risk has neither increased nor decreased in the current year.	Our approach focussed on: • 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. • Performing analytical procedures to identify trends and corroborating movements not in line with our expectations. • 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. We increased our standard sample size for transactional testing to correspond to the increased risk in this area. • Agreeing, on a sample basis, transactions to supporting transaction documentation and cash receipts for fees and commissions, challenging any judgment made over the timing of the amount recognised. We increased our standard sample size for transactional testing to correspond to the increased risk in this area. • Performing year end cut-off testing to ensure that revenue was recognised in the correct period. • Checking to supporting evidence any adjustments to the accounting records that we have identified that have characteristics that could indicate unusual or inappropriate adjustments. • Assessing the appropriateness of the revenue recognition accounting policies adopted including in relation to the new Accounting Standards.	As a result of the procedures performed, we did not identify any evidence of material misstatement in the recognition of revenue.

Adequacy and appropriateness of the allowance for expected credit losses **Financing arrangements** **2018: £700.9 million** *(under IFRS 9 – ECL provision £10.3 million)* **2017: £556.6 million** *(under IAS 39 - specific provision £9.6 million, collective provision £1.7 million)* **Finance lease receivables** **2018: £256.5 million** *(under IFRS 9 – ECL Provision £4.4 million)* **2017: £170.5 million** *(under IAS 39 - specific provision £3.2 million, collective provision £1.5 million)* **Off balance sheet exposures £137 million** *(under IFRS 9 – ECL Provision £0.2 million)* **2017: £135 million** *(under IAS 39 collective and specific provision - NIL)* *Refer to the Accounting policies (page 28); and Note 14 of the Financial Statements (page 54)* IFRS 9 *Financial Instruments* became effective on 1 January 2018. The implementation of IFRS 9 resulted in substantial changes to three aspects of the Bank's financial reporting: classification and measurement, allowance for expected credit losses, and associated disclosures. With respect to allowances for expected credit losses, the adoption of IFRS 9 has fundamentally changed the Bank's accounting for credit impairments by replacing IAS 39's incurred loss approach with a forward looking expected credit loss ("ECL") approach. ECL applies for all financial assets that are held at	Our approach focused on: • Assessing the design and testing the operating effectiveness of controls within relevant processes focusing on model governance, transition to IFRS 9, the classification at initial recognition of financial assets or liabilities, off balance sheet exposures and ECL. After our assessment we adopted a substantive audit approach for the model; • Checking the Bank's classification and measurement policy and allowance for expected credit losses policy; • Testing the data flow of the underlying records of the Bank's input into the ECL model for completeness and accuracy; • With assistance of EY model specialists assessing the ECL model used to calculate ECL for stages 1 and 2. This included analysing how the model is implemented, the governance over the model, and the approach taken by the Bank to monitor inputs and outputs. EY model specialists also checked whether forward-looking macroeconomic indicators are taken into account in the calculation of probability of default and loss given default; • Performing credit file reviews of a sample of financing arrangements allocated as stages 1 and 2 to determine the reasonableness of the staging allocation and to seek to identify any significant increase in credit risk or indicators of impairment not identified by the Bank. We increased our standard sample size to respond to the increased risk in this area; • For all assets in stage 3, testing the individual impairment and the evidence supporting the assumptions made by the Bank by forming an independent view, using our valuation specialists, of collateral or exit values, cash flow assumptions and exit strategies; • Reviewing the credit files, arrears report, exposures on the watch list, and, where appropriate, collateral arrangements and valuations, as well as publicly available information that we judge to be relevant, in order to assess the appropriateness and adequacy of the allowances for expected credit	As a result of the procedures performed, we are satisfied that financial instruments are classified and measured in accordance with IFRS 9, that the Bank's judgements are reasonable and the allowance for expected credit losses is fairly stated as at 31 December 2018. Further we conclude the disclosures materially capture the requirements of IFRS 9.

amortised cost. We focussed our testing financing arrangements, finance lease receivables and off-balance sheet exposures as these are the areas containing greater subjectivity and risk. ECL represents management's best estimate of the losses that will occur on the existing exposures at a future date. Given the subjective nature of the calculation of ECL there is heightened risk that the timing and extent of these allowances could be subject to error or to management override. Finally, given the extensive new disclosure requirements, there is a risk that the disclosures in the financial statements are inaccurate or incomplete. The risk has increased in 2018 due to it being the first year of IFRS 9 adoption.	losses, focusing on areas where significant estimation is involved. To respond to the risk in this area we lowered our testing threshold for items on the watchlist; • Checking the opening balance sheet adjustment for first time adoption of IFRS 9 by reperforming underlying calculations; and • Assessing the adequacy and appropriateness of disclosures for compliance with IFRSs including disclosure of transition from IAS 39.	

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 and other factors such as recent internal audit results when assessing the level of work to be performed. All audit work was performed 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 identified misstatements 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 Bank to be £2.3m (£2017: £2.2m), which is 1% of net assets (2017: 1% of net assets). 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, amounting to £1.8million (2017: £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 £0.1million, 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 evaluate 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 the 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 the 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 11, 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.

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.

Other matters we are required to address

- We were appointed by the Bank on 19 May 2017 to audit the financial statements for the year ending 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement is two years, covering the years ending 31 December 2017 to 31 December 2018.

- 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 Ernst & Young LLP, Statutory Auditor
London
20 March 2019

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 2018 to 31 December 2018

	Note	2018 £000	2017 £000
Income			
Income from financing and investing activities	*5a*	48,725	39,650
Returns to financial institutions and customers	*6*	(17,551)	(16,285)
Net margin		**31,174**	**23,365**
Fee and commission income	*5b*	2,360	1,816
Fee and commission expense		(417)	(494)
Net fee and commission income		**1,943**	**1,322**
Net investment losses	*7*	(256)	(2,330)
Credit impairment (losses) / gains	*14*	(2,030)	2,734
Operating lease income		7,733	5,312
Other operating income	*8*	2,093	6,580
Net operating income		**40,657**	**36,983**
Expenses			
Personnel expenses	*10*	(15,827)	(15,239)
Operating lease depreciation	*21*	(6,027)	(4,318)
Other depreciation and amortisation	*20, 22*	(1,069)	(1,515)
Other operating expenses	*12*	(10,015)	(12,549)
Total operating expenses		**(32,938)**	**(33,621)**
Profit before tax		**7,719**	**3,362**
Tax credit	*15*	2,954	105
Profit for the year		**10,673**	**3,467**

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

The notes on pages 26 to 94 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year 1 January 2018 to 31 December 2018

	Note	2018 £000	2017 £000
Income			
Profit for the year		10,673	3,467
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss if specific conditions are met:			
Fair value reserve recycled to the income statement		-	507
Net losses in fair value of FVOCI debt instruments		(70)	-
Net losses in fair value of available-for-sale financial assets taken to equity		-	(451)
Income tax credit / (expense) on other comprehensive income	*15*	135	(105)
		65	**(49)**
Items that will not be reclassified subsequently to profit or loss:			
Net gains in fair value of FVOCI equity instruments		426	-
Other comprehensive expense for the year net of income tax		**426**	**-**
Total comprehensive income for the year attributable to equity holders of the Company		**11,164**	**3,418**

The notes on pages 26 to 94 are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Note	2018 £000	2017 £000
Assets			
Cash and balances with banks		103,585	94,931
Due from financial institutions	16	8,045	28,544
Due from customers	16	14,612	9,027
Investment securities	17	135,043	126,250
Financing arrangements	18	700,949	556,642
Finance lease receivables	19	256,458	170,546
Operating lease assets	21	43,242	34,205
Profit rate swaps	9	73	-
Property and equipment	20	488	986
Intangible assets	22	266	837
Other assets	23	6,671	3,920
Deferred tax asset	15	3,514	-
Total assets		**1,272,946**	**1,025,888**
Liabilities			
Due to financial institutions	24	672,240	514,392
Due to customers	25	357,427	277,341
Profit rate swaps	9	469	636
Other liabilities	26	14,246	12,998
Current tax liability		438	-
Total liabilities		**1,044,820**	**805,367**
Equity			
Share capital	29	48,933	48,933
Share premium	29	140,623	180,623
Capital contribution	30	2,207	1,911
Fair value reserve		(713)	(380)
Retained earnings / (losses)		37,076	(10,566)
Total equity attributable to equity holders of the Bank		**228,126**	**220,521**
Total liabilities and equity		**1,272,946**	**1,025,888**

These financial statements were approved by the Board of Directors on 20 March 2019 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 26 to 94 are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year 1 January 2018 to 31 December 2018

	2018	2017
Cash flows from operating activities	**£000**	**£000**
Profit before tax	7,719	3,362
Adjusted for:		
Exchange differences	(173)	(1,745)
Fair value loss on investment securities	252	2,359
Provision for impairment	2,030	(2,734)
Depreciation and amortisation	7,097	5,833
Share-based payment awards	293	307
Mark-to-market movement in profit rate swaps	363	114
Amortisation of fair value reserve	-	26
	17,581	**7,522**
Net decrease / (increase) in operating assets:		
Due from financial institutions	21,288	77,139
Due from customers	(5,585)	(9,027)
Financing arrangements	(150,426)	(75,068)
Finance lease receivables	(86,255)	65,383
Operating lease assets	(15,065)	(16,439)
Other assets	(2,746)	4,138
	(238,789)	**46,126**
Net increase / (decrease) in operating liabilities:		
Due to financial institutions	152,563	(67,650)
Due to customers	80,168	63,683
Other liabilities	6,808	1,190
	239,539	**(2,777)**
Corporation tax paid	(113)	-
Net cash inflow/(outflow) from operating activities	**18,218**	**50,871**
Cashflow from investing activities		
Purchase of property and equipment	-	(7)
Purchase of intangible assets	-	(118)
Purchase of investments	(33,753)	(89,021)
Sale of investments	29,790	62,565
Net cash inflow/(outflow) from investing activities	**(3,963)**	**(26,581)**
Cash flows from financing activities		
Dividend paid to BLME Holdings plc	(3,750)	-
Net cash inflow from financing activities	**(3,750)**	**-**
Net change in cash and cash equivalents	**10,505**	**24,290**
Cash and cash equivalents at the beginning of the period	94,931	68,560
Exchange differences in respect of cash and cash equivalents	(1,851)	2,081
Cash and cash equivalents at the end of the period	**103,585**	**94,931**

The notes on pages 26 to 94 are an integral part of these financial statements.

BANK STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Share capital	Share premium	Capital contribution	Fair value reserve	Retained earnings / (losses)	Total
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Balance at 31 December 2017	48,933	180,623	1,911	(380)	(10,566)	220,521
Changes on initial application of IFRS 9	-	-	-	-	25	25
Restated balance at 1 January 2018	**48,933**	**180,623**	**1,911**	**(380)**	**(10,541)**	**220,546**
Profit for the year	**-**	**-**	**-**	**-**	**10,673**	**10,673**
Other comprehensive income /(expense)						
Foreign currency translation	-	-	-	-	-	-
Fair value reserve recyled through income statement	-	-	-	-	-	-
Net change in fair value of equity/debt instruments at FVOCI	-	-	-	356	-	356
Tax on items transferred directly to equity	-	-	-	135	-	135
Total other comprehensive expense	**-**	**-**	**-**	**491**	**-**	**491**
Total comprehensive income/(expense) for the year	**-**	**-**	**-**	**491**	**10,673**	**11,164**
Contributions by and distributions to owners						
Court approved reduction of the Share Premium account	-	(40,000)	-	-	40,000	-
Dividends to Parent company	-	-	-	-	(3,750)	(3,750)
Sale of equity instrument at FVOCI	-	-	-	(824)	824	-
Equity-settled share-based payment awards	-	-	266	-	27	293
Tax on items transferred directly to equity	-	-	30	-	(157)	(127)
Total transactions with owners	**-**	**(40,000)**	**296**	**(824)**	**36,944**	**(3,584)**
Balance at 31 December 2018	**48,933**	**140,623**	**2,207**	**(713)**	**37,076**	**228,126**

FVOCI – Fair value through other comprehensive income

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.

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 was recognised as a Capital contribution in 2013**.**

The transfer to retained earnings of £27k represents the recycling of credits previously recognised within the Share Based Payment Reserve in relation to DABS options which have lapsed and/or forfeited.

The notes on pages 26 to 94 are an integral part of these financial statements.

BANK STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2017	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 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**

The notes on pages 26 to 94 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, England, 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 2018.

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

a. Presentation of financial statements

The Bank has prepared its financial statements in accordance with IFRS as adopted by the EU and effective for the Bank's reporting for the year ended 31 December 2018.

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 cover impairment losses on financial assets, fair value measurement, effective profit rate adjustments and deferred taxes. Refer to Note 3 for further detail. The adoption of IFRS 9 requires consideration of a number of key assumptions. Refer to section d – changes in accounting policies and disclosures for further information.

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. Changes in accounting policies and disclosures

New and amended standards and interpretations

The Bank applied IFRS 15 and IFRS 9 with effect from 1 January 2018. The nature and impact of the changes as a result of adoption of these new accounting standards are described below.

Several other amendments and interpretations apply for the first time in 2018, but do not have an impact on the financial statements of the Bank. The Bank has not early adopted any standards, interpretations or amendments that have been issued, but are not yet effective.

IFRS 15 *Revenue from Contracts with Customers*

In these audited financial statements for the year ended 31 December 2018, the Bank has adopted the requirements of IFRS 15 for the first time. The Bank 's revenue streams are predominantly not within the scope of IFRS 15 as they are within the scope of IFRS 9 *Financial Instruments* or IAS 17 *Leases*. Notwithstanding, there are certain arrangements that fall within the scope of IFRS 15. It was determined, however, that a retrospective financial adjustment to retained earnings as of 1 January 2018 is not necessary as the Bank's corresponding accounting policies are compliant with the principles of IFRS 15.

IFRS 9 *Financial Instruments*

In these audited financial statements for the year ended 31 December 2018, the Bank has adopted the requirements of IFRS 9 for the first time. The Bank elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39.

The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. The accounting policies complying with IAS 39 can be found in the Financial Statements for the year ended 31 December 2017. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in section vii IFRS 9 Transition Disclosures below.

i) IFRS 9 *Financial Instruments* measurement categories of financial assets and liabilities

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and its contractual terms, and measure them using one of the following categories which we described in section iv below:

- Amortised cost (AC),
- Fair value through other comprehensive income (FVOCI), and
- Fair value through profit and loss (FVPL).

ii) Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;

- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected); and
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

iii) The Solely Payments of Principal and Yield (SPPY) test

As a second step of its classification process the Bank assesses the contractual terms of financial assets to identify whether they meet the SPPY test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are payments of principal or amortisation of the premium/discount).

The most significant elements of the yield from a financing arrangement are typically the consideration for the time value of money and credit risk. To make the SPPY assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the profit rate is set.

In contrast, contractual terms that introduce more than a de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic financing arrangement do not give rise to contractual cash flows that are solely payments of principal and yield on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

iv) Changes to classification and measurement

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

- **Financial Instruments measured at amortised cost ('AC')**

The financial assets held to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and yield are measured at amortised cost. From 1 January 2018, 'Financing Arrangements' , 'Due from financial institutions', 'Due from customers' and 'Investment securities' that were classified as 'loans and receivables (L&R)' or 'held to maturity (HTM)' under IAS 39 are now measured at amortised cost (AC).

Undrawn finance commitments and letters of credit are commitments under which, over the duration of the commitment the Bank is required to provide finance with pre-specified terms to the customer. The premium received is amortised over the life of the commitment.

- **Financial Assets measured at fair value through other comprehensive income ('FVOCI')**

Financial assets held within a business model with the objective of both holding to collect contractual cash flows and selling and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and yield are measured at FVOCI. 'Investment Securities' that are classified as available for sale under IAS 39 are now measured at FVOCI. Investment securities classified as equity instruments are measured at fair value through other comprehensive income, where an irrevocable election has been made by management. Amounts presented in other comprehensive income are not subsequently transferred to profit or loss. Dividends on such investments are recognised in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment.

- **Derivatives measured at Fair value through profit and loss ('FVPL')**

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, profit rates or other indices. Derivatives are recognised initially and subsequently measured at fair value. Derivatives are classified as assets when their fair value is positive or as liabilities when their fair value is negative. 'FX Forwards', and 'Profit rate swaps' held for trading are measured at FVPL under this category. The profit and /or foreign exchange on certain fixed rate Sukuk issued has been matched with the profit and/or foreign exchange exposure of certain profit rate swaps as part of a documented risk management strategy. The changes in fair values are recorded in the income statement.

v) Changes to impairment calculation

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for financing loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECLs for all financing and other debt financial assets not held at FVPL, together with financing commitment contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination.

- **Overview of the ECL principles**

From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all financing and other debt financial assets not held at FVPL, together with financing arrangements, due from financial institutions and customers, finance lease receivable contracts and cash and balances with banks (collectively 'financial instruments'). The simplified approach for finance lease receivables has not been adopted. An ECL allowance is also recorded for off-balance sheet credit exposures such as undrawn finance commitments, letters of credit and guarantees where current circumstances indicate that losses may be incurred.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The Bank's policies for determining if there has been a significant increase in credit risk are set out in page 31.

The 12mECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments. The Bank's policy for grouping financial assets measured on a collective basis is explained in below.

Based on the above process, BLME groups its financing into Stage 1, Stage 2, and Stage 3 as described below:

• Stage 1: When financing is first advanced, the Bank recognises an allowance based on 12mECLs. Stage 1 financing also include facilities where the credit risk has improved and the financing has been reclassified from Stage 2.

• Stage 2: When a financing has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 financing also include facilities, where the credit risk has improved and the financing has been reclassified from Stage 3.

• Stage 3: Financing considered credit-impaired, the Bank records an allowance for the LTECLs.

- **The calculation of ECLs**

The Bank calculates ECLs based on the weighted outcome of the three scenarios (base case, best case, and a worst case scenario) to measure the expected cash shortfalls, discounted by the effective profit rate (EPR). A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

• PD The Probability of Default is an estimate of the likelihood of default over a given time horizon. Probabilities of Default are owned by the Risk department and are approved by CCRC and ERC. These are to be regularly reviewed by the Risk department in line with the agreed formula for their calculation. All amendments to the methodology require ERC approval.

• EAD The Exposure at Default is the principal exposure at the point which a default event is triggered, this is the monetary figure that the Bank may lose prior to adjustment for collateral. This takes into account the committed facility amount. The same approach has been taken for off-balance sheet credit exposures such as letters of credit and financial guarantees where current circumstances indicate that losses may be incurred.

• LGD The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the financier would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. The Bank's Internal LGD methodology is owned by the Risk department and approved by ERC. Amendments to the methodology require ERC approval.

The other macro-economic inputs in the ECL model are listed in section vi.

When estimating the ECLs, the Bank considers three scenarios (a base case, a best case, and a worst case). Each of these is associated with different PDs, EADs and LGDs. When relevant, the assessment of multiple scenarios also incorporates how defaulted financing arrangements are expected to be recovered, including the probability that the financing arrangements will cure and the value of collateral or the amount that might be received for selling the asset.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The mechanics of the ECL method are summarised below:

• Stage 1: The 12mECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by the original effective profit rate (EPR).

• Stage 2: When a financing has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by the original EPR.

• Stage 3: For financing considered credit-impaired, the Bank recognises the lifetime expected credit losses for these financings. The method is similar to that for Stage 2 assets, with the PD set at 100%.

The Bank calculates ECLs on an individual basis for all Stage 3 assets, regardless of the class of financial assets. Stage 1 and Stage 2 ECLs are calculated on a collective basis by grouping financial assets based on type of customer which includes banking, property and treasury.

- **Significant increase in credit risk**

The transition from recognising 12-month expected credit losses (i.e. Stage 1) to lifetime expected credit losses (i.e. Stage 2) in IFRS 9 is based on the notion of a significant increase in credit risk over the remaining life of the instrument. The focus is on the changes in the risk of a default, and not the changes in the amount of expected credit losses.

BLME measures the increase in credit risk by monitoring the changes in credit scores of its counterparties since origination. The notch downgrade is based on the credit score, where a “BBB+” or higher rated counterparty has a 3 notch movement required to show deterioration, whilst a lower quality counterparty (“BBB-” to “BB-”) needing a 2 notch movement, and the worst quality (“B+” and below) a 1 notch. This follows the broad principals of credit deterioration being seen when a default rate doubles. In addition, the Bank also considers whether the counterparty payment performance is deteriorating (i.e. payments are 30-day past due and the counterparty is added to the watchlist).

- **Default**

Refer to page 73 of the Financial Risk Management note for the definition of default.

vi) Forward looking information

In its ECL models, the Bank relies on historical trends and future projections for the following economic inputs:

- CPI - Consumer Price Index (Inflation)
- Central Bank Policy rates
- House price indices

The Bank uses forecasted macroeconomic factors for the next quarter and uses historic data to forecast PDs going forwards by taking an average of the PDs in the years which the forecasted macro factors occurred. The PDs are then incorporated in the impairment model.

vii) Multiple economic scenarios

The Bank carries out three 12 month forward looking stress scenarios per material portfolio. Each stress event is based on the macroeconomic conditions most impactful to each of the Bank’s material portfolios.

Baseline: The core stress test is based on the Bank’s consensus view on the key macroeconomic conditions over the next 12 months.

Best-case: The stress test is based on the Bank’s consensus view on the key macroeconomic conditions over the next 12 months in a positive macro environment. This is deemed to be appropriately simulated via a 2 STD shift in the macro factor driving the PDs.

Worst-case: The stress test is based on the Bank’s consensus view on the key macroeconomic conditions over the next 12 months in a negative macro environment. This is deemed to be appropriately simulated via a 1 STD shift in the macro factor driving the PDs.

The three scenarios are run, and then each scenario is probability adjusted to remove some error within the estimation.

viii) Write-offs

Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense. This policy was the same in 2017 under IAS 39 as it is currently under IFRS 9.

ix) IFRS 9 Transition Disclosures

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 1 January 2018 is, as follows:

	31-Dec-17 IAS 39 measurement			Re-Measurement	01-Jan-18 IFRS 9	
	Category	Amount	Re-classification	ECL	Amount	Category
Financial Assets		**£000**			**£000**	
Cash and balances with banks	L&R	96,780	-	-	96,780	AC
Due from financial institutions	L&R	28,544	-	-	28,544	AC
Due from customers	L&R	9,027	-	-	9,027	AC
Investment securities	HTM	9,075	-	-	9,075	AC
Investment securities	AFS	105,855	-	-	105,855	FVOCI
Financing arrangements	L&R	567,820	-	175	567,995	AC
Finance lease receivables	L&R	170,546	-	(150)	170,396	AC
Other assets (FX Forward contracts)	FVPL	3,141	-	-	3,141	FVPL
		990,788	**-**	**25**	**990,813**	
Financial Liabilities						
Due to financial institutions	L&R	514,392	-	-	514,392	AC
Due to customers	L&R	277,341	-	-	277,341	AC
Profit rate swaps	FVPL	636	-	-	636	FVPL
Other liabilities (FX Forward contracts)	FVPL	12,032	-	-	12,032	FVPL
		804,401	**-**	**-**	**804,401**	

Key

L&R: Loans and receivables
HTM: Held to maturity
AFS: Available for sale
AC: Amortised Cost
FVOCI: Fair value through other comprehensive income
FVPL: Fair value through profit and loss

Classification and measurement

Classification is based on two criteria (discussed above): the Bank's business model for managing the assets (section ii); and whether the instruments' contractual cash flows represent 'solely payments of principal and yield' on the principal amount outstanding (section iii). An assessment of the Bank's financial assets was made using this criteria which resulted in no financial impact since the classification in either IAS 39 or IFRS 9 for different categories of financial assets of the Bank resulted in the same measurement method being applied.

Impairment

Details on the change in impairment calculation has been discussed in section v above.

Upon adoption of IFRS 9 the Bank recognised an additional impairment on the Bank's Finance Lease Receivables of £150,000 and a reduction in impairment on the Bank's Financing Arrangements of £175,000, which resulted in an increase in Retained earnings of £25,000 as at 1 January 2018.

The following table reconciles the aggregate opening impairment allowances under IAS39 to the ECL allowances under IFRS 9.

	31-Dec-17 Impairment under IAS 39/IAS 37 measurement				01-Jan-18 IFRS 9 ECLs			
	Collective	Specific	Total	Re-measurement	Stage 1	Stage 2	Stage 3	Total
Financial Assets	**£000**	**£000**	**£000**		**£000**	**£000**	**£000**	**£000**
Financing arrangements	1,674	9,558	11,232	(175)	1,137	362	9,558	11,057
Finance lease receivables	1,492	3,190	4,682	150	1,258	384	3,190	4,832
Other assets	-	73	73	-			73	73
	3,166	**12,821**	**15,987**	**(25)**	**2,395**	**746**	**12,821**	**15,962**

The impact of transition to IFRS 9 on reserves and retained earnings is, as follows:

	Reserves and Retained Earnings
	Amount
Retained Earnings	**£000**
Closing balance under IAS 39 (31 December 2017)	156,894
Recognition of IFRS 9 ECLs including those measured at FVOCI	25
Opening balance under IFRS 9 (1 January 2018)	156,919
Total change in equity due to adopting IFRS 9	25

The impact of transition to IFRS 9 on regulatory capital is, as follows:

	Regulatory Capital
	Amount
	£000
Closing balance under IAS 39 (31 December 2017)	223,708
Recognition of IFRS 9 ECLs including those measured at FVOCI	25
Opening balance under IFRS 9 (1 January 2018)	223,733
Total change in capital due to adopting IFRS 9	25

e. New standards and interpretations not yet adopted

The new and amended standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these new and amended standards and interpretations, if applicable, when they become effective.

i. IFRS 16 *Leases*

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases-Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the finance charge on the lease liability and the depreciation expense on the right-of-use asset. Depreciation expense is calculated on a straight-line basis over the minimum lease term.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

Transition to IFRS 16

The Bank plans to adopt IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 January 2019. The Bank will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 as at 1 January 2019. The Bank will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Bank will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. The Bank has leases of certain office equipment (i.e., personal computers, printing and photocopying machines) that are considered of low value.

The cumulative effect of initially applying IFRS 16 is recognised at the date of initial application as an adjustment to the opening balance of retained earnings. Therefore, the comparative information will not be restated and continues to be reported under IAS 17 and IFRIC 4.

The effect of adopting IFRS 16 as at 1 January 2019 was, as follows:

Impact on the statement of financial position (increase/(decrease)) as at 1 January 2019:

	£000
Assets	
Property and equipment (right-of-use-assets)	4,827
Prepaid rent	(301)
	4,526
Liabilities	
Lease liabilities	6,109
Other liabilities	(1,347)
	4,762

Impact on opening retained earnings as at 1 January 2019:

	£000
Retained earnings	
Closing balance under IFRS 17 (31 December 2018)	37,079
Impact of adopting IFRS 16	(236)
Opening balance under IFRS 16 (1 January 2019)	36,843

Per IFRS.16.C12, an entity applying the modified retrospective approach is required to disclose an explanation of the difference between

- operating lease commitments disclosed when applying IAS 17 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application; and
- lease liabilities recognised in the statement of financial position at the date of initial application.

	1 January 2019 £000
Operating lease obligations at 31 December 2018 per Note 27	6,889
Operating lease obligations at 31 December 2018 not disclosed due to low value	11
Gross lease liabilities at 1 January 2019	**6,900**
Discounting	(791)
Additional lease liabilities as a result of the initial application of IFRS 16 as at 1 January 2019	**6,109**

ii. Other new and amended standards and interpretations

- IFRS 17 *Insurance Contracts*
- IFRIC Interpretation 23 *Uncertainty over Income Tax Treatment*
- Amendments to IFRS 9: *Prepayment Features with Negative Compensation*
- Amendments to IFRS 10 and IAS 28: *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*
- Amendments to IAS 19: *Plan Amendment, Curtailment or Settlement*
- Amendments to IAS 28: *Long-term interests in associates and joint ventures*
- Annual Improvements 2015-2017 Cycle (issued in December 2017)
  These improvements include:
    - IFRS 3 Business Combinations
    - IFRS 11 Joint Arrangements
    - IAS 12 Income Taxes
    - IAS 23 Borrowing Costs

These other new and amended standards and interpretations are either not relevant to the Bank , not expected to have any impact or it is not feasible to determine whether there will be an impact to the Bank's financial statements.

f. Basis of measurement

The financial statements have been prepared on the historical cost basis, except for investment securities at fair value through other comprehensive income, 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

Profit rate income or expense is 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.

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 control of the underlying services are transferred to the customer at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for those services. This will normally be at the point when the activity to which the fees and commission relate has been completed.

iii. Financial assets

The Bank classifies its financial assets in the following categories: 'due from financial institutions', 'due from customers', 'financing arrangements' and 'investment securities'. Investment securities are financial assets whose classification and measurement basis is either at amortised cost, fair value through profit or loss or fair value through other comprehensive income. Management determines the classification of financial assets at initial recognition based on the financial asset's contractual cash flow characteristics and the Bank's business model for managing them.

iv. Due from financial institutions and customers and financing arrangements

Due from financial institutions and customers and financing arrangements are financial assets measured at amortised cost as they are held within a business model with the objective of collecting contractual cash flows that are solely payments of principal and yield. Amortised cost is determined using the effective profit share basis. Gains and losses are recognised in the income statement when the asset is derecognised, modified or impaired.

v. Investment securities

- **Financial instruments at fair value through profit or loss**

Financial assets at fair value through profit or loss include financial assets held for trading, financial assets designated upon initial recognition at fair value through profit or loss, or financial assets mandatorily required to be measured at fair value. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Financial assets with cash flows that are not solely payments of principal and profit are classified and measured at fair value through profit or loss, irrespective of the business model. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value recognised in the statement of profit or loss.

- **Financial instruments at fair value through other comprehensive income (OCI)**

These investment securities can be either debt or equity non-derivative financial assets. The Bank has an unlisted equity portfolio which it accounts for at fair value through other comprehensive income as they are equity instruments that meet the definition of equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Gains and losses arising from changes in the fair value of these financial instruments are never recycled to the income statement. Dividends on such investments are recognised in the income statement unless the dividend clearly represents a recovery of part of the cost of the investment. For debt instruments, gains and losses arising from changes in the fair value are recognised in a separate component of equity. Upon disposal, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to the income statement.

- **Amortised cost**

Investment securities that are held to collect contractual cash flows that are solely payments of principal and yield (previously 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

Refer to Note 2(d)(v) (on pages 29 to 31) for detail on impairment of financial assets.

- **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 81 to 82 in Note 33.

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 hedges of the change in fair value of recognised assets or liabilities or firm commitments (‘fair value hedges’). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value hedge provided certain criteria is 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 group 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 have been presented on a gross basis in the current year. In the comparative financial information, financial assets and liabilities were offset and the net amount reported in the balance sheet if, and only if, there was a legally enforceable right to set off the recognised amounts and there was 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 occurred, all outstanding transactions with the counterparty would fall due and all amounts outstanding would 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 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

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-profit rate 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, other assets and deferred tax 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. Impairment losses on financial assets

The measurement of impairment losses under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model, which assigns PDs to the individual grades.
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment.
- The segmentation of financial assets when their ECL is assessed on a collective basis.
- Development of ECL models, including the various formulae and the choice of inputs.
- Determination of associations between macroeconomic scenarios and, economic inputs, such as inflation levels and collateral values, and the effect on PDs, EADs and LGDs.
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

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 33.

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 through other comprehensive income.

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

IFRS 9 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).

d. Deferred taxes

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available in the future against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits, together with future tax planning strategies.

4. SEGMENTAL INFORMATION

The Bank has three operating segments as described strategic report on page 3, 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 two 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 2018

	Treasury Division £000	Commercial Finance £000	Wealth Management £000	Unallocated items £000	Total £000
Net margin from financing and investing activities	2,652	15,833	12,689	-	31,174
Operating lease income	1,079	6,654	-	-	7,733
Net fee income	24	1,232	687	-	1,943
Net impairment credit/(charge)	(24)	(1,764)	(242)	-	(2,030)
Net fair value (losses)/gains	(278)	-	22	-	(256)
Other operating income	173	686	1,234	-	2,093
Total operating income	**3,626**	**22,641**	**14,390**	**-**	**40,657**
Directly attributable segment expenses	(1,298)	(4,023)	(2,299)	-	(7,620)
Operating lease depreciation	-	(6,027)	-	-	(6,027)
Net segment contribution	**2,328**	**12,591**	**12,091**	**-**	**27,010**
Common costs not directly attributable to segments					(19,291)
Net operating profit before tax					**7,719**
Reportable segment assets	**240,639**	**654,893**	**369,587**	**7,827**	**1,272,946**

£8.1m of the total operating income was derived through the effective profit rate (EPR) model.

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 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**

Entity wide disclosures

Geographical analysis of non-current assets

	31 December 2018 £000	31 December 2017 £000
United Arab Emirates	47	32
United Kingdom	54,306	39,676
USA	(99)	240
Total	**54,254**	**39,948**

Non-current assets include operating lease assets, investment properties, deferred tax assets, profit rate swaps, property and equipment, intangible assets, goodwill and other assets.

5. INCOME

5(a) Income from financing and investing activities	2018 £000	2017 £000
Due from financial institutions:		
Murabaha income	468	386
Wakala income	681	330
Finance lease receivables:		
Finance lease income	5,729	4,246
Hire Purchase income	3,984	3,775
Istisna and Ijara income	246	184
Financing arrangements:		
Murabaha income	34,699	26,986
Musharaka income	-	19
Wakala income	405	285
Participation Agreements	32	24
Investment securities:		
Sukuk income	2,481	3,415
	48,725	**39,650**

5(b) Fee and commission income	2018 £000	2017 £000
Fees - letters of credit and uncommitted facilities	1,048	849
Management fees	498	483
Acquisition and structuring transaction fees	460	265
Other	354	219
	2,360	**1,816**

6. RETURNS TO FINANCIAL INSTITUTIONS AND CUSTOMERS

	2018 £000	2017 £000
Customer deposits	6,307	5,288
Murabaha	9,152	9,604
Wakala	2,092	1,393
	17,551	**16,285**

7. NET FAIR VALUE LOSSES ON INVESTMENTS

	2018 £000	2017 £000
Net realised losses on investments	(47)	(29)
Net unrealised losses on investments	(209)	(1,880)
Realised gain/(loss) on hedge	-	(421)
	(256)	**(2,330)**

8. OTHER OPERATING INCOME

	2018	2017
	£000	£000
Gain on foreign exchange transactions	173	1,745
Gain on leased asset sales	139	962
Other	1,781	3,873
	2,093	**6,580**

In the other income line above, £1.72m out of £1.78m relates to dividends from subsidiaries (2017: £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. PRS 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 as FVTPL and the Mark to Market movement is recognised in the profit and loss. The Bank has two PRS as at 31 December 2018 (2017: one) which are not used for hedging purposes and are fair valued through profit and loss. These are described under the relevant headings below:

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

Notional contract amounts of PRS held by product type:

Bank

	2018 FVTPL	2018 FVTPL	2018 Fair value hedges	2018 Fair value hedges
	$000	£000	$000	£000
Profit rate swaps - USD	-	-	50,000	-
Profit rate swaps - GBP	-	15,000	-	20,000
	0	**15,000**	**50,000**	**20,000**

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**

With regard to PRS, 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 PRS 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 PRS and in the fair value of the item in relation to the risk being hedged are recognised in the income statement.

Fair value of PRS designated as fair value hedges:

Bank	**2018 Fair value assets £000**	**2018 Fair value liabilities £000**	**2017 Fair value assets £000**	**2017 Fair value liabilities £000**
Profit rate swaps	**73**	**429**	**-**	**638**

Movement in the fair value of PRS used for fair value hedging:

Bank	**2018 £000**	**2017 £000**
Net profit rate swap liability as at 1 January	(638)	(1,254)
Gains / (losses):		
Exchange translation	(2)	30
On hedging instruments through the income statement	284	80
On effective hedges	-	506
Net profit rate swap liability as at 31 December	**(356)**	**(638)**
Unhedged Profit Rate Swap Asset/(Liability) recognised as Fair Value through Profit and Loss:	(40)	2
	(396)	**(636)**

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 2018 a loss of £0.3 million (2017: £0.1 million) was recognised due to hedge ineffectiveness.

10. PERSONNEL EXPENSES

	2018 £000	**2017 £000**
Wages and salaries	12,448	11,710
Social security costs	1,444	1,653
Defined contribution pension scheme costs	1,037	1,044
Recruitment costs	105	398
Other staff costs	793	434
	15,827	**15,239**

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

	2018 Number	2017 Number
Period end	116	112
Average for the period - management	11	10
Average for the period - non-management	104	104

11. DIRECTORS' EMOLUMENTS

	2018 £000	2017 £000
Directors' emoluments	2,103	1,962
Pension contributions	32	65
	2,135	**2,027**

The aggregate emoluments of the highest paid Director was £1.0 million (2017: £0.8 million), and pension contributions of £0.02 million (2017: £0.06 million) were made on his behalf. During the year, no Director exercised share options and this is disclosed in more detail in note 31. (2017: one).

12. OTHER OPERATING EXPENSES

	2018 £000	2017 £000
Advertising and market development	133	91
Board and SSB related expenses	610	409
Communications and IT costs	1,621	1,768
Consultancy	907	1,673
Legal and professional fees	2,695	3,972
Other operating charges	2,701	2,921
Rent and other occupancy costs	1,348	1,715
	10,015	**12,549**

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

	2018	2017
	£000	£000
Auditor's remuneration		
Audit of financial statements pursuant to the legislation		
- Ernst & Young LLP	473	500
Tax Advisory and Compliance Services		
- Ernst & Young LLP - CASS audit	11	11
Other advisory and assurance services		
- Ernst & Young LLP	5	16
	489	**527**

13. SHARE-BASED PAYMENTS

During the year £0.6 million (2017: £0.5 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:

	2018	2017
Equity settled schemes	**£000**	**£000**
Approved Share Option Plan ("ASOP")	24	25
Unapproved Share Option Plan ("USOP")	267	287
Executive Share Option Scheme ("ESOP")	-	-
Deferred Incentive Plan Scheme ("DIPS")	2	(5)
	293	**307**
Cash settled schemes		
Deferred Annual Bonus Scheme ("DABS")	330	199
	623	**506**

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 were 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 was 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 2018 and 2017.

Options issued in 2018 and 2017	ASOP	USOP	ASOP	USOP
	2018	2018	2017	2017
Fair value (cents) *	5.42	5.42	5.23	5.55
Share price (cents) *	40.00	40.00	40.15	40.66
Exercise price (cents) *	50.00	50.00	50.58	50.25
Expected volatility (% p.a.)	18.01	18.01	19.03	19.01
Expected option life (years)	6.88	6.88	6.80	6.79
Expected dividends (% p.a.)	Nil	Nil	Nil	Nil
Risk free interest rate (%)	1.27	1.27	0.72	0.72

* 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 2018	Weighted average excercise price (pence) 2018	Number of options 2017	Weighted average excercise price (pence) 2017
Outstanding at 1 January	2,863,344	49.5	1,627,892	66.1
Granted in the year	335,246	37.4	1,832,676	39.2
Forfeited in the year	(616,039)	46.7	(597,224)	64.7
Outstanding at 31 December	**2,582,551**	**48.6**	**2,863,344**	**49.5**
Exercisable at 31 December	**331,513**		**339,493**	

The weighted average remaining contractual life of the above ASOPs outstanding at the balance sheet date was 7.8 years (2017: 8.5 years). The weighted average exercise price is 48.6 pence (2017: 49.5 pence).

All of the ASOPs granted in 2018 were issued with a vesting profile of 50% vesting after 3 years, 25% vesting after 4 years and 25% vesting after 5 years. (2017: 1.6 million)

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 2018**	**Number of options 2017**
Outstanding at 1 January	39,992	52,298
Granted in the year	-	-
Forfeited in the year	-	(12,306)
Outstanding at 31 December	**39,992**	**39,992**
Exercisable at 31 December	**39,992**	**39,992**

The weighted average remaining contractual life of the above parallel options outstanding at the balance sheet date was 1.2 years (2017: 2.2 years). The weighted average exercise price is 125 pence (2017: 125 pence). All of these options were exercisable at the balance sheet date (2017: 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 ASOPs up to their aggregate market value limit of £30,000. The options may vest after three to five years and are exercisable up to the tenth anniversary of the date of grant, after which they lapse.

USOPs	**Number of options 2018**	**Weighted average excercise price (pence) 2018**	**Number of options 2017**	**Weighted average excercise price (pence) 2017**
Outstanding at 1 January	17,319,151	42.7	11,092,251	44.3
Granted in the year	782,254	37.4	7,847,324	39.4
Forfeited in the year	(1,767,742)	49.3	(1,287,091)	48.6
Exercised in the year	-	Nil	(333,333)	Nil
Outstanding at 31 December	**16,333,663**	**41.7**	**17,319,151**	**42.7**
Exercisable at 31 December	**1,102,203**		**795,504**	

The weighted average remaining contractual life of the above USOPs outstanding at the balance sheet date was 8.0 years (2017: 8.9 years). The weighted average exercise price is 41.7 pence (2017: 42.7 pence).

All of the USOPs granted in 2018 were issued with a vesting profile of 50% vesting after 3 years, 25% vesting after 4 years and 25% vesting after 5 years. (2017: 7.5 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 2018	Number of options 2017
Outstanding at 1 January	755,191	1,832,427
Granted in the year	-	-
Forfeited in the year	(393,483)	(1,077,236)
Outstanding at 31 December	**361,708**	**755,191**
Exercisable at 31 December	**361,708**	**755,191**

The weighted average remaining contractual life of the executive share options outstanding at the balance sheet date was 1.4 years (2017: 2.0 years). The weighted average exercise price is 162.5 pence (2017: 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 2018	Number of options 2017
Outstanding at 1 January	329,747	601,549
Granted in the year	-	-
Forfeited in the year	(83,262)	(271,802)
Outstanding at 31 December	**246,485**	**329,747**
Exercisable at 31 December	**147,891**	**-**

The weighted average remaining contractual life of the above DIPS options outstanding at the balance sheet date was 6.2 years (2017: 7.2 years). The weighted average exercise price was 45.0 pence (2017: 45.0 pence).

Cash-settled schemes

Deferred annual bonus scheme ("DABs")

DABs were 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 entitled the employee to receive a matching award at no cost providing certain conditions, including a performance condition, were 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 2018	Number of nil cost options 2017
Outstanding at 1 January	1,515,521	1,236,592
Awarded and deferred	-	-
Awarded under matched award	282,107	321,529
Forfeited in the year	-	-
Exercised in the year	(115,614)	-
Settled in the year	(68,249)	(42,600)
Outstanding at 31 December	**1,613,765**	**1,515,521**
Exercisable at 31 December	**203,232**	**181,511**

The weighted average remaining contractual life of the above nil cost options outstanding at the balance sheet date was 6.9 years (2017: 7.7 years). The weighted average exercise price was nil (2017: nil).

14. IMPAIRMENTS OF FINANCIAL ASSETS

The table below shows the ECL charges on financial assets in the income statement and statement of financial position:

Statement of Financial Position

As at 31 December 2018	Stage 1 Collective £000	Stage 2 Collective £000	Stage 3 Specific £000	Total £000
Financing arrangements	710	1,697	7,927	10,334
Finance lease receivables	595	2,728	1,091	4,414
Total Impairment	**1,305**	**4,425**	**9,018**	**14,748**

Within Stage 1 and Stage 2 for financing arrangements there is an ECL balance of £69k relating to off balance sheet letters of credit and guarantees, an ECL balance of £164k relating to undrawn commitments and an ECL balance of £45k relating to investment securities.

Forborne exposures that have not been specifically provided for equates to £33m. The Stage 1 and Stage 2 ECLs relating to these forborne exposures is £1,228k.

Income Statement

For the year ended 31 December 2018	£000
New and increased provisions (net of releases)	2,030
Total Impairment Loss	**2,030**

An analysis of changes in the gross carrying amount and the corresponding ECL allowances is as follows:

	Stage 1 Collective £000	Stage 2 Collective £000	Stage 3 Specific £000	Total £000
ECL				
Balance at 1 January 2018	2,395	746	12,821	15,962
Changes due to financial assets recognised in the opening balance that have				
Transferred to Stage 1	151	(151)	-	-
Transferred to Stage 2	(341)	341	-	-
Transferred to Stage 3	-	-	-	-
New and increased provisions (net of releases)	(900)	3,489	(559)	2,030
Write-offs from specific provisions	-	-	(3,593)	(3,593)
Foreign currency translation adjustments	-	-	349	349
Balance at 31 December 2018	**1,305**	**4,425**	**9,018**	**14,748**

Bank			**2017**
Impairments of financial assets:	**Specific £000**	**Collective £000**	**Total £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**

The comparative figures are accounted for under *IAS 39 Financial Instruments: Recognition and Measurement*

There were no collective and specific impairments against cash and balances with banks, due from financial institutions and customers or investment securities (2017: Nil).

15. TAXATION

Bank	2018	2017
	£000	£000
UK Corporation Tax		
- current tax for the year	270	(72)
- prior year current tax adjustment	114	(33)
	384	(105)
Overseas tax for the year	-	-
Deferred tax for the year	(3,338)	-
Tax (credit) / charge in income statement	**(2,954)**	**(105)**

The tax charge for the year is lower (2017: lower) than the standard rate of corporation tax which is explained as follows:

Bank	2018	2017
	£000	£000
Reconciliation of effective tax rate		
Profit / (Loss) for the year before tax	7,719	3,362
Profit / (Loss) for the year multiplied by standard rate of corporation tax in the UK of 19% (2017: 19.25%)	1,466	647
Recognition of deferred tax asset	(3,338)	-
Movement in unrecognised deferred tax	(1,262)	(669)
Expenses not deductible for tax purposes	125	54
Tax exempt income	(328)	(104)
Tax on controlled foreign companies	200	-
Prior year adjustment	114	(33)
Effect of change in tax rates	69	-
Tax (credit) / charge in income statement	**(2,954)**	**(105)**

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. Relevant deferred tax balances have been calculated with reference to these enacted rates.

Tax recognised in other comprehensive income

Bank	2018	2017
	£000	£000
Fair value reserve	(135)	105
	(135)	**105**

Tax recognised directly in equity

Bank	2018	2017
	£000	£000
Capital contribution reserve	(30)	-
Retained earnings	157	-
	127	**-**

Deferred tax

A deferred tax asset (DTA) is recognised on deductible temporary differences, unused tax losses and unused tax credits to the extent that it is probable that future taxable profits will be available against which these can be utilised. The Bank has returned to profitability in 2017 and 2018 and has forecast taxable profits in future years. Based on the evidence, Management has recognised a DTA as at 31 December 2018 on trading losses carried forward of £2.2m (net) (2017: nil) and other temporary differences of £1.3m (2017: nil).

Movements in deferred tax balances (net)

Bank - 2018	**Balance at 1 January**	**Recognised in profit or loss**	**Recognised in OCI**	**Balance at 31 December**
	£000	**£000**	**£000**	**£000**
Tax losses carried forward	-	2,217	-	2,217
Other temporary differences	-	1,121	176	1,297
Deferred tax assets	**-**	**3,338**	**176**	**3,514**

Unrecognised deferred tax assets (gross)

Bank	**2018**	**2017**
	£000	**£000**
Accelerated depreciation	13,106	15,230
Tax losses carried forward	6,701	24,461
Other temporary differences	-	4,054
Deferred tax assets	**19,807**	**43,745**

16.DUE FROM FINANCIAL INSTITUTIONS AND CUSTOMERS

Due from Institutions

	0 - 3 months	**4 - 12 months**	**1 - 5 years**	**2018**
	£000	**£000**	**£000**	**£000**
Murabaha	-	-	-	-
Wakala	-	8,045	-	8,045
	-	**8,045**	**-**	**8,045**
Provision for impairment				-
				8,045

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 Customers

	0 - 3 months	4 - 12 months	1 - 5 years	2018
	£000	£000	£000	£000
Wakala	7,424	-	7,188	14,612
	7,424	**-**	**7,188**	**14,612**
Provision for impairment				-
				14,612

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

17. INVESTMENT SECURITIES

			2018
Bank	**Listed**	**Unlisted**	**Total**
	£000	**£000**	**£000**
Fair value through other comprehensive income			
Equity	-	341	341
Sukuk	93,894	-	93,894
Investment in subsidiaries at cost	-	31,171	31,171
Amortised cost			
Sukuk	9,637	-	9,637
	103,531	**31,512**	**135,043**

			2017
Bank	**Listed**	**Unlisted**	**Total**
	£000	**£000**	**£000**
Available-for-sale			
Equity	-	973	973
Sukuk	104,883	-	104,883
Investment in subsidiaries at cost	-	11,319	11,319
Held to Maturity			
Sukuk	9,075	-	9,075
	113,958	**12,292**	**126,250**

There is an ECL balance of £45k relating to investment securities within Stage 1 and Stage 2 for financing arrangements. Refer to Note 14.

The comparative figures are accounted for under *IAS 39 Financial Instruments: Recognition and Measurement.*

Investment in subsidiaries includes £6.3m in Aspenway Limited and £24.87m in AQ1 Limited (2017: BLME Umbrella Fund Management Sarl $25k; Aspenway Limited £11.3m).

18. FINANCING ARRANGEMENTS

These tables represent contractual maturities.

Bank	Less than 1 year £000	1 - 5 years £000	Over 5 years £000	2018 Total £000
Murabaha	655,883	50,686	-	706,569
Mudaraba	3,643	-	-	3,643
Participation agreements	140	-	-	140
Sukuk	931	-	-	931
	660,597	**50,686**	**-**	**711,283**
Provision for impairment				(10,334)
				700,949
IFRS 9 Stage 1 and 2 ECL				(2,407)
IFRS 9 Stage 3 ECL				(7,927)
				(10,334)

Refer to Note 14 for the analysis of changes in IFRS 9 Stages 1 and 2 and IFRS 9 Stage 3 ECLs.

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
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)

The comparative figures are accounted for under *IAS 39 Financial Instruments: Recognition and Measurement.*

19. FINANCE LEASE RECEIVABLES

Bank	2018	2017
	£000	£000
Gross investment in finance lease receivables		
Within one year	50,616	32,256
One to five years	83,324	43,338
Over five years	4,913	6,547
	138,853	82,141
Hire purchase		
Within one year	61,472	54,124
One to five years	79,597	52,277
Over five years	192	-
	141,261	106,401
Unearned future income on finance leases	(10,973)	(7,868)
Unearned future income on hire purchase	(8,269)	(5,446)
IFRS 9 Stage 1 & 2 ECL	(3,323)	(1,492)
IFRS 9 Stage 3 ECL	(1,091)	(3,190)
Net investment in finance leases and hire purchase	**256,458**	**170,546**
The net investment in finance leases comprises:		
Within one year	42,009	24,444
One to five years	77,652	39,209
Over five years	4,596	6,273
	124,257	**69,926**
The net investment in hire purchase comprises:		
Within one year	56,231	50,577
One to five years	75,783	50,043
Over five years	187	-
	132,201	**100,620**
Net investment in finance leases and hire purchase	**256,458**	**170,546**

These tables represent contractual maturities. The Bank's investment in finance lease receivables covers a wide range of equipment types including transport, construction, and mining and heavy machinery equipment.

The comparative figures are accounted for under *IAS 39 Financial Instruments: Recognition and Measurement.* Accordingly, the 2017 comparatives for the IFRS 9 Stage 1 & 2 ECL and IFRS 9 Stage 3 ECL lines above relate to Collective Impairment and Specific Impairment respectively.

Refer to Note 14 for the analysis of changes in IFRS 9 Stages 1 and 2 and IFRS 9 Stage 3 ECLs.

20. PROPERTY AND EQUIPMENT

Bank	Computer Equipment £000	Office Equipment £000	Fixtures & Fittings £000	Total £000
Cost				
At 1 January 2018	532	69	2,184	2,785
Additions	-	-	-	-
Disposals	-	-	-	-
At 31 December 2018	532	69	2,184	**2,785**
At 1 January 2017	525	69	2,184	2,778
Additions	7	-	-	7
Disposals	-	-	-	-
At 31 December 2017	**532**	**69**	**2,184**	**2,785**
Depreciation				
At 1 January 2018	509	62	1,228	1,799
Charge for the year	18	6	474	498
Disposals	-	-	-	-
At 31 December 2018	527	68	1,702	**2,297**
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**
Net Book Value				
At 1 January 2018	23	7	956	986
At 31 December 2018	**5**	**1**	**482**	**488**
At 31 December 2017	**23**	**7**	**956**	**986**

21. OPERATING LEASE ASSETS

Bank	At 31 December 2017 £000	Additions 2018 £000	Disposals 2018 £000	Depreciation 2018 £000	At 31 December 2018 £000
Gross carrying amount	42,334	27,846	(15,554)	-	54,626
Less depreciation	(8,129)	-	2,772	(6,027)	(11,384)
	34,205	**27,846**	**(12,782)**	**(6,027)**	**43,242**

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**

Rental receipts under operating leases	**2018**	**2017**
Future rentals are as follows:	**£000**	**£000**
Less than one year	8,291	3,270
Between one and five years	19,076	13,815
More than five years	2,671	1,971
	30,038	**19,056**

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	**2018**	**2017**
Cost	**£000**	**£000**
Opening balance	5,643	5,528
Additions	-	115
Disposals	-	-
Closing balance	**5,643**	**5,643**
Amortisation and impairment losses		
Opening balance	4,806	3,835
Charge for the year	571	971
Disposals	-	0
Closing balance	**5,377**	**4,806**
Net Book Value	**266**	**837**

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

23. OTHER ASSETS

Bank	2018	2017
	£000	£000
VAT recoverable	2,625	1,105
Contract assets*	65	145
Collateral deposits**	404	487
Prepayments	1,105	723
Other receivables and assets***	2,472	1,460
	6,671	**3,920**

* Per IFRS 15 *Revenue from Contracts with Customers*, a contract asset (accrued income) or a contract liability (deferred income, see Note 26 below) is recognised for difference between the cumulative revenue recognised and the cumulative amounts billed for a contract.

** The Bank has pledged cash collateral deposits of £0.05 million (2017: £0.5 million) as security against rental payments on its premises.

***Other receivables and assets line above include foreign exchange forward deal balance of £1.2 million (2017:£Nil).

24. DUE TO FINANCIAL INSTITUTIONS

Bank	2018	2017
	£000	£000
Reverse Murabaha	544,842	391,186
Wakala	127,398	123,206
	672,240	**514,392**

25. DUE TO CUSTOMERS

Bank	2018	2017
	£000	£000
Customer deposits	353,643	270,645
Security deposits	3,784	6,696
	357,427	**277,341**

26. OTHER LIABILITIES

Bank	2018	2017
	£000	£000
Trade payables	14	175
Contract liability	-	48
Social security and income tax	334	354
Accruals	9,896	8,160
Other creditors	4,002	4,261
	14,246	**12,998**

*Other creditors line above include foreign exchange forward deal balance of £0.2 million (2017:£0.9 million).

27. COMMITMENTS UNDER OPERATING LEASES

Cannon Place	2018	2017
	£000	£000
Future minimum rentals are as follows:		
Lease expiring in more than five years	6,477	12,130
	6,477	**12,130**

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 (2017: £0.8 million).

Dubai Branch	2018	2017
	£000	£000
Future minimum rentals are as follows:		
Lease expiring in less than five years	412	117
	412	**117**

There is a commitment at the year-end under a non-cancellable operating lease for the Bank's Branch in Dubai for a three year period from 15 November 2018 to 14 November 2021, at an annual rental of AED 0.7 million, which was equivalent to £0.1 million at the balance sheet date (2017: AED 0.7 million / £0.1 million).

During the year £0.1 million was recognised as an expense in the income statement in respect of this operating lease (2017: £0.1 million).

In addition to above, the Bank has one more non-cancellable operating lease agreements in relation to one other UK office premises. The future minimum lease rental for this premises is £0.011 million (2017: £0.019m). During the year an expense of £0.033 million (2017: £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 2018	Cashflows	FX Movement	Changes in Fair Value	Other	31 December 2018
	£000	£000	£000	£000	£000	£000
Due to Financial Institutions	(514,392)	(152,624)	(5,224)	-	-	(672,240)
Due to Customers	(277,341)	(80,168)	82	-	-	(357,427)
Profit Rate Swaps	(636)	-	(2)	215	27	(396)
Total	(792,369)	(232,792)	(5,144)	215	27	(1,030,063)

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)

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 2017	195,733,691	48,933	180,623
Court approved reduction of the Share Premium account			(40,000)
At 31 December 2018	**195,733,691**	**48,933**	**140,623**

As explained in the Directors Report, during 2018 the Bank reduced its Share Premium account by £40 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 22 August 2018. This process was formally approved by the High Court of Justice in London and became effective on 25 September 2018.

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	2018 £000	2017 £000
Assumption of share incentive scheme liabilities by parent company:		
Opening balance	1,911	1,604
Transfer to Retained Earnings	-	-
Equity-settled share-based payment awards	295	307
Closing balance at 31 December	**2,206**	**1,911**

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.

	Relationship	2018 £000	2017 £000
Boubyan Bank K.S.C.P	Shareholder		
Wakala placement		817,238	826,850
Wakala deposit taking		269,051	168,176
Participation deposit		48,173	-
The Public Institution for Social Security	Shareholder		
Reverse Murabaha		519,202	238,155
Aspenway Limited	Subsidiary		
Due to financial institutions		6,300	11,300
AQ1 Limited	Subsidiary		
Due to financial institutions		24,870	-

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

Included within:	2018	2017
	£000	£000
Cash and balances with banks		
Nostros	1,372	2,720
Due to financial institutions		
Wakala deposit taking	31,128	31,893
Participation deposit	15,597	-

As at 31 December 2018, Boubyan Bank K.S.C.P held an economic interest of 27.91% of the Parent Company's voting shares (2017: 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 and the Chairman of Boubyan Capital Investment Company 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:	2018	2017
	£000	£000
Reverse Murabaha	525,193	381,185

As at 31 December 2018, The Public Institution for Social Security held 8.10% (2017: 7.67%) of the Bank's shares. The Bank's Vice Chairman formerly held 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:

	2018	2017
	£000	£000
Key management emoluments *	1,766	1,429
Bank contributions to pension plans	32	65
	1,798	**1,494**

* Key management emoluments includes share-based payments of £0.18 million (2017: £0.15 million).

During the year, the Company did not receive any notification by the Directors' for the purchase of Company shares.

On 17 October 2016 the Bank's Dubai Branch 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. The contract came to an end on 30 April 2018. Subsequently Jabra Ghandour has been appointed as CEO of Boubyan Capital, a subsidiary of Boubyan Bank K.S.C.P.

The Bank recognised an expense of £0.10 million (31 December 2017: £0.24 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.

32. PARENT COMPANY AND SUBSIDIARIES

As at 31 December 2018 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	Profit / (loss) for the year £000	Principal business activity	Ultimate parent undertaking	Immediate parent undertaking
Directly held:							
Bank of London and The Middle East plc	United Kingdom	100%	£48,933,422	10,673	Regulated Bank	BLME Holdings plc	BLME Holdings plc
Indirectly held:							
BLME Asset Management Limited	United Kingdom	100%	£2	-	Dormant	BLME Holdings plc	BLME plc
BLME Holdco Limited	United Kingdom	100%	£102	-	Dormant	BLME Holdings plc	BLME plc
BLME Holdings EBT	Jersey	100%	N/A	-	Employee benefit trust	BLME Holdings plc	BLME plc
BLME Limited	United Kingdom	100%	£2	-	Dormant	BLME Holdings plc	BLME plc
Global Liquidity Solutions Limited	United Kingdom	100%	£1	-	Dormant	BLME Holdings plc	BLME plc
MKL Construction Equipment Finance Limited	United Kingdom	60%	£1,000	586	Leasing	BLME Holdings plc	BLME plc
Renaissance Property Finance Limited	United Kingdom	100%	£2	-	Dormant	BLME Holdings plc	BLME plc
Renaissance Trade Finance Limited	United Kingdom	100%	£2	-	Dormant	BLME Holdings plc	BLME plc
AQ1 Limited	Jersey	100%	£24,870,000	363	Investment Holding Company	BLME Holdings plc	BLME plc
Aspenway Limited	Jersey	56%	£11,300,000	903	Investment Holding Company	BLME Holdings plc	BLME plc

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 (trading book and banking book)
- operational risk (including cyber and conduct risk)
- capital risk

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 in late 2016, the following objectives were 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 2019.

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 Bank's 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 mitigate all principal risks and:

- 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.

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;
- Assurance – assurance and advice are provided by the Bank's Third Line of Defence where the Internal Audit function provides the Board with independent, objective assurance or advice whether the risk management, control and governance processes are adequate and operating in line with expectations. Additional assurance is provided by external audit; and
- Monitoring and reporting – the Second Line of Defence is responsible for monitoring the operation of the controls and adherence to risk direction and limits.

The RMF provides the necessary discipline to oversee risks comprehensively through the Bank and in line with the Board Risk Appetite, and the overall strategy.

The constituting elements of the RMF are:

- Sharia'a principles;
- BLME governance;
- Business strategy, vision, values and culture;
- Risk appetite;
- Risk management approach;
- Policies and procedures;
- Infrastructure; and
- Training, remuneration and rewards.

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.

Impairment of Financial assets

- **Definition of Default and Cure**
  Credit financing risk is the risk of the Bank sustaining a loss from a customer or other counterparty being unable to meet its contractual obligations. This default risk applies to all credit-sensitive transactions.

  Incorporated within credit default risk are the following sub-types:

  Primary Financing Risk: the possibility that payments (Principal, Profit share yield and / or other) due from a transaction will not be paid by the obligor when due. Financing and issuer risk may include amounts that may crystallise from contingent transactions such as letters of credit and underwriting.

  Counterparty Credit Risk (also known as Pre-settlement risk): the potential exposure that could arise if a trading partner for a Profit Rate or Foreign Exchange (FX) product defaults prior to expiration (either maturity or termination) leaving the Bank exposed to a loss if the market has moved adversely. BLME uses a bespoke methodology to calculate pre-settlement risk, which represents a conservative view of the possible negative currency fluctuation over time. The resultant calculated or "net" credit risk is then assessed on the same basis as primary financing risk.

  Settlement Risk: the possibility that a counterparty might not honour the settlement of a transaction in a financial instrument, leaving BLME exposed if it has paid but failed to receive the corresponding settlement. BLME policy, not including its major Financial Institution ("FIs") Counterparties, is to enter into customer FX or Profit Rate transactions on a delivery versus payment ("DVP") so that no additional exposure arises at maturity. Market transactions with FIs will involve settlement exposure which is covered by the allocation of a specific Settlement Limit.

  Collectively, the total credit default risk represents the majority of the Bank's total identified risk as outlined in the Bank's ICAAP. This is therefore considered to be the key risk undertaken by BLME.

  BLME seeks to mitigate its credit default risk via:

  - A comprehensive credit application process for individual credit exposures.
  - Regular, focused portfolio reviews.
  - Key risk indicator tracking undertaken on a monthly basis via ERC.

Customers are transferred to the Bank's Asset Recovery Unit (ARU) as a result of the incremental risks identified via triggering of the Early Warning Indicators and Watchlist resulting in concerns that BLME could be faced with a non-performing finance ("NPF") situation. BLME policy towards the identification of NPLs mirrors Basel Committee guidance. All customers that have suffered sufficient credit deterioration require specialist intensive care and restructuring involvement from the ARU team. Unless specifically approved otherwise, day-to-day management of the file transfers to ARU.

Customers being managed by ARU will typically exhibit one or more of the following traits:

- Multiple Basel II judgemental triggers or one or more Basel II obligatory triggers
- Covenant breach(es)
- Overdue profit or principal payments
- A known requirement for facility restructuring
- Forbearance or a requirement for forbearance in the short-term
- One or more other escalation events per the First Line of Defence (1 LOD) escalation criteria

1 LOD includes those individuals responsible for ensuring that a risk and control environment is established as part of day to-day operations and for performing customer due diligence.

The Credit Risk Department reserve the right to recommend that any name is elevated to ARU status, subject to CCRC approval. It is also possible for customers to exhibit one or more of the above traits, but not receive an ARU classification (for instance a non-distressed facility restructuring requirement or a minor covenant breach). The ARU checklist contains full details on the requirements of the ARU function on transferal of a file however the below key steps are to be taken in all cases:

1. Day 1: Impairment and transferral to ARU approved by CCRC
2. Day 7: Transferral of file from 1 LOD to be completed
3. Day 14: Customer handover meeting with 1 LOD to be completed
4. Day 30: Finance Loss Reserve form to be submitted to CCRC for approval, containing:
    - Exit analysis
    - Background
    - Future strategy
    - Headline DCF assumptions (to be discussed/agreed at CCRC)
    - Recommendations as to third party business and legal documentation reviews

It is recognised that 30 days may be too soon to adequately determine the level of provisions required. In the event that this is the case, a formal provision recommendation will be provided in line with the quarterly finance loss review (FLR) process. ARU undertakes various actions on receipt of a newly-impaired customer file. These are outlined in full in the ARU checklist, which is completed on an individual basis. In addition to the four steps outlined above, actions arising from ARU classification include, but are not limited to:

- Amendment of the credit rating to a default rating.
- Change of reporting department to ARU.
- Account placed on non-accrual.
- Consideration to be given to a formal, external security review.
- Consideration to be given to a formal, external Independent Business Review or valuation of the underlying assets.
- File is discussed at CCRC on an ad-hoc basis in line with any changes or business updates and is then subject to quarterly FLR.

- **Internal rating and PD estimation process**

  The Bank's independent Credit Risk Department operates its internal rating models, which rates customers on a scale of 1 to 20.

	Fitch	Moody's	BLME (Internal Ratings)	
Investment Grade	AAA	Aaa	aaa	1
	AA+	Aa1	aa+	2
	AA	Aa2	aa	3
	AA-	Aa3	aa-	4
	A+	A1	a+	5
	A	A2	a	6
	A-	A3	a-	7
	BBB+	Baa1	bbb+	8
	BBB	Baa2	bbb	9
	BBB-	Baa3	bbb-	10
Non-Investment Grade "Junk"	BB+	Ba1	bb+	11
	BB	Ba2	bb	12
	BB-	Ba3	bb-	13
	B+	B1	b+	14
	B	B2	b	15
	B-	B3	b-	16
	CCC+	Caa1	ccc+	17
	CCC	Caa2	ccc	17
	CCC-	Caa3	ccc-	17
	CC+	Ca1	d	18
	CC	Ca2	d	18
	CC-	Ca3	d	18
	C+	C1	d	19
	C	C2	d	19
	C-	C3	d	19
	D	D	d	20

Credit ratings are subject to the following hierarchy:

- ECAI (Moody's, and Fitch only) long-term issuer rating
- Moody's Creditedge rating (to be mapped to BLME Internal rating).
- Moody's RiskCalc
- BLME Internal Rating Model (Corporate).
- Manual Rating

BLME Internal Credit Ratings follow a numerical scale and are equated to ECAI ratings in accordance with the BLME Internal Credit Ratings Scale. It is the responsibility of the 1 LOD to populate and propose Credit ratings, with these then challenged and analysed by the Credit Risk department. Formal approval of an individual credit rating is the responsibility of the relevant delegated authority holder, in all cases being the most senior signatory to such a proposal. Customers with a BLME Internal Credit Rating greater than 17 are considered to be in default.

a. Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty is not able to pay 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 permitted 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 by Statement of Financial Position line

The tables below present the Bank's exposure to credit risk on their balance sheet financial instruments as at 31 December 2018, before taking account of any collateral held or other credit enhancements. The amounts at the current reporting date are indicative of the amounts at risk throughout the year.

Bank	**2018**	**2017**
	£000	**£000**
Cash and balances with banks	103,585	94,931
Due from financial institutions		
Murabaha	-	24,844
Wakala	8,045	3,700
Due from customers	14,612	9,027
Investment securities	135,043	126,250
Financing arrangements	700,949	556,642
Finance lease receivables	256,458	170,546
Other assets (Foreign exchange forward deals)	1,154	-
Profit rate swaps	73	-
Total credit exposure	**1,219,919**	**985,940**

The Bank had 11 letters of credit (£14,232K) and 3 guarantees (£2,162k) (2017: 9 letters of credit (£16,034K) and 3 guarantees (£2,061k) with a total exposure of £16 million (2017: £18 million). These letters of credit and guarantees mainly relate to short dated Trade Finance and Corporate and Asset Finance facilities with a maturity of less than twelve months. BLME is only called upon to satisfy a guarantee when the guaranteed party fails ot meet its obligations. BLME expects most guarantees it provides to expire unused. In addition, BLME has a credit exposure to £121m in undrawn commitments (2017: £117m).

iii. Exposure by country of the financed counterparty

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

Bank	**2018**	**2017**
	£000	**£000**
GCC countries		
Bahrain	5,669	8,464
Kuwait	94,293	94,017
Qatar	41,889	14,008
Saudi Arabia	77,829	92,570
United Arab Emirates	15,473	16,064
EEA countries		
United Kingdom	863,995	673,061
Other countries		
Belgium	633	-
Cayman Islands	3,060	6,097
Canada	230	-
Guernsey	-	15,491
Jordan	-	1,369
Isle of Man	-	16,234
Jersey	31,147	11,300
Netherlands	2,399	-
New Zealand	2,104	-
Switzerland	16,716	866
USA	64,482	36,399
Total credit exposure	**1,219,919**	**985,940**

iv. Exposure by economic sector

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

Bank	2018	2017
	£000	£000
Financial services		
GCC financial institutions	147,258	141,042
UK financial institutions	129,947	124,387
Other financial institutions	49,647	45,652
Mining and quarrying	4,806	4,146
Manufacturing	50,508	31,100
Real estate	309,876	295,181
Transportation and storage	41,059	38,447
Government	46,486	40,788
Wholesale / Retail	127,555	84,701
Commodities	86,047	66,886
Energy	13,247	14,072
Construction	117,409	45,151
Others	96,074	54,387
Total credit exposure	**1,219,919**	**985,940**

v. Credit risk quality

The Bank's credit quality and direct investments are managed by CCRC and the Assets & 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 table below shows the breakdown of credit quality as at 31 December 2018. Of the total portfolio 19% (31 December 2017: 24%) was directly rated by at least one of the ECAI, with 81% (31 December 2017: 76%) using internal ratings.

For counterparties not rated by the major ECAI the Bank determines underlying counterparty credit quality by use of rating agency systems including Moody's CreditEdge and Real Estate Models and 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 2018	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	103,585	-	-	-	-	-	-	103,585
Due from financial institutions	-	-	8,045	-	-	-	-	8,045
Due from customers	-	-	14,612	-	-	-	-	14,612
Investment securities								
FVOCI								
Government debt securities	31,839	-	-	-		-	-	31,839
Other Investment securities	62,055	-	-	341	31,171	-	-	93,567
AC								
Government debt securities	3,953	5,684	-	-		-	-	9,637
Other Investment securities	-	-	-	-		-	-	-
Financing arrangements	21,538	-	384,676	251,615	14,087	22,510	6,523	700,949
Finance lease receivables	-	-	103,662	139,678	5,327	552	7,239	256,458
Other assets (Foreign exchange forward deals)	-	-	1,149	5	-	-	-	1,154
Profit rate swaps	73	-	-	-	-	-	-	73
Total credit exposure	**223,043**	**5,684**	**512,144**	**391,639**	**50,585**	**23,062**	**13,762**	**1,219,919**

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**

The Bank's cash balances, amounts due from financial institutions and investment securities were neither past due nor impaired as at 31 December 2018 and 31 December 2017.

Analysis of past due amounts and impairments

Bank	Financing arrangements		Finance Leases	
	2018	2017	2018	2017
	£000	£000	£000	£000
Neither past due nor impaired	679,843	501,318	249,757	157,639
Past due but not impaired	22,510	40,255	552	479
Gross exposure associated with impairment provision	6,523	24,627	7,240	15,618
Less: allowance for impairments	(7,927)	(9,558)	(1,091)	(3,190)
Total	**700,949**	**556,642**	**256,458**	**170,546**

Past due but not impaired	**£000**	**£000**	**£000**	**£000**
Past due up to 30 days	7,565	-	535	367
Past due 30 to 60 days	8,430	374	17	33
Past due 60 to 90 days	6,515	34,659	-	33
Past due over 90 days	-	5,222	-	46
Total	**22,510**	**40,255**	**552**	**479**

The past due but not impaired balances as at 31 December 2018 include £22.5 million (2017: £39.2 million) relating to three real estate transactions (2017: two) where the facility balances are lower than the collateral values. 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".

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 payment. 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 financing 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 pay 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 2018 there had been nine instances (2017: seventeen):

- where the Bank waived material financial covenants or agreed to temporary relaxation of payment 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 2018 of exposures relating to forborne counterparties with no specific impairment charge was £32.7 million, which represents 3% of the Bank's total assets (2017: £37.2 million and 4%). The Stage 1 and 2 ECLs relating to these forborne exposures is £1,228k.

- **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 financed party 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	**2018**	**2017**
	£000	**£000**
Murabaha	-	8,125
Real estate	-	-
Total	**-**	**8,125**

The Murabaha collateral relates to a yacht that was arrested by the receiver as at 31 December 2017. This facility was subsequently repaid in 2018 and the collateral released.

Bank	**2018 On balance sheet exposure**	**2018 Collateral**	**2017 On balance sheet exposure**	**2017 Collateral**
	£000	**£000**	**£000**	**£000**
Cash and balances with banks	103,585	-	94,931	-
Due from financial institutions	8,045	-	28,544	-
Due from customers	14,612	7,188	9,027	-
Investment securities	135,043	-	126,250	-
Financing arrangements	700,949	578,599	556,642	405,535
Finance lease receivables	256,458	236,350	170,546	131,339
Other assets (Foreign exchange forward deals)	1,154	-	-	-
Profit rate swaps	73	-	-	-
Total credit exposure	**1,219,919**	**822,137**	**985,940**	**536,874**

As at 31 December 2018, collateral represented 67% (2017: 55%) of the Bank's total credit exposure.

Bank analysis of collateral	**2018**	**2017**
	£000	**£000**
Plant and equipment	261,516	146,433
Property	359,920	246,173
Raw materials/ finished stock	200,701	144,268
Total credit exposure	**822,137**	**536,874**

In addition, the Bank holds financial guarantees of £82.7 million (2017: £107.6 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.

As at 31 December 2018, 80% (2017: 94%) of the Bank's property financing exposure had an average 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. In the current year we have disclosed financial assets and liabilities subject to offsetting and netting arrangements at their gross value in the statement of financial position.

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			**2018**	**2018**	**2017**	**2017**
		Fair value hierarchy	**Carrying value**	**Fair value**	**Carrying value**	**Fair value**
	Note		**£000**	**£000**	**£000**	**£000**
Cash and balances wih banks		1	103,585	*	94,931	*
Due from financial institutions	i	2	8,045	7,854	28,544	28,498
Due from customers	i	2	14,612	14,600	9,027	9,016
Investment securities	ii, iii	See next table**	135,043	135,043	126,250	126,250
Financing arrangements	iii	3	700,949	692,212	556,642	550,021
Finance lease receivables	iii	3	256,458	254,679	170,546	170,262
Other assets (Foreign exchange forward deals)	iv	2	1,154	1,154	-	-
Profit rate swaps asset	ii	2	73	73	-	-
Due to financial institutions	iii	3	672,240	653,319	514,392	511,278
Profit rate swaps liability	ii	2	469	469	636	636
Due to customers	iii	3	357,427	352,690	277,341	275,261
Other liabilities (Foreign exchange forward deals)	iv	2	237	237	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 accounted for as financial assets at amortised cost.

Notes

i. These assets represent short term liquidity; the majority of these assets have an average residual life of less than one month and a maximum individual residual maturity of 6 months. 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

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	**2018 Level 1 £000**	**2018 Level 2 £000**	**2018 Level 3 £000**	**2018 Total £000**
Investment securities	93,894	-	31,512	125,406
Profit rate swaps asset	-	73	-	73
Profit rate swaps liability	-	469	-	469
Foreign exchange forward deals (assets)	-	1,154	-	1,154
Foreign exchange forward deals (liabilities)	-	237	-	237

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

During the year, there were no transfers between Level 1 and Level 2 fair value measurements (2017: none) and no transfers into or out of Level 3 fair value measurements (2017: none). Transfers between levels occur at the date of the event or change in circumstances that caused the transfer.

The level 3 investment securities' 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.

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 **Investment securities**	**2018** **£000**	**2017** **£000**
Balance at 1 January	12,293	3,189
Total gains / (losses) recognised in:		
- profit or loss*	2	(1,769)
- other comprehensive income**	(195)	(427)
Purchases	24,870	26,000
Sales	(5,458)	(14,700)
Balance at 31 December	**31,512**	**12,293**

premium this amount is included in "net fair value losses on investment securities" in the income statement*

*** this amount is included in "net gain/(losses) on financial assets measured at FVOCI" in the statement of comprehensive income*

The reconciliation for investment securities is included in Note 17.

The table below demonstrates the impact on fair values of FVOCI securities of reasonably possible changes at the 31 December 2017 to one of the significant unobservable inputs, holding the other inputs constant:

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)

The sensitivity analysis in 2018 was not material.

ix. Financial assets and liabilities

The following table details the carrying value by category of financial assets and liabilities as at 31 December 2018.

Bank	2018 Fair value through profit and loss	2018 Fair value through other comprehensive income	2018 Financial assets at amortised cost	2018 Total
Assets	**£000**	**£000**	**£000**	**£000**
Cash and balances with banks	-	-	103,585	103,585
Due from financial institutions	-	-	8,045	8,045
Due from customers			14,612	14,612
Investment securities:				
Sukuk	-	93,894	9,637	103,531
Equity	-	341	-	341
Investment in subsidiaries	-	-	31,171	31,171
Financing arrangements	-	-	700,949	700,949
Finance lease receivables	-	-	256,458	256,458
Other assets	1,154	-	-	1,154
Profit rate swaps	73	-	-	73
Total financial assets	**1,227**	**94,235**	**1,124,457**	**1,219,919**

	Fair value through profit and loss	Other Profit Rate Swaps	Financial liabilities at amortised cost	2018 Total
Liabilities	**£000**	**£000**	**£000**	**£000**
Due to financial institutions	-	-	672,240	672,240
Due to customers	-	-	357,427	357,427
Profit rate swaps	469	-	-	469
Other liabilities (Foreign exchange forward deals)	237	-	-	237
Total financial liabilities	**706**	**-**	**1,029,667**	**1,030,373**

Bank	**2017 Fair value through profit and loss**	**2017 Fair value through other comprehensive income**	**2017 Financial assets at amortised cost**	**2017 Total**
Assets	**£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**

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 as and when they fall due. Liquidity risk also includes the funding concentration risk which is the risk associated to the dependence on a single or limited number of counterparties to provide funding for the Bank's activities.

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 ILAAP, as required by the PRA. Included in the Recovery Plan 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 PRA 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 2018, the Bank held £672 million (2017: £765 million) of term deposits and held £nil (2017: £0.9m) of secondary market assets.

The Bank monitors wholesale funding as part of its Executive Risk Appetite Statement to ensure that:

- The proportion of wholesale liabilities with remaining maturity of less than 3 month is less than 50% of total funding; and
- No single wholesale counterparty is greater than 52% of the aggregated wholesale depositors.

The Bank's 5-year plan intends to reduce the proportion of wholesale funding as a percentage of total funding by targeting retail depositors (Premier Deposit Accounts (PDA) and notice accounts).

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	2018 Total £000
Cash and balances with banks	103,585	-	-	-	-	103,585
Due from financial institutions	-	8,218	-	-	-	8,218
Due from Customers	14,627	-	-	-	-	14,627
Investment securities	31,627	40,133	29,370	38,789	146	140,065
Financing arrangements	371,938	239,617	67,256	34,858	-	713,669
Finance lease receivables	7,107	17,505	83,064	162,921	5,105	275,702
Other assets (Foreign exchange forward deals)	336	819	-	-	-	1,155
Profit rate swaps (asset)	64	59,777	94	15,415	-	75,350
	529,284	**366,069**	**179,784**	**251,983**	**5,251**	**1,332,371**

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**

The tables above show the contractual, undiscounted cash flows of the Bank's financial assets apart from profit rate swaps which are stated at fair value.

None of the Bank's assets have been pledged as collateral apart from cash collateral deposits of £0.05 million (2017: £0.5 million) as security against rental payments on the Bank's premises.

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 £	2018 Total £000
Due to financial institutions	182,138	174,608	321,080	-	-	677,826
Due to customers	41,451	137,676	105,829	85,748	697	371,401
Profit rate swaps	174	60,022	130	15,700	-	76,026
Other liabilities (Foreign exchange forward deals)	3	234	-	-	-	237
	223,766	**372,540**	**427,039**	**101,448**	**697**	**1,125,490**

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**

The tables above show the contractual, undiscounted cash flows of the Bank's financial liabilities apart from profit rate swaps which are stated at fair value.

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 ("LAB") – in line with the Prudential Regulation Authority BIPRU rules

– of £76.1 million as at 31 December 2018 (2017: £91.1 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	**2018**	**2017**
	£000	**£000**
Cash and cash equivalents	103,585	94,931
Highly liquid securities (including LAB)	93,893	104,882
Total	**197,478**	**199,813**

As at 31 December 2018, there are no limitations on the use of the liquidity reserve held by the Bank (2017: 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 2018, 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 £21,511 (2017: £7,951). 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 2018		**At 31 December 2017**	
	Increase of 100 bp £000	**Decrease of 100 bp £000**	**Increase of 100 bp £000**	**Decrease of 100 bp £000**
Increase in profit & loss	6,182	-	4,153	-
Decrease in profit & loss	-	5,884	-	3,761
Increase in equity	5,946	-	3,983	-
Decrease in equity	-	5,522	-	3,579

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 positions 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 2018 £000	At 31 December 2017 £000
Resultant foreign exchange revaluation gain from a 10% strengthening or weakening of the net foreign currency positions against Sterling	(85)	30
	Year to 31 December 2018 £000	**Year to 31 December 2017 £000**
Net foreign exchange gain / (loss) for the period	173	1,746

iii. Equity price risk

Equity prices are monitored by the Bank's Assets & Liabilities Committee ("ALCO") 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 Policy is built around the three lines of defence model. This Policy 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 £6.2 million using the Basic Indicator Approach (2017: £7.0 million) (unaudited).

e. Capital adequacy

At 31 December 2018 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:

	2018	2017
Audited	**£000**	**£000**
Tier 1 Capital - CET1		
Ordinary share capital	48,933	48,933
Share premium	140,623	180,623
Retained earnings / (losses)	38,571	(10,566)
Total Tier 1 capital	**228,127**	**218,990**
Unaudited		
Deductions from Tier 1 capital		
Intangible assets	(266)	(837)
Others	(3,514)	1,640
Total Tier 1 capital after deductions	**224,347**	**219,793**
Tier 2 capital	-	3,915
Total Tier 2 capital	**-**	**3,915**
Total Tier 1 and Tier 2 capital	**224,347**	**223,708**
Deductions from Tier 1 and Tier 2 capital:	NIL	NIL
Total regulatory capital	**224,347**	**223,708**

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.

The Bank'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:

	2018 £000 (unaudited)	2017 £000 (unaudited)
Pillar 1 capital requirements		
Credit risk	93,066	75,456
Market risk - foreign currency PRR	319	110
Counterparty risk capital component	34	13
Operational risk	6,221	7,018
Total Pillar 1 capital requirement	**99,640**	**82,597**
Total regulatory capital in place	**224,347**	**223,708**

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, and 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 2018. The capital planning process continues to incorporate these measures.

GLOSSARY OF ABBREVIATIONS

AED	Arab Emirate Dirham
AFS	Available-for-Sale
AGM	Annual General Meeting
ALCO	Assets & Liabilities 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
CTF	Commodity Trade Finance
DABS	Deferred Annual Bonus Scheme
DFSA	Dubai Financial Services Authority
DIFC	Dubai International Finance Centre
DIPs	Deferred Incentive Plan 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 Standards

IASB	International Accounting Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
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 Customer
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 of 1 basis point
RMF	Risk Management Framework
RRP	Recovery Resolution Plans
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
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

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.
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 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

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