



Pillar III Disclosures

31st December 2009

Pillar III Contents

1. Introduction

- 1.1 Bank of London and The Middle East plc

2. Scope of Pillar III Application

- 2.1 Background
- 2.2 Policy Statement
- 2.3 Consolidation Basis

3. Risk Management Objectives and Policies

- 3.1 Risk Governance
- 3.2 BLME Board of Directors
- 3.3 Non-Executive Committee Structures
- 3.4 Executive Committee Structures
- 3.5 Sharia'a Supervisory Board
- 3.6 Organisation of Risk Management
- 3.7 Compliance
- 3.8 Internal Audit
- 3.9 Risk Categorisation

4. Capital Resources

5. Capital Adequacy

- 5.1 Adhering to BIPRU Capital Requirements

6. Credit Exposure

7. Quality of Credit Portfolio

8. Counterparty Credit Risk

9. Secondary Credit Exposure through Collateral

10. Credit and Dilution Risk

10.1 Impairment of Credit Risks

10.2 Impairment Assessment and Provision at year-end, 31 December 2009

11. Analysis of Credit Exposures and Impairment

12. Credit Risk Mitigation

13. Non-Trading Book Exposures in Equities

14. Profit Rate Risk in the Banking Book

15. Securitisation

1. Introduction

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

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

2. Scope of Pillar III Application

2.1 Background

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

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

The overall Basel II framework is structured around three pillars:

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

2.2 Policy Statement

The Directors, having taken into account the size and complexity of the Bank’s operations, believe that an annual disclosure is appropriate, and that these disclosures be made available on the Bank’s website, www.blme.com. This document represents the Bank’s annual public Pillar III disclosure for the financial year ended 31 December 2009.

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

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

2.3 Consolidation Basis

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

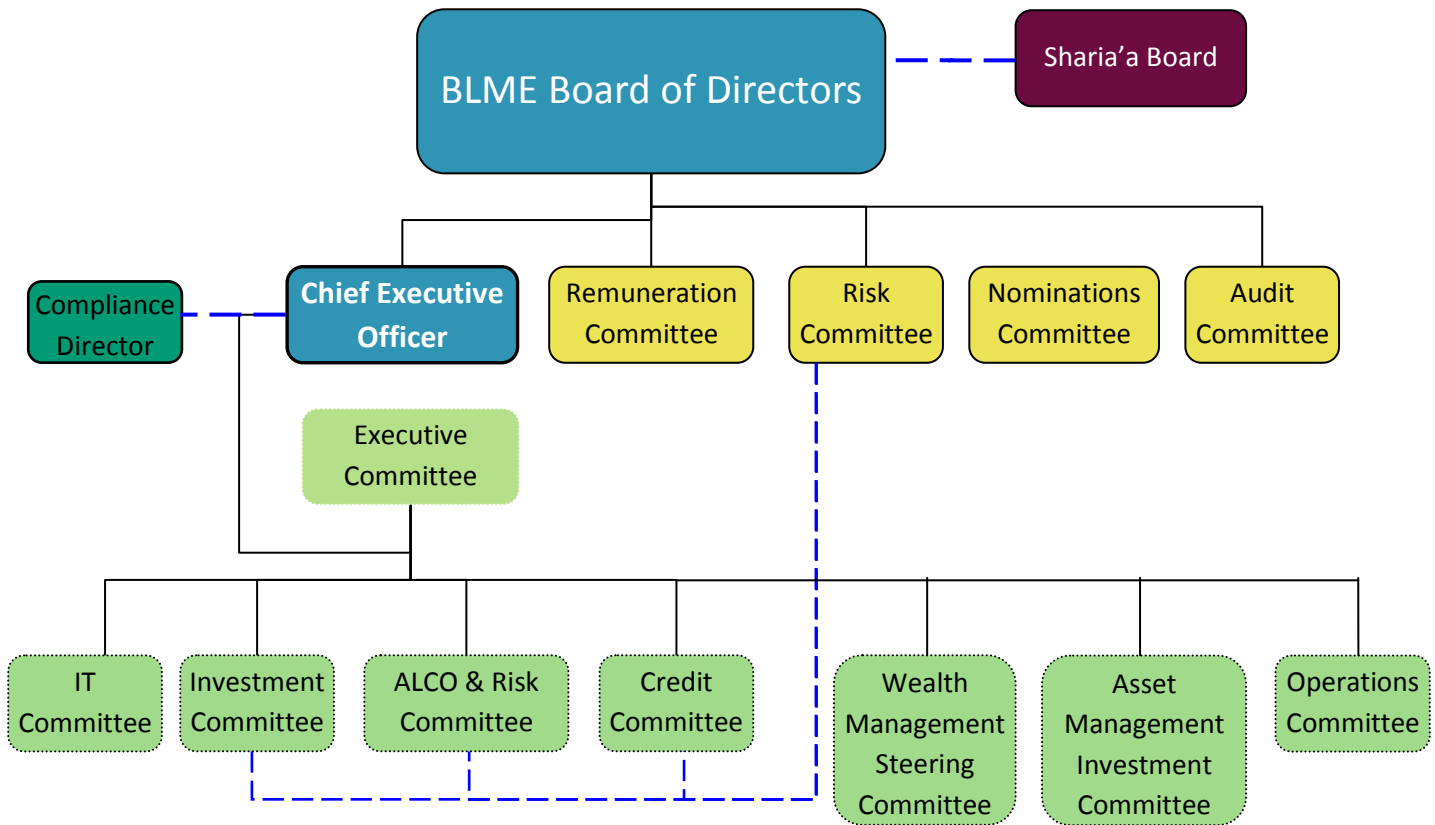
- BLX13 Inc
- Kalakane Transatlantic Investors II Inc
- DMJ I LLC
- DMJ II LLC
- SC-BC LP
- TP Funding Company LLC

This consolidation is consistent with the accounting basis used for the Financial Statements as at 31 December 2009. At this date, management believes that there were no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities among the Bank and its consolidated SPVs.

3. Risk Management Objectives and Policies

3.1 Risk Governance

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



3.2

BLME Board of Directors

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

- A Risk Categorisation that defines the governance of risk within BLME’s committee structure. This provides a definition of the risk, the responsible committee and the regularity that the committees review each risk type. Within this, a strategic assessment is made of the materiality of each risk category, including a quantification of any relevant mitigating factors.
- A Stress Test and Scenario Analysis Policy which defines stress test limits and a programme for such testing for the major categories of risk.
- Materiality Thresholds within the Bank’s Internal Capital Adequacy Assessment Process (ICAAP) document that express BLME’s appetite for risk and which drive the setting of risk limits.

3.3 **Non-Executive Committee Structures**

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

3.3.1 Risk Committee

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

3.3.2 Audit Committee

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

3.3.3 Remuneration Committee (RemCo)

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

3.3.4 Nominations Committee (NomCo)

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

3.4 Executive Committee Structures

3.4.1 The Executive Committee (EXCO)

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

3.4.2 Asset and Liability and Risk Committee (ALCO)

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

3.4.3 Counterparty Credit Risk Committee (CCRC)

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

3.4.4 Investment Committee (IC)

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

3.4.5 Information Technology Committee (ITC)

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

3.4.6 Wealth Management Steering Committee (WESCO)

WESCO provides input and oversight on all aspects of the development and execution of BLME Wealth Management activities until such time as these businesses achieve the critical mass and resources to operate more independently under a Wealth Management umbrella. This committee reports to the Executive Committee.

3.4.7 Operations Committee (OPCO)

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

3.4.8 Asset Management Investment Committee (AMIC)

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

3.5

Sharia'a Supervisory Board

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

3.6 Organisation of Risk Management

The Risk Management Department reports to the BLME Chief Executive Officer. It is managed by a Head of Risk, under which the area is divided into 2 areas:-

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

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

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

3.7. Compliance

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

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

- is independent from the business activities of BLME;
- has direct access to senior management;
- has direct access to any director, officer or employee of BLME;
- has access to all relevant data and records and
- will intervene in any transaction where it has reason to believe that a breach of legal, regulatory or Sharia'a requirements, or of internal policies and standards has occurred or may occur.

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

3.8 Internal Audit

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

3.9 Risk Categorisation

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

- Credit Risk
- Market Risk

- Liquidity Risk
- Operational Risk

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

i. Credit Risk (including Concentration Risk)

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

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

Credit risk limits and guidelines are established in the Bank's Credit Risk Matrix (the Matrix) framework that aligns strategic priorities with the risk appetite of the Bank. Within this framework the Bank's maximum appetite is defined by business sector, tenor and credit rating to ensure that a suitable level of portfolio diversification is achieved. The Matrix limits link into BLME's overall risk appetite, and take account of externally sourced default probabilities.

As the Credit Risk Matrix defines the Bank's appetite by business sector this mitigates the risk of undue concentration risks developing. The Bank also monitors its portfolio in terms of industry and country concentration, and residual value risk in the case of Operating Leases. These reports are given to the Board.

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

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

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

Group Credit Risk capital requirement as at 31st December 2009

Exposure Class	Capital Requirement (8%) GBP thousands
Central governments or central banks	556
Institutions	2,071
Corporates	31,515
Short term claims on institutions and corporates	3,798
CIUs	140
Other items	228
Total Credit Risk Capital	38,308

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

Leasing

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

Property

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

ii. Market Risk

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

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

Daily mark-to-market assessments are made to gauge the behaviour of the ALM book to changes in market rates. On top of this, the Bank’s Stress Testing and Scenario Analysis Policy requires regular stress tests, and sets limits to measure the ability of BLME’s capital resources to withstand extreme adverse changes in market rates. These are presented to ALCO on a monthly basis and quarterly to the Risk Committee.

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

Group Market Price Risk capital requirement as at 31 December 2009

Exposure Class	Capital Requirement GBP thousands
FX Risk	1,454
Total Market Risk Capital Requirement	1,454

iii. Liquidity Risk

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

Liquidity planning and strategy are evaluated in the annual budget process, within which detailed balance sheet and liquidity planning is undertaken for each business area. It is further guided by the

Bank's Liquidity Management Policy as well as the recent changes in FSA policy, notably the December 2009 "Strengthening Liquidity Standards" policy statement. The Liquidity Management Policy lays out the Bank's liability gathering strategy, and its internal prudential liquidity ratios and funding targets. ALCO reviews these liquidity measures and ratios on a monthly basis. These ratios also link into the BLME Stress Testing and Scenario Analysis Policy, particularly the ability of BLME to withstand and adapt to an extreme liquidity squeeze. Detailed liquidity reports and assessments are provided to the Risk Committee on a quarterly basis.

iv. Operational Risk

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

- Implemented a detailed Business Continuity Plan.
- Successfully undertaken a number of full and partial tests of the Disaster Recovery site.
- Implemented the secure SWIFT system for payment messages, as well as a Sharia'a compliant banking system that requires all transactions and data changes to be subject to the four eyes principle.
- Maintained comprehensive insurance policies covering those risks that were identified by an accredited insurance consultant.
- Undertaken an internal legal review, with specialist external support, of all core agreements, contracts and legal documentation.
- Introduced a New Product Approval process that ensures that all new products are reviewed and authorised by relevant business and support areas.
- Ensured that all departments have their own operating procedures.
- Implemented business and operational committees to facilitate the development of the new Wealth Management businesses within a robust and integrated operational framework.

BLME's Operational Risk Policy is founded on the Basel "Sound Practices for the Management and Supervision of Operational Risk" guidelines dated February 2003. The Bank operates and reports to the FSA under the Basic Indicator Approach, under which a prescribed percentage of the Bank's historic and budgeted revenues form the basis of BLME's Operational Risk Capital Adequacy reporting.

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

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

Group Operational Risk capital requirement as at 31 December 2009

Exposure Class	Capital Requirement GBP thousands
Operational Risk – Basic Indicator Approach	3,515

v. Business and Consequential Risks

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

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

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

4. Capital Resources

The Group's capital resources are all components of Tier 1 and Tier 2 Capital. At December 31 2009 these were as follows:

	GBP thousands
Tier 1 Capital	
Share capital	48,928
Share premium	206,206
Retained earnings	(10,697)
Fair value reserve	(514)
Total Tier 1 Capital	243,923
Deductions from Tier 1 Capital:	
Intangible assets	(793)
Total Tier 1 Capital after deductions	243,130
Tier 2 Capital	
Collective allowances for impairment	1,841
Total Tier 2 Capital before deductions	1,841
Total Tier 1 and Tier 2 Capital	244,971
Deductions from Tier 1 and Tier 2 Capital:	
Investment in BLME \$ Income Fund	(32,561)
BLME Umbrella Fund Management Sarl	(15)
Private equity investments	(933)
Total Capital Resources	211,462

5. Capital Adequacy

5.1 Adhering to BIPRU Capital Requirements

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

- Credit risk
- Market risk
- Liquidity risk

- Operational risk
- Business risk

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

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

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

6. Credit Exposure

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

Exposure by Economic Sector and Geographical Region as at 31 December 2009:

	Asia	Middle East	Europe	Americas	Africa
	GBP mn				
Central Governments or Central Banks	55	8%			
Institutions	156	7%	14%		
Corporates	283	4%	26%	7%	2%

	of which:					
	Real Estate	131		2%	15%	
	Transport, Storage & Communication	91		1%	5%	5%
	Mining and Quarrying	17			2%	
	Electrical, Medical and Optical Equip.					
	Supply of Elec. Gas & Hot Water	14				2%
	Other Manufacturing	4			0%	0%
	Retail Trade and Repair	18			2%	
	Other	8			1%	
Short Term		158	1%	7%	14%	
	of which:					
	Institutions	118	1%	6%	10%	
	Other Manufacturing	19			3%	
	Real Estate	9		1%		
	Transport, Storage & Communication	6			1%	
	Other	6		0%	1%	
CIU		2		0%		
Exposure by Economic Sector and Geographical Region as at 31 December 2009 continued:						
			Asia	Middle East	Europe	Americas
						Africa
Other items		80				11%
	of which:					
	Retail Trade & Repair	21				3%
	Mining and Quarrying	16				2%
	Electrical, Medical and Optical Equip.	2				0%
	Food, Beverages & Tobacco	4				1%
	Health & Social work	11				1%
	Real Estate	7				1%
	Other Manufacturing	17				2%
	Pulp, paper, publishing & printing	2				0%
Total		734				

Average exposure over four quarters in 2009 by Economic Sector:

	GBP mn
Central Governments or Central Banks	34
Institutions	78
Corporates	386
<i>of which :</i>	
Real Estate	148
Transport, Storage & Communication	69
Wholesale & Retail Trade	42
Mining and Quarrying	38
Other Manufacturing	24
Leasing Corporate	16
Health & Social work	15
Legal/Accounting/Business Cons & Other Business Activities	12
Electrical, Medical and Optical Equip.	6
Electric, Gas & Hot water supply	4
Pulp, paper, publishing & printing	2
Recreational, Cultural & Sporting	2
Food, Beverages & Tobacco	1
Other	7
Average exposure over four quarters in 2009 by Economic Sector continued:	
Short Term	236
<i>of which :</i>	
Institutions	183
Other Manufacturing	27
Investment Companies	12
Transport, Storage & Communications	5
Mining & Quarrying	3
Wholesale & Retail Trade	3
Real Estate	2
Other	1
CIU	30

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

Exposure by Economic Sector and Maturity as 31 December 2009:

	GBP mn	GBP mn	GBP mn	GBP mn
	<12m	<24m	<60m	>5yrs
Central Governments or Central Banks	0	0	45	10
Institutions	112	15	29	0
Corporates	50	36	134	63
Short Term	158			
CIU	2			
Other	8	15	35	22
	330	66	243	95

7. Quality of Credit Portfolio

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

Exposure by Rating Band 31 December 2009:

RATING BAND	GBP mn
AAA TO AA-	193
A+ TO A-	157
BBB+ TO BBB-	256
BB+ TO BB-	105
B+ TO B-	13
CCC+ and Below	10
Total Credit Exposure	734

Where more than one ECAI rating exists and the ratings differ (i.e. a split rating) BLME will assign the most conservative of the ratings. Where none of the three afore-mentioned ECAI ratings exist BLME assigns its own internal counterparty rating. Any such rating is subject to “no objection” being raised by the CCRC. Overall, 82.6% of BLME’s credit exposure is investment grade or equivalent. Within this, 64% of the portfolio was directly rated by at least one of the ECAI, with the remaining 36% being mapped using internal ratings.

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

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

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

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

8. Counterparty Credit Risk

Counterparty pre-settlement risk is very limited. It arises through a small number of Profit Rate Swaps (PRS) transacted to hedge the fixed rate exposures in Banking Book transactions. These PRS have been undertaken with ECAI investment grade rated banks, for which BLME allocates separate sub-limits. There is no collateral given or taken for PRS transactions. BLME’s assessment of pre-settlement risk takes account of the daily mark-to-market of these positions plus a conservative

volatility add-on. The latter manages the risk that adverse future changes in market rates could result in higher counterparty risks. The exposures from these transactions are deemed to be immaterial for the purposes of this disclosure.

9. Secondary Credit Exposure through Collateral

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

10. Credit and Dilution Risk

10.1 Impairment of Credit Risks

For accounting and credit risk management purposes:

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

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

10.2 Impairment assessment and provision at year end, 31 December 2009

The Bank has established a Non-Accrual and Provisioning Policy to monitor impairment events that could lead to losses in its asset portfolio. This policy covers specific loss events for individual exposures, as well as events that relate to collective losses on groups of homogenous assets that have yet to be identified and assessed individually for impairment. The Bank writes off a balance and any related allowances for impairment when the Credit Risk Management department determines

that the balance is uncollectable. This determination is reached after considering information such as the occurrence of significant changes in the counterparty’s financial position such that the borrower’s obligation can no longer be serviced, or that proceeds from collateral will not be sufficient to pay back the entire exposure. The provision is recommended by the CCRC before being referred to the Audit Committee and the Board for ultimate approval. For the period ending 31 December 2009 BLME considered it prudent to take an impairment charge of £21, 011,494 in respect of four exposures. These equate to 2.8% of total assets.

As at 31 December 2009

Exposures past due	GBP
Exposures considered impaired	£37,239,000
Impairment provision	£17,728,374

11. Analysis of Credit Exposures and Impairment

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

12. Credit Risk Mitigation

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

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

13. Non-Trading Book Exposures in Equities

The Bank has only a small number of minor Private Equity and Venture Capital exposures. The exposure from these transactions is deemed to be immaterial for the purposes of this disclosure.

14. Profit Rate Risk in the Banking Book

These risks principally emanate from the following sources:

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

The December 31 2009 sensitivity to a standard parallel 100 basis points change in the yield curve across all currencies for the Bank’s transactional and capital risks was a reduction in potential earnings of £5,876,000 across all currencies over the seven year term of the Bank’s asset and liability re-price risk profile.

Currency	100 Basis Points Move GBP thousands
GBP (£)	(7,195)
USD (\$)	1,340
EUR (€)	69
TOTAL (GBP)	(5,786)

15. Securitisation

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