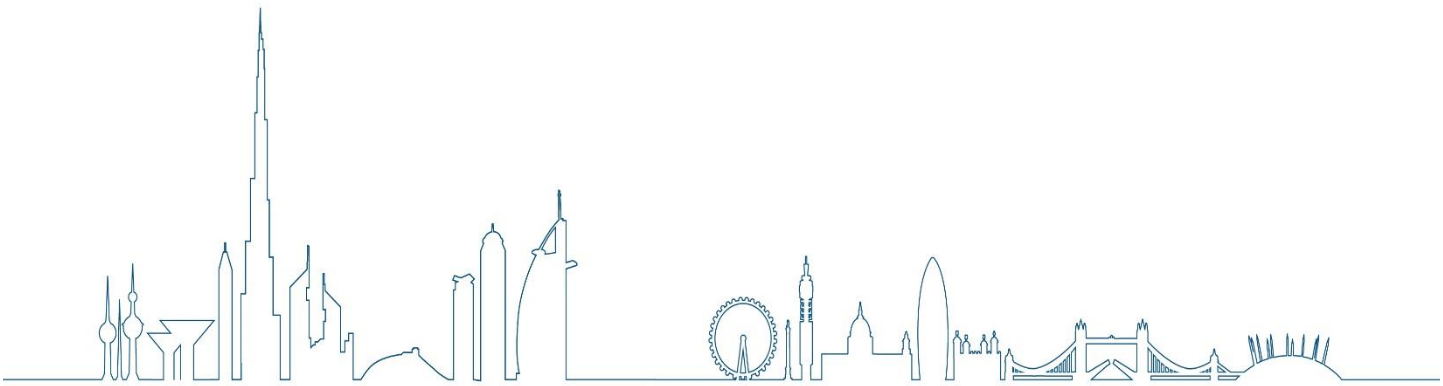
blme | بنك لندن والشرق الأوسط
Bank of London & The Middle East

# BLME Holdings plc
# Annual Report and Financial Statements
# For the year ended 31 December 2018

Registered number 08503102



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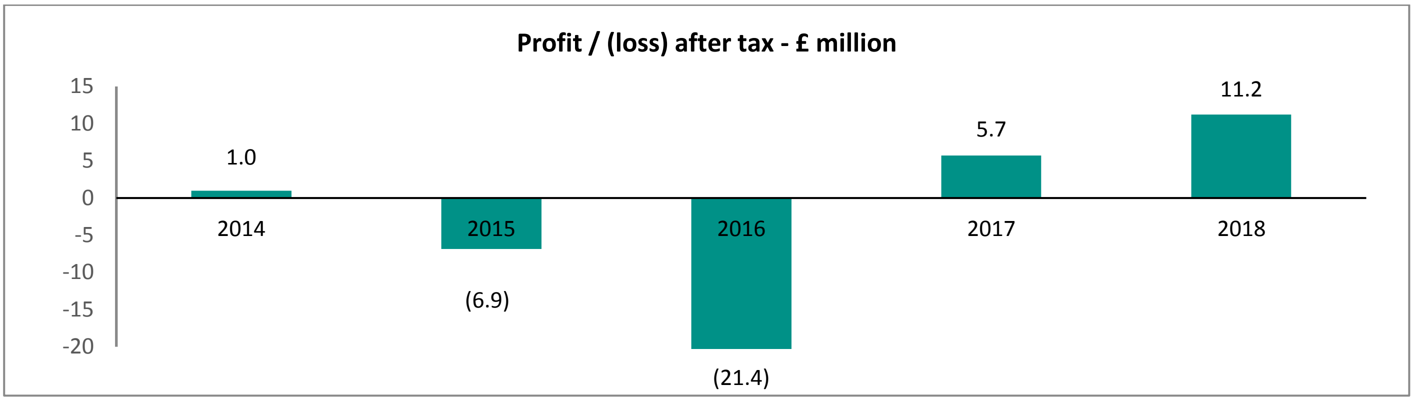
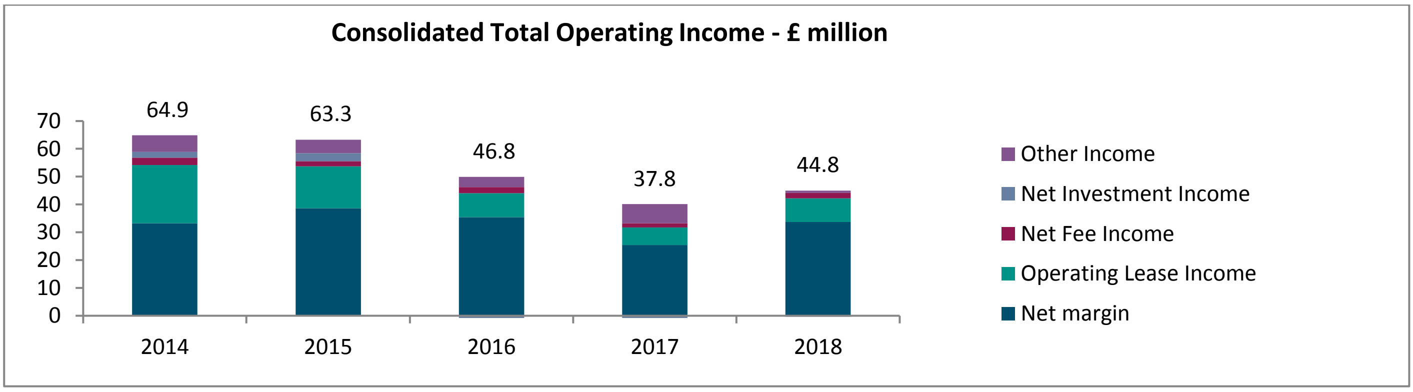
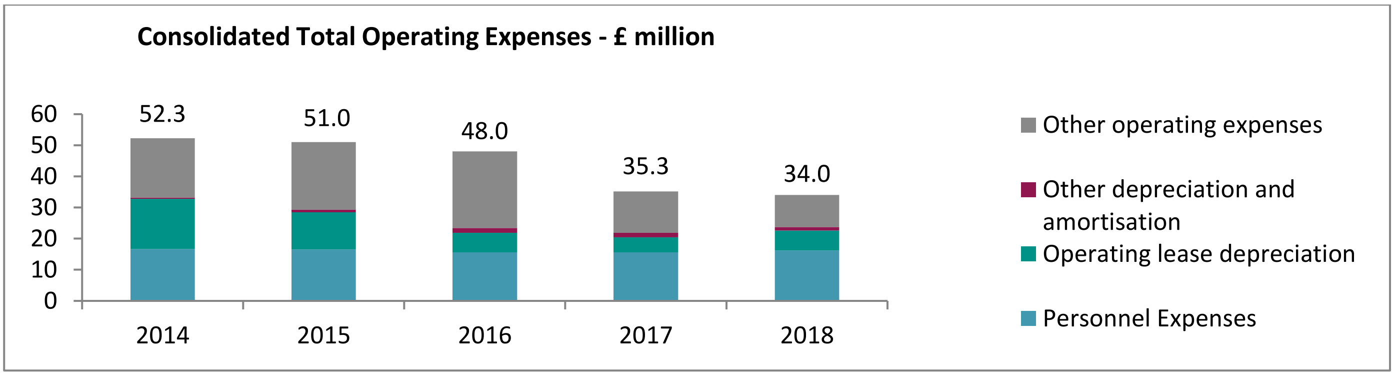
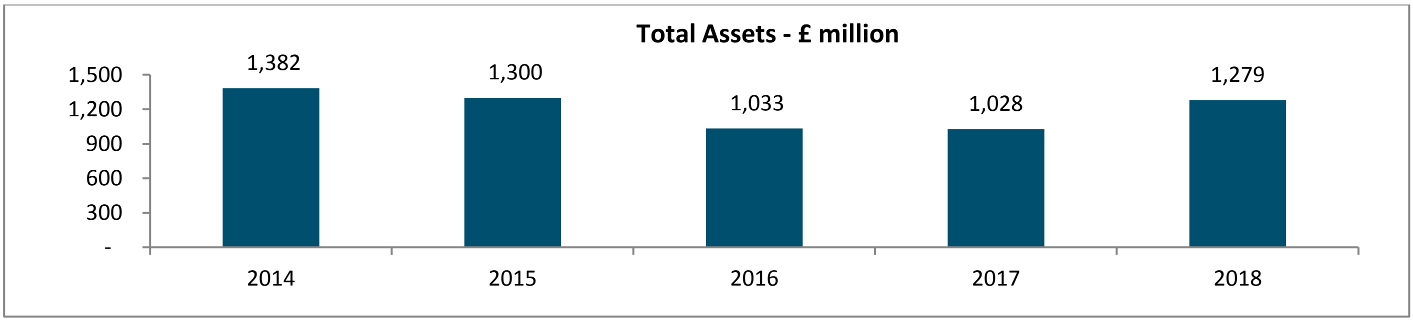
## 2018 GROUP HIGHLIGHTS FOR BLME HOLDINGS PLC

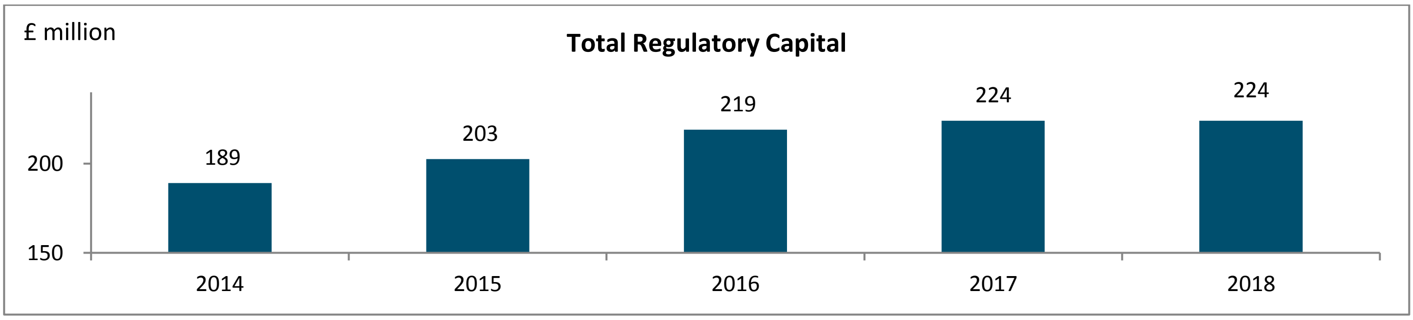
The Group's profit after tax for the year ended 31 December 2018 was £11.2 million (year to 31 December 2017: £5.7 million).



# CHAIRMAN'S STATEMENT

***In the name of Allah, the Most Gracious, the Most Merciful***

**Dear Shareholders**

2018 was an excellent year for BLME. I am so pleased with the progress the Group has made during another profitable year.

The launch of the Dubai International Financial Centre (DIFC) Branch provides the perfect base to grow the GCC client base in line with the Wealth Management focused strategy.

Last year we welcomed Joanne Hindle to the BLME board. She has since become the Chairman of the Remuneration Committee, bringing a wealth of experience and a deep understanding of the UK regulatory and financial services sector.

The Board has taken significant steps to address the concerns of our shareholders and as a result, instigated a Share Repurchase Programme after the half year point. The Share Repurchase Programme conducted in December 2018 went smoothly with 10,357,374 shares repurchased for a total consideration of US$4.51m. We maintain an open dialogue with our shareholders and thank them for their support.

I would like to thank the staff and the senior management team for their hard work and the focus they have applied in the continuing success of BLME.

Finally the Board are grateful for the support and guidance of the Sharia'a Supervisory Board.

Adel Abdul Wahab Al-Majed
**Chairman**
20 March 2019

**Naming convention and abbreviations:**
The expression "the Company" or "the Group" or "the BLME Group" refers to BLME Holdings plc and its subsidiaries. BLME Holdings plc is the ultimate parent company and is listed on Nasdaq Dubai.
The name of the principal subsidiary, Bank of London and The Middle East plc is shortened to "BLME" or "the Bank" in narrative text.

## CHIEF EXECUTIVE OFFICER'S STATEMENT

BLME built upon the successful turnaround of 2017 and took another significant step forward. The Wealth Management focussed strategy has started to bear fruit and our cautious and disciplined approach to risk, compliance and operational resilience has paid off. BLME has proven, despite considerable economic and political headwinds, that BLME has a sustainable and value creating business model.

A key highlight for BLME Holdings plc during the year was the completion of the Share Repurchase Programme in December 2018 where 10,357,374 of the Company's shares were repurchased for a total consideration of US$4.51m.

**Financial Performance**

In 2018 the Group achieved a profit after tax of £11.2m, by far the best year in our history, compared to £5.7m in 2017. The cost to income ratio, a core indicator of efficiency for commercial banks, improved considerably from 93% in 2017 to 72%. Importantly, this improvement in the efficiency of the Bank was achieved by increased revenues as well as reduced costs.

Total assets increased 25% to £1.28bn, with asset growth in all the major business lines. Our capital ratios have remained healthy, with a Tier 1 ratio of 18% and a Tier 1 capital surplus of £125m both of which are above the minimum regulatory requirements, ensuring BLME remains one of the best capitalised banks in its peer group.

**Risk Management**

Throughout 2018 we have maintained a cautious risk appetite, choosing to prioritise asset quality ahead of asset growth. Non-performing financing assets as a proportion of our financing portfolio have fallen once again from 5.5% in 2017 to 2.2%. A net impairment loss of £2.3m (of which £2.6m is a result of the new IFRS 9 stage 1 and 2 ECL model implementation) reflects both the Bank's credit quality and the efficient management and recovery of historic distressed assets.

Operational risk, particularly cyber risk and conduct risk, remained at the top of our agenda. Whilst we had no major operational events during 2018, we have nevertheless continued to build and test our defences and incident resolution capabilities, acknowledging the constantly changing world we operate in.

**Distribution**

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. Our number of Private Banking clients doubled in 2018. Another key element of our Wealth Management-focussed strategy is to build partnerships with GCC Sharia'a compliant banks that do not have a UK presence; a good example of our success was our referral agreement with Al Baraka Group to support clients from their extensive branch network.

The BLME UK Leasing business, in which we see considerable potential, also grew its origination capabilities through support for the start-up small ticket leasing company, Carrick Asset Finance. We have continued to increase our UK Leasing sales force to complement our large network of broker relationships.

**Products**

In addition to our longstanding expertise in real estate financing, developing investment products for our High Net Worth clients has been a priority. The £55m acquisition of the landmark Atlantic Quay 1 building in Glasgow, backed by a top quality long lease, demonstrated our ability to acquire, structure and market innovative investment opportunities for clients.

Further development of our leading online fixed deposit products saw a 32% growth in our retail deposits despite strong competition in the market.

**People**

The independent annual staff survey once again demonstrated that we have maintained very high levels of staff engagement, drawing on our strong values and culture to make BLME a great place to work.

We are committed to the training and development of our people. We proudly announce that 18% of our employees have passed the Islamic Finance Qualification (IFQ), accredited by the Chartered Institute for Securities & Investment, providing the highest level of Sharia'a expertise in our sector. By the end of 2019, our ambition is to have over 33% of BLME staff with an IFQ.

**Shareholders**

We are truly grateful to our longstanding shareholders who have been extremely patient and understanding since our launch. We have recognised shareholder concerns about the lack of liquidity of BLME Holdings shares and of the current share price and whether it reflects the inherent value of BLME. In 2018 we undertook a share repurchase programme, acquiring 5.3% of the shares at a price of up to 50% premium to the previously traded price. We continue to actively listen to our shareholders.

**Future**

We now have a stable bank with a strong balance sheet and further room to grow. The markets we operate in, however, remain highly competitive and it will take resourcefulness, customer centricity and outstanding execution for us to continue to succeed.

I'm very proud to be leading the Bank through this next, challenging stage of its evolution. I would like to thank our Chairman, Adel Al Majed, and the Board for their valuable support and guidance, my BLME team members for their outstanding efforts again this year, and finally the Sharia'a Supervisory Board for their wise counsel.

Giles Cunningham
**Chief Executive Officer**
20 March 2019

# THE BOARD AND EXECUTIVE MANAGEMENT

**Adel Abdul Wahab Al-Majed – Chairman**

Adel is the Non-executive Chairman of the Board of BLME Holdings plc. He has over 30 years of experience in banking. He is currently Chief Executive Officer and Vice-Chairman of BLME's largest shareholder, Boubyan Bank K.S.C.P, having previously held the position of Chairman. From 1980 to 2009 Adel worked for National Bank of Kuwait where he held a number of positions including Deputy Chief Executive Officer and General Manager. Adel has played a key role in the development of the Kuwait banking sector including regulation, shared enterprises (Credit Bureau and K-Net Shared Switch) and Islamic Banking.

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

Sheikh Abdullah is the Non-executive Vice Chairman of the Board of BLME Holdings plc. He has over 30 years of experience in financial services. Previously he was the Deputy Director General for Investment and Operations at Kuwait's Public Institution for Social Security ("PIFSS"), the Vice Chairman of Ahli United Bank of Kuwait and the Chairman of Housing Finance Company (Unicap Investment and Finance Company). He also was a Board Member of the Ahli Bank of Kuwait, Global Investment House, and the Chairman of Kuwait Financing Service Co. He started his career at PIFSS and then became a Vice President at Wafra Investment Advisory Group in New York where he was involved in direct equity, real estate and equity portfolios.

**Executive Directors**

**Giles Cunningham – Chief Executive Officer**

Giles Cunningham joined BLME in October 2016 having previously served as Chief Executive Officer, International at Qatar Islamic Bank in Doha. Prior to that appointment Giles was Group Chief Executive Officer of The Zubair Corporation from 2008 until 2011. He started his career at Kleinwort Benson, the investment bank, before moving to Lloyds Banking Group where he spent 17 years. Giles held a number of senior roles with Lloyds, both in the UK and internationally. This included two years as Head of Finance & Strategy in Lloyds Banking Group , Brazil and three years as the Bank's Middle East Chief Executive Officer, based in Dubai. Most recently he was based in London and responsible for the Lloyds International strategy and business, including a role as International Transformation Director, leading the Bank's international disposals and reorganisation. Giles is a mathematics graduate, an Associate of the Chartered Institute of Bankers, holds an MBA and is an active Harvard Business School alumnus.

**Chris Power – Chief Financial Officer**

Chris joined the Bank in September 2015 as CFO and temporarily also holding the COO role. He graduated from the London School of Economics and holds an MBA. He qualified as a chartered accountant at Deloitte in London in 1986 and became an FCA and progressed to become a Senior Manager heading up the Hong Kong Banking and Securities Group of Deloitte. Chris joined the ABN Amro group in 1994, heading the Corporate Control and Compliance function before becoming joint CFO/COO of the listed Bank in Asia. In 2004, Chris became a Corporate Executive Vice President of ABN Amro's Top Executive Group heading up the control function for South America based in Brazil. In 2008 he joined CLS Group Holdings AG (the world's foreign exchange settlement utility) as the Chief Financial Officer and in 2010 was the Group Finance Director of the Board.

**Non-executive Directors**

**Michael Williams (Senior Independent Director)**

As well as being the Senior Independent Director of BLME Holdings plc, Michael Williams is also the Chairman of the Nominations Committee. He joined the Bank in 2012 and held positions including Chairman of the Nominations Committee and of the Risk Committee prior to being appointed Chief Executive Officer on an interim basis between May 2015 and March 2016. He is a qualified banker with an extensive background in international finance. He has held a number of senior and board level positions in the UK and in the Middle East. Prior to joining the Board of BLME, he was Chief Executive Officer of the International Bank of Qatar in Doha before which he was in Dubai as the Chief Executive Officer of the National Bank of Fujairah, having previously been the Managing Director of Nomura Bank International Plc for 6 years. Michael started his career with Barclays Bank Group working for them for 25 years holding a number of senior positions including Managing Director of Barclays Global Services and Corporate Banking Director at Barclays Bank PLC.

**David Williams (Independent)**
David Williams joined the Bank in October 2015 as an Independent Non-executive Director and Chairman of the Risk Committee. He is a senior credit risk professional with 28 years of experience in international banking operating at executive and board level in the Middle East, Europe and Asia. Over a career with Barclays PLC his executive roles included Wholesale Credit Risk Director of the Barclays Group and Chief Credit Officer at Barclays Capital. David was a Non-executive Board Director of LCH Clearnet Group Ltd. David is a former British Army officer and is currently a Trustee of Haig Housing Trust, a major services charity.

**Jabra Ghandour**
Jabra Ghandour is a Non-executive Board member of BLME Holdings plc having previously served as Chief Executive Officer between March and November 2016. He has more than 30 years of experience in Financial Services. He is currently Chief Executive Officer of Boubyan Capital Investment Company, a subsidiary of BLME's largest shareholder, Boubyan Bank K.S.C.P Before joining BLME he was the Managing Director and Board member of International Bank of Qatar. Jabra began his career at Cairo Amman Bank where he was Head of Treasury before moving to Union Bank as Executive Manager responsible for Treasury and Financial Institutions. Jabra joined Jordan National Bank (Ahli Bank) in 1994 as Assistant General Manager followed by four years at Merrill Lynch (Jordan) as General Manager. From 2002 to 2012 he worked at National Bank of Kuwait holding several senior positions including General Manager, Jordan and Head of Private Banking. Jabra has played a key role in developing and growing market leading banks. He is also an independent Board member of Bank of Etihad.

**Calum Thomson (Independent)**
Calum Thomson joined the Board of BLME Holdings Plc in April 2017 as Chairman of the Audit Committee and a member of the Risk Committee, Nominations Committee and the Board Credit Committee. He has over 25 years of experience in the Financial Services industry and was at Deloitte LLP for 21 years, specialising in the Financial Services sector. During his career at Deloitte he has led the global and UK asset management groups. Calum qualified as an accountant at EY, from there he went on to work at Lloyds of London's Regulatory Review department. His experience includes clients in the Middle East, Malaysia, UK and the US covering wealth management, private banking, private equity and the General Insurance Markets. Calum is a Non-Executive Director and Audit Committee Chair of The Diverse Income Trust plc, British Empire Trust plc, Baring Emerging Europe plc and Standard Life Private Equity plc and a Non-executive Director of Schroder Pension Management Ltd and Schroder Unit Trusts Ltd.

**Joanne Hindle (Independent)**
Joanne Hindle joined the Board of BLME Holdings as an Independent Non-Executive Director in July 2018. She has over 30 years of experience in the financial services industry having held both executive and board level positions. Over her career Joanne has been Corporate Services Director at Unum Limited and Director of Pensions Development at NatWest Life. Amongst her portfolio of non-executive board positions, Joanne is Chairman of Shepherd's Friendly Society, a legal and compliance consultant for AXA Assistance and formerly was Chairman of Holmesdale Building Society.

# GROUP STRATEGIC REPORT

**THE BUSINESS MODEL**
BLME Holdings plc operates as the holding company of The Bank of London and The Middle East plc ("BLME") which 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 Group'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 $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 and Group's capital, liquidity and funding, ensuring that the Group 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. We have 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. We have 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 we build on our 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 Group.

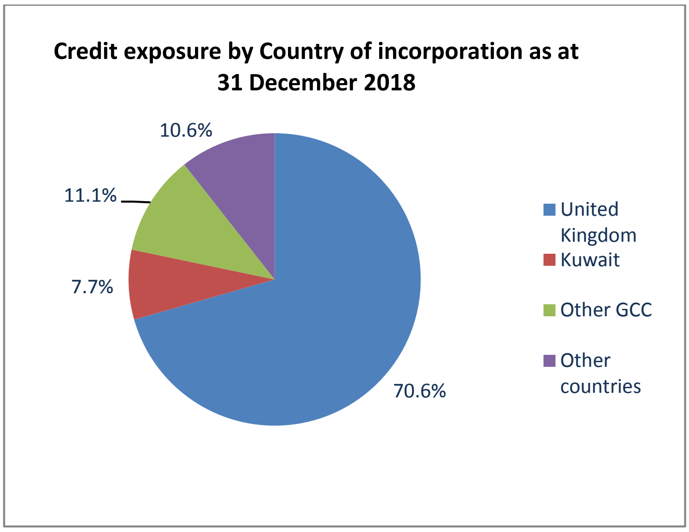
BLME works hard to align their core values with our strategic objectives to ensure that our employees operate in accordance with our conservative risk appetite. Central to our values, we take measures to ensure that we are operating in accordance with Sharia'a, as a result we liaise with our Sharia'a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

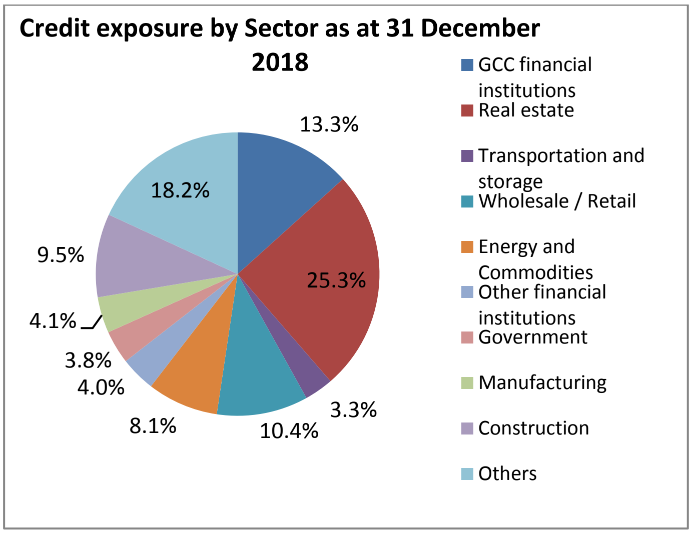
**FINANCIAL RESULTS**

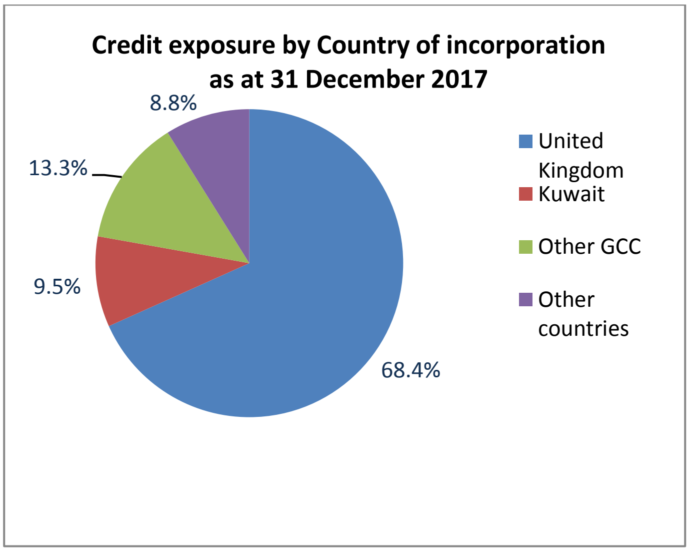
The financial statements for the year ended 31 December 2018 are shown on pages 37 to 46. The profit after tax for the year amounted to £11.2 million (2017: £5.7 million). Below are the highlights of the financial performance and the position as at 31 December 2018.

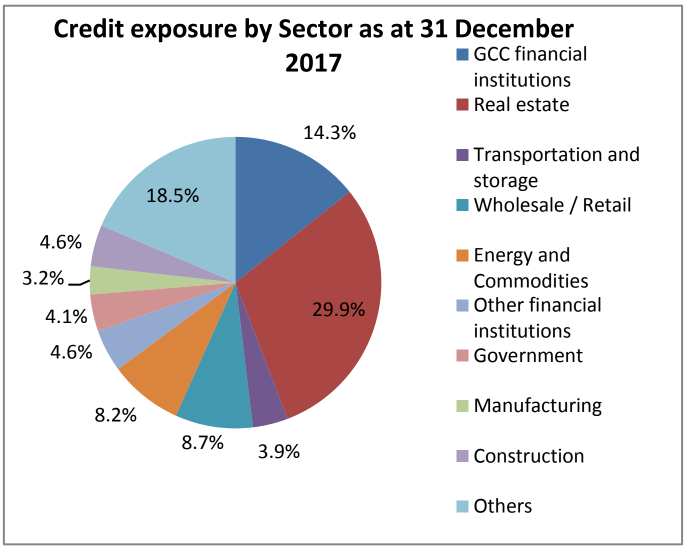
| **Key performance indicators** | **2018** | **2017** |
|---|---|---|
| Post-tax return on equity | 4.8% | 2.8% |
| Cost income ratio | 72% | 93% |
| Net fee income / total income | 4.8% | 3.7% |
| Non-performing Financing Assets to overall Financial Assets | 2.2% | 5.5% |
| Number of depositors | 4,857 | 3,204 |

The charts show the credit exposure by country of incorporation and by sector. Further details can be found in Note 36.




## GROUP NON-FINANCIAL INFORMATION STATEMENT

### BLME Employee Engagement

The Group 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 Group 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 Group and have introduced regular training programmes. An important part of the training programme has been the Islamic Finance Qualification which the Group encourages all employees to take.

### The Environment

The Group's 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**

The Group 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 Group'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 Group 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 Group. 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

# DIRECTORS' REPORT

The Directors present their annual report and audited financial statements for the year ended 31 December 2018.

**Principal activities**

BLME Holdings plc ("the Company" or "the Group") was incorporated in the United Kingdom on 24 April 2013 and its principal activity is to act as a holding company for Bank of London and The Middle East plc ("the Bank" or "BLME") and its subsidiaries. The insertion of the Company as a holding company of the Bank was effected pursuant to a Scheme of Arrangement in 2013.

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. The results for the year are discussed further in the Group's strategic report.

**Financial results and dividends**

The financial statements for the year ended 31 December 2018 are shown on pages 37 to 46. The consolidated Group profit for the year after taxation amounts to £11.2 million (2017: £5.7 million). The result for the stand-alone Company for the year was a loss of £6.6 million (2017: £21.8 million profit). The Directors do not recommend the payment of a dividend for the year ended 31 December 2018 (2017: £Nil).

During the year, BLME 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. BLME initially owned 100% of the equity of AQ1 Limited, the Jersey company which is financing the transaction. BLME sold down part of its investment prior to the year end resulting in a remaining equity investment of 56%.

**Share Repurchase Programme**

The Company conducted a share repurchase programme on the Nasdaq Dubai Stock Exchange over eight trading days commencing on Monday 10 December 2018. Boubyan Bank K.S.C.P. and the directors of the Company did not participate in the programme. The purpose of the share repurchase programme was to increase the liquidity of the stock and was targeted towards the smaller shareholders. The total number of shares purchased was 10,357,374 for a total consideration of $4.510m (£3.57m) at an average price paid per share of $0.4354 (£0.3446). As referred to in Note 34, on 9 January 2019 the Company repurchased the 10,357,374 shares from NBK Banque Privée (Suisse) SA and these shares are now held in treasury.

In USD$

| **Month** | **Number of shares** | **Highest price paid per share** | **Lowest price paid per share** | **Average price paid per share** | **Aggregate price paid** |
|---|---|---|---|---|---|
| | | $ | $ | $ | $ |
| Share buy-back in 2018 | | | | | |
| Dec-18 | 10,357,374 | 0.6000 | 0.3950 | 0.4354 | 4,510,007 |

In GBP

| Month | Number of shares | Highest price paid per share | Lowest price paid per share | Average price paid per share | Aggregate price paid |
|---|---|---|---|---|---|
| | | £ | £ | £ | £ |
| Share buy-back in 2018 | | | | | |
| Dec-18 | 10,357,374 | 0.4748 | 0.3126 | 0.3446 | 3,569,622 |

**Directors and Directors' interests**

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<br>*Chairman of the Board* | 26 April 2013 | | |
| Sheikh Abdullah Jaber Al-Ahmed Al-Sabah<br>*Vice Chairman of the Board* | 26 April 2013 | | Audit<br>Risk<br>Remuneration |
| Giles Cunningham<br>*Chief Executive Officer* | 17 November 2016 | | Executive |
| Chris Power<br>*Chief Financial Officer* | 26 September 2016 | | Executive |
| Michael Williams (Senior Independent Director)<br>*Chairman of the Nominations Committee* | 26 April 2013 | | Nominations<br>Remuneration<br>Risk |
| Joanne Hindle (Independent)<br>*Chairman of the Remuneration Committee* | 1 July 2018 | | Nominations<br>Remuneration<br>Audit<br>Risk |
| Calum Thomson (Independent)<br>*Chairman of the Audit Committee* | 1 April 2017 | | Audit<br>Risk<br>Nominations<br>Remuneration |
| Jabra Ghandour | 25 March 2016 | | |
| David Williams (Independent)<br>*Chairman of the Board Risk Committee* | 15 October 2015 | | Nominations<br>Remuneration<br>Risk |
| Neil Holden (Independent) | 26 April 2013 | 14 May 2018 | N/A |

Pursuant to the provisions of the Company's Articles of Association, any Director who has been appointed by the Board during the financial year, rather than at a general meeting of Shareholders, must stand for election by the Shareholders at the first Annual General Meeting (AGM) following their appointment. Following that AGM the Directors must stand for re-election by the Shareholders at least every three years. All of the current Directors will offer themselves for re-election at the AGM in 2019.

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

The Directors who held office at 31 December 2018 had the following beneficial interests in the ordinary shares of the Company at the end of the year.

| Name | Class of share | Number of shares held at 31 December 2018 | Number of shares held at 31 December 2017 |
|---|---|---|---|
| Adel Abdul Wahab Al-Majed | Ordinary 25p | 1,000,000 | 1,000,000 |
| Sheikh Abdullah Jaber Al-Ahmed Al-Sabah | Ordinary 25p | 80,000 | 80,000 |
| Michael Williams | Ordinary 25p | 30,000 | 30,000 |
| David Williams | Ordinary 25p | 30,000 | 30,000 |
| Calum Thomson | Ordinary 25p | 30,000 | 30,000 |
| Jabra Ghandour | Ordinary 25p | 500,000 | 500,000 |
| Joanne Hindle | Ordinary 25p | Nil | Nil |
| Giles Cunningham | Ordinary 25p | 813,120 | 813,120 |
| Chris Power | Ordinary 25p | 30,000 | 30,000 |

**Chairman's other significant commitments**

| Director | Company | Appointment | Date of Appointment |
|---|---|---|---|
| Adel Abdul Wahab Al-Majed (BLME Group Chairman 31 March 2014 to present) | Boubyan Bank K.S.C.P | Chief Executive Officer and Vice Chairman | 27 March 2013 |
| | Boubyan Capital Investment Company K.S.C.P | Chairman | 27 March 2013 |

The Board acknowledges that Adel Abdul Wahab Al-Majed's other commitments may give rise to conflicts of interest and have procedures in place to ensure that the Group is not disadvantaged. A Director shall not vote at a meeting of the Board or of a Committee of the Board on any resolution concerning a matter in which a direct or indirect interest is held.

The Directors complete annual conflicts of interest declarations and ensure the Board is informed of any change in circumstances throughout the year.

**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 Group 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 Group manages these risks is provided in Note 36.

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 Group made no political contributions during the year (2017: £nil).

**Future developments**

The business strategy and prospects for future financial years are included in the Group Strategic Report on pages 8 to 11. The material business risks are set out in Note 36 Financial Risk Management from page 94.

**Going concern**

The Directors have reviewed the business activities and financial position of the Group and have a reasonable expectation that it has adequate resources to continue in operational existence for the foreseeable future. In making this assessment the Directors have considered a wide range of information about the current and future condition of the Group including the strategic direction, activities and risks that affect the financial position.

For these reasons the consolidated financial statements of the Group and parent Company 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 Company'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 Company'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.

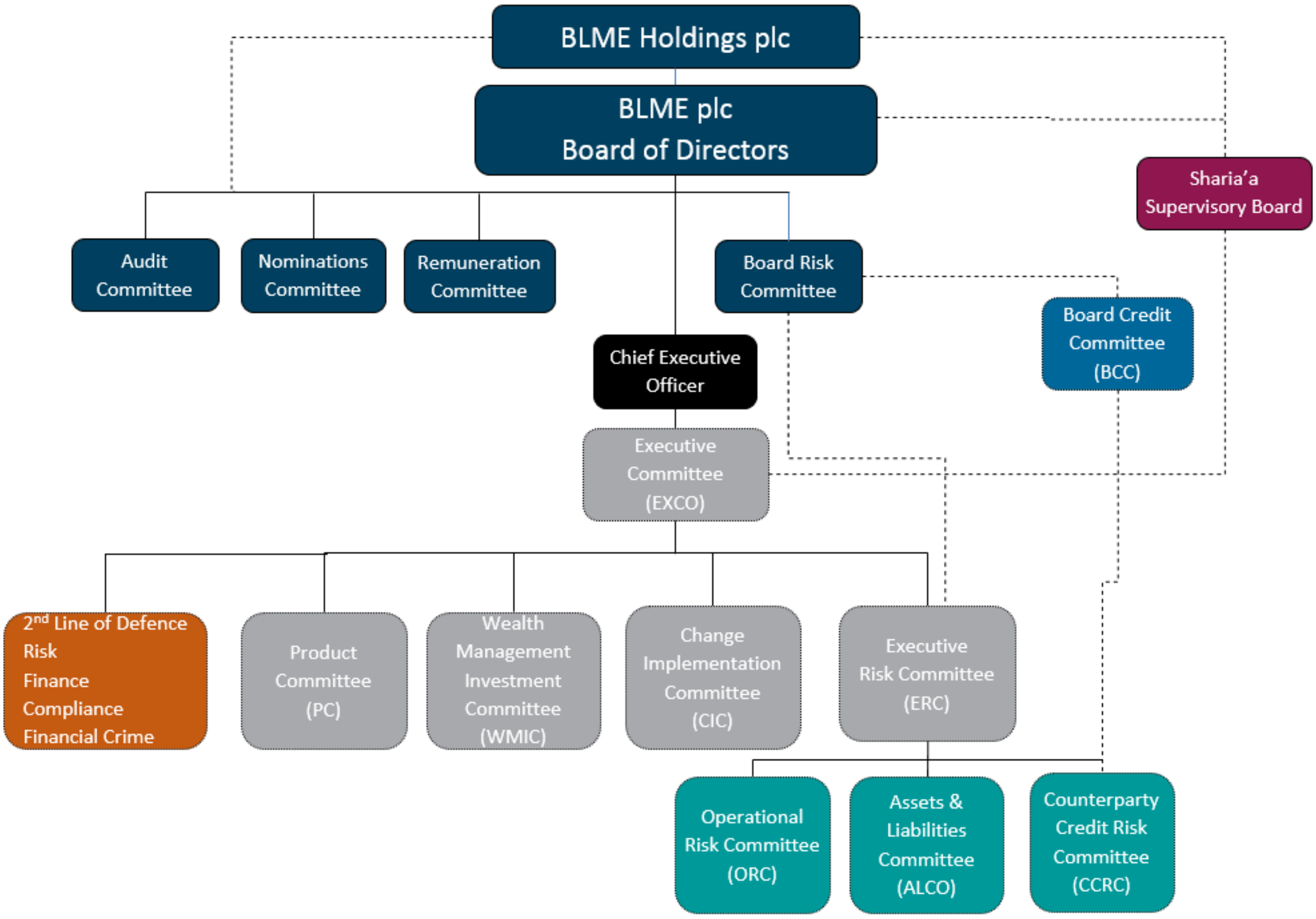
By order of the Board

Peter Bulkeley
**Company Secretary**
20 March 2019

# CORPORATE GOVERNANCE REPORT

The Board considers that good corporate governance is central to achieving the Group's objectives. To this end, the Board has established a governance framework that sets out procedures, policies and practices that are required by law, regulation and/or best practice guidelines. The framework is also used to determine risk appetite in line with the Group's defined strategic objectives. Risk appetite adherence is monitored through a formalised process of risk identification, control assessment and performance monitoring. Board and executive committee structures have been implemented, together with clearly defined roles and responsibilities for both the individuals and the committees. These committees oversee the activities of the Group and help ensure controls are operating as designed. These structures, including individual department business plans, ensure that appropriate financial and human resources are in place to deliver the Group's strategic objectives. Policies and behavioural standards have been established and reiterated to all staff through regular training programmes, including anti-money laundering and financial crime, the UK Bribery Act, conflicts of interest and treating customers fairly.

**Governance structure**




Note: The Group operates with a dual board structure with mirror image Audit, Nominations, Remuneration and Board Risk Committees for both BLME Holdings plc and Bank of London and The Middle East plc ("BLME plc").

**The Board of Directors**

The Board is responsible for the Group's system of corporate governance.

As at 31 December 2018 the Board of Directors comprised two Executive Directors:

- Giles Cunningham – Chief Executive Officer
- Chris Power – Chief Financial Officer

and seven Non-executive Directors, including the Non-executive Chairman:

- Adel Abdul Wahab Al-Majed – Non-executive Chairman
- Sheikh Abdullah Jaber Al-Ahmed Al-Sabah – Vice Chairman of the Board
- Michael Williams - Senior Independent Director and Chairman of Nominations Committee
- Calum Thomson – Chairman of Audit Committee (Independent)
- David Williams – Chairman of Risk Committee (Independent)
- Joanne Hindle – Chairman of Remuneration Committee (Independent)
- Jabra Ghandour

The appointment of Directors is considered by the Nominations Committee and ratified by the Board. Pursuant to the provisions of the Company's Articles of Association, any Director who has been appointed by the Board during the financial year, rather than at a general meeting of Shareholders, must stand for election by the Shareholders at the first Annual General Meeting following their appointment, and following that meeting, must stand for re-election by the Shareholders at least every three years.

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

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

**Board Meetings**

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

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

**Board Committees**

The Board has delegated to the Committees of the Group the responsibility to review and make recommendations to the full Board. The Board Committees operate within clearly defined terms of reference.

**Board and Committee meetings attendance record 2018**

| | Board | | | Nominations Committee | | | Audit Committee | | | Risk Committee | | | Remuneration Committee | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Regular meetings attended | Ad hoc meetings attended | Meetings eligible to attend | Meetings attended | Ad hoc meetings attended | Meetings eligible to attend | Meetings attended | Ad hoc meetings attended | Meetings eligible to attend | Meetings attended | Ad hoc meetings attended | Meetings eligible to attend | Meetings attended | Ad hoc meetings attended | Meetings eligible to attend |
| **Executive Directors** | | | | | | | | | | | | | | | |
| Giles Cunningham | 7 | 2 | 9 | | | | | | | | | | | | |
| Christopher Power | 7 | 2 | 9 | | | | | | | | | | | | |
| **Non-executive Directors** | | | | | | | | | | | | | | | |
| Adel Abdul Wahab Al-Majed | 5 | 0 | 9 | | | | | | | | | | | | |
| Sheikh Abdullah Jaber Al-Ahmed Al-Sabah | 6 | 0 | 9 | | | | 5 | 0 | 6 | 2 | 1 | 9 | 4 | 0 | 5 |
| Michael Williams | 7 | 2 | 9 | 3 | 1 | 4 | | | | 6 | 3 | 9 | 5 | 0 | 5 |
| Neil Holden | 3 | 0 | 3 | 2 | 1 | 3 | 3 | 0 | 3 | 3 | 1 | 5 | 3 | 0 | 3 |
| David Williams | 7 | 2 | 9 | 3 | 1 | 4 | | | | 6 | 3 | 9 | 5 | 0 | 5 |
| Jabra Ghandour | 7 | 1 | 9 | | | | | | | | | | | | |
| Calum Thomson | 7 | 2 | 9 | 3 | 1 | 4 | 6 | 0 | 6 | 5 | 3 | 9 | 2 | 0 | 2 |
| Joanne Hindle | 4 | 2 | 6 | 1 | 0 | 1 | 3 | 0 | 3 | 2 | 2 | 4 | 2 | 0 | 2 |

Of the nine board meetings held during the year, seven were regular meetings and two were ad hoc meetings. The ad hoc meetings covered a number of topics including the approval of the Share Premium Reduction of BLME plc and the Share Repurchase Programme of the Company. The approval of the Annual Report and Financial Statements, approving the notice of AGM and approving the 2018 ICAAP, ILAAP and RRP were all covered in regular scheduled Board meetings. The Executive Directors regularly attend the Audit Committee and Risk Committee meetings as guests. The three Kuwaiti directors who represent institutional shareholders did not attend one of the ad-hoc Board meetings in order to abstain from voting in any Board decision regarding the details of the Share Repurchase Programme because of a potential conflict of interest.

**Board Audit Committee**

The Audit Committee is chaired by Calum Thomson and comprises Sheikh Abdullah Jaber Al-Ahmed Al-Sabah and Joanne Hindle.

The Committee's main responsibility is to review any reports from management, the internal auditor, and the external auditor regarding the internal control systems implemented throughout the Group, along with consideration of both Interim and Annual Report and Financial Statements. It also makes recommendations to the Board on the appointment of the auditors and the audit fee.

The Board considers that the members of the Audit Committee possess recent and relevant financial experience. The Audit Committee has unrestricted access to the Group's auditors. The external auditor, Ernst & Young LLP (EY), provide non-audit services in addition to the provision of audit services. In the year ending 31 December 2018, non-audit services provided by EY comprised advice with regards to employment and overseas tax services. Further details regarding the fees paid to EY for these services are included in Note 12 on page 72.

The Audit Committee is responsible for reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process. The process through which the Committee assesses the auditor's independence and objectivity each year includes the following:

- a review of non-audit services provided to the Group and related fees
- discussion with the auditors of any relationships with the Group and any other parties that could affect independence or the perception of independence
- a review of the auditor's own procedures for ensuring the independence of the audit firm and partners and staff involved in the audit, including the regular rotation of the audit partner
- obtaining written confirmation from the auditors that, in their professional judgement, they are independent

More information regarding the Group's Audit Committee is included in the Audit Committee report on page 23.

**Board Risk Committee**

The Board Risk Committee (BRC) is chaired by David Williams and comprises Sheikh Abdullah Jaber Al-Ahmed Al-Sabah, Joanne Hindle, Michael Williams and Calum Thomson.

BRC is responsible for the oversight of the risk profile of the Bank and for providing guidance, advice and recommendations to the Board on credit, market, liquidity and operational risks with a view to re-enforcing a culture that encourages good stewardship of risk. Within this mandate it reviews risk levels in consideration of the Group's overall risk appetite, market conditions and business strategy. It also reviews BLME's Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment Process (ILAAP) and Recovery and Resolution Planning Process (RRP) and assesses the adequacy of stress testing and risk policies.

Ultimate responsibility for risk rests with the Board which, with advice and recommendations from BRC, approves the risk appetite for each major class of risk in line with BLME's business model and strategic priorities and also approves the annual ICAAP and ILAAP. Board Credit Committee is a sub-committee of BRC established to review and opine on decisions made by the Counterparty Credit Risk Committee that are outside of stated risk appetite and/or meet other escalation criteria.

The management of risk is delegated to the Chief Executive Officer who in turn delegates the day-to-day management of risk to the Executive Committee and, in particular, to the Executive Risk Committee which oversees the three sub-committees of the Bank responsible for risk oversight (being ALCO, CCRC and ORC). The day-to-day independent oversight of risk is performed by the Bank's risk department. This process is supported by the regulatory reporting team's internal control role in monitoring adherence to risk limits, management action triggers and regulatory limits.

**Board Remuneration Committee**

The Remuneration Committee is chaired by Joanne Hindle and comprises Sheikh Abdullah Jaber Al-Ahmed Al-Sabah, Michael Williams, David Williams and Calum Thomson.

The Remuneration Committee ensures that employees, management and executive compensation is appropriately aligned to business and individual performance, and is consistent with Shareholder interests and is in compliance with the FCA's Remuneration Code. It performs these duties within a framework that takes account of prevailing market conditions, best market practice and regulatory compensation guidelines. The Remuneration Committee has appointed Mercer as a professional advisor. Mercer is independent and has no connection with BLME.

More information regarding the Group's Remuneration policy is included in the Remuneration report on page 25.

**Board Nominations Committee**

The Nominations Committee is chaired by Michael Williams and comprises Joanne Hindle, David Williams and Calum Thomson.

The Nominations Committee is responsible for matters relating to the composition of the Board, including the appointment of new Directors, and making recommendations to the Board as appropriate. The Committee is also responsible for overseeing the annual performance evaluation of the Board, its principal Committees and the Chairman.

The Nominations Committee identifies qualified candidates to be Directors, through a robust and prudent process, with the use of external consultants as necessary.

**Chairman and Chief Executive**

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

a. The Non-executive Chairman, Adel Abdul Wahab Al-Majed, is responsible for the leadership of the Board, ensuring effectiveness in all aspects of its role, reviewing the Board's agenda and conducting Board meetings, and ensuring effective communication with Shareholders and the conduct of Shareholders meetings.

b. Executive management is led by the Chief Executive Officer (CEO), Giles Cunningham, who has been delegated responsibility by the Board for the day-to-day management of the Bank within the control and authority framework set by the Board. The CEO is supported by Chief Financial Officer (CFO), Chris Power, in managing the business.

c. The Company Secretary, Peter Bulkeley, is responsible for ensuring good information flows within the Board and its Committees and between senior management and Non-executive Directors, as well as facilitating inductions and assisting with professional development of Board members as required. The Company Secretary ensures that Board procedures are complied with, and advises the Board, through the Chairman, in all governance matters. The Board has the responsibility for appointing and removing the Company Secretary.

**Board balance**

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

During the year ended 31 December 2018, two of the Directors were Executive Directors; on average four were Non-executive Directors who were considered by the Company to be independent.

The Board believes that the Non-executive Directors who are classified as independent have retained their independent character and judgement. The Board periodically reviews the independence of its Non-executive Directors to assess whether their judgement could be impaired in any way which could affect the interests of the Company. The Board uses objective criteria to make this assessment, including:

- the length of term which the Non-executive Director has already served
- whether the Non-executive Director has any material business relationships which may conflict with the interests of the Bank
- relationships with other Directors
- whether the Non-executive Director is a Shareholder
- the nature of the Non-executive remuneration, including any participation in employee incentive arrangements

**Information and professional development**

The Board is supplied in a timely manner with information in a form, and of a quality appropriate to enable it to discharge its duties. The Company Secretary is responsible for ensuring the Directors receive accurate, timely and clear information, which is provided by operational management and enhanced or clarified where necessary. Professional development and training for the Board is monitored by the Nominations Committee as part of the annual performance evaluation review. In addition the Continued Professional Development (CPD) of the individual Directors are assessed by the Chairman and the Senior Independent Director as part of the annual fit and proper assessment and compliance with the Senior Managers and Certification Regime.

**Board effectiveness review**

An external review of the Board was undertaken in Q4 2018 by a specialist consultancy firm with no other connections with the Group. This independent review consisted of a review of board papers; confidential interviews with all Directors, along with selected executives who have significant interaction with the Board and its Committees; and observation of a Committee meeting and a Board meeting. The review outcomes were discussed fully with the Chairman, Senior Independent Director and the Chief Executive Officer and summarised at a Board Meeting on 8 March 2019. The final written report will be circulated to the Board shortly and an action plan will be instigated to cover key recommendations which will be overseen by the Nominations Committee.

**Financial reporting**

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

**Internal control**

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

The internal control framework covers financial, operational and compliance areas and risk management. There are limitations to any system of internal control, which can only provide reasonable but not absolute assurance with respect to the preparation of financial information, the safeguarding of assets and the possibility of misstatement or loss. As the first line of defence, management design and perform the control function. They are then periodically tested independently through the Compliance Monitoring Plan and by the Risk department providing a second line of defence. They are monitored and assured by thorough reviews conducted by internal audit acting as the third line of defence. The findings of these reports and subsequent tracking of the remedial actions required are monitored by the appropriate internal committees and by the Audit Committee to ensure all open action points are closed and the adequacy of all systems and controls are maintained.

**Relations with Shareholders**

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

# SHARIA'A SUPERVISORY BOARD REPORT

***In the name of Allah, the Most Gracious, the Most Merciful***

**To the Shareholders of BLME Holdings plc**

**Assalamu Alaikum wa Rahmat Allah wa Barakatuh.**

The management of the BLME Group is responsible for ensuring that the BLME Group 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 the BLME Group. It is the responsibility of management to implement the decisions of the Sharia'a Supervisory Board.

We, the Sharia'a Supervisory Board of BLME Holdings plc, have reviewed and monitored the operations, agreements and transactions conducted by the BLME Group 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 Holdings plc Annual Report and Accounts for the year ended 31 December 2018. We conducted our reviews to form an opinion as to whether the BLME Group 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 the BLME Group 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 the BLME Group are in compliance with the principles of the Sharia'a.
3. All profit generated by the BLME Group 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 Group'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 the BLME Group towards integrity, correctness and further success.

Wassalam Alaikum wa Rahmat Allah wa Barakatuh

Signed on behalf of the Sharia'a Supervisory Board of BLME Holdings plc

Sheikh Dr. Abdulaziz Al-Qassar
**Chairman**
20 March 2019

# AUDIT COMMITTEE REPORT

**Statement from the Chairman of the Board Audit Committee**

| |
|---|
| **Audit Committee Members** |
| Calum Thomson – Chair |
| Sheikh Abdullah Jaber Al Ahmed Al Sabah |
| Joanne Hindle |
| **Audit Committee Guests** |
| EY – (external auditor) |
| PwC – (internal audit) |
| David Williams – INED |
| Chief Financial Officer |
| Chief Executive Officer |
| Head of Internal Audit |
| Chief Compliance Officer |
| Company Secretary |

The Audit Committee met six times during 2018. In March, the Committee reviewed the Annual Report and Financial Statements for the year ended 31 December 2017 and recommended its approval to the Board. Similarly, the Committee reviewed and recommended the Pillar III disclosures document to the Board. The Committee were also presented with an update to the internal audit report on Credit Risk and it was recommended that a revised internal audit review of the Senior Managers and Certification Regime be issued. In May, the Committee received status updates to the Cyber Risk and HR Audit action points documents prepared internally and approved the Internal Audit Charter, Internal Audit Terms of Reference and Rationale for Date Extensions presented by the Head of Internal Audit. The Committee also approved amendments to the PwC Internal Audit Plan for the next two quarters and for the implementation of a co-sourced model. In August, the Committee reviewed the Interim Report for the six months ended 30 June 2018 and recommended its approval to the Board. Key area of focus was around disclosure required under IFRS 9. In September, the Committee reviewed and received updates to the Internal Audit Report on SCV and Internal Review of Liquidity Returns / COREP. The Committee were presented with the external auditor's Audit Plan for the year ended 31 December 2018. The Committee discussed the updated Policy on Provision of Non-Statutory Audit Services (NAS) by BLME's external auditor that had been presented for approval. In December, the Committee were presented with the Internal Audit update report and discussion took place on a number of other internal audit reports across various themes. The Committee were also presented with the draft 2019 Internal Audit Plan and were provided with a status update on the impact assessment of IFRS 16 *Leases* and IFRS 15 *Revenue from Contracts with Customers*. After the review of the progress to Plan the Committee has decided to revert to an outsourced internal audit approach for the 2019 Plan.

In March 2019, the Committee received and reviewed the results report from the external auditors on the annual audit and the Annual Report and Financial Statements for the year ended 31 December 2018 and recommended the approval of these to the Board.

**Role of the Audit Committee**

The Audit Committee's main functions are:

- To monitor the financial reporting process and integrity of the Interim Report and Annual Report and Financial Statements of the Group by reviewing and challenging, where necessary the actions of the management, its significant judgements, applicability of the accounting standards adopted, and estimates contained within the financial statements and the Group's accounting policies.
- To monitor the effectiveness of the Group's internal financial controls and risk management systems including the effectiveness of the internal audit function. The Committee reviews and approves the annual internal audit plan, ensuring it utilises BLME's Operational Risk Register. The Committee presents regular reports showing management responses on delivering recommended changes.
- To meet the independent external auditor of the Company to review their proposed Audit Plan and the subsequent Audit Report and to assess the effectiveness of the audit process, the nature of the non-audit work and the levels of fees paid in respect of both audit and non-audit work.
- To make recommendations to the Board in relation to the appointment, re-appointment or removal of the external auditor, and to negotiate their remuneration and terms of engagement on audit and non-audit work.
- To monitor and review annually the external auditor's independence, objectivity, effectiveness, resources and qualifications.
- To ensure it fulfils its responsibilities under its terms of reference the Committee establishes an annual agenda.
- The Committee also reviews reports received from management on key business areas, with particular emphasis on compliance (including financial crime and compliance monitoring).

**Significant Issues & Internal Controls**

- The Committee has benchmarked its terms of reference against regulations and best practice for similar businesses, and found that no significant adjustments were required and has established its annual programme of activities to enable it to meet the requirements set out by regulation and in the terms of reference.
- The Committee discussed various issues facing the Group including the growing threat of cyber security risk and improving the stronger financial crime and compliance functions of the Group.
- The Committee reviewed and challenged the level of impairments including IFRS 9 Stage 1, 2 and 3 provisions throughout the year.
- The Committee had a detailed review of the financial statements including the appropriateness of the accounting policies adopted for the recognition of income, allowance for expected credit losses as required by IFRS 9 and the valuation of the Company's investment in its subsidiary.
- The Committee assessed the Internal Auditor's risk assessment, audit plan for the current and next year, and consistently reviewed the internal audit reports and recommendations on the audit of various areas of the Bank including Human Resources, Finance, Financial Crime, Cyber Security, Regulatory Reporting including Capital and Liquidity reporting, Compliance Risk Framework, Credit on boarding and monitoring, Middle Office including Anti-Money Laundering (AML), Know your customer (KYC) and Senior Managers and Certification Regime (SM&CR). It evaluated the risk and control framework of these areas in light of the report and recommendation.
- The Committee worked with the Head of Internal Audit to review the effectiveness of the internal audit function.
- The Committee reviewed the Compliance Monitoring Plan and the implementation of regulations including MIFID II; Senior Managers and Certification Regime; Payment Services Directive II; CRD IV and Basel III.

**External Audit Process**

The Committee makes recommendations to the Board on the appointment of the external auditors and has unrestricted access to BLME's external auditors. The Audit Committee is responsible for reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process. The process through which the Committee assesses the auditor's independence and objectivity each year includes the following:

- review and discussion of the external audit plan and results of the annual audit
- a review of non-audit services provided to the Group and related fees
- discussion with the external auditors of any relationships with the Group and any other parties that could affect independence or the perception of independence
- a review of the external auditor's own procedures for ensuring the independence of the audit firm and partners and staff involved in the audit
- obtaining written confirmation from the external auditors that, in their professional judgement, they are independent.

The Audit Committee meets at least twice a year with the external auditor in the absence of Management. The external auditor provides a planning report in advance of the annual audit, a results report on their review of the Interim Report and a results report on the annual audit of the Annual Report and Financial Statements. The Audit Committee has an opportunity to question and challenge the external auditor in respect of each of these reports.

After each audit, the Audit Committee reviews the audit process and considers its effectiveness. The review of the 2018 audit concluded that the audit process had worked well, and the issues raised during the year have been adequately addressed.

**Auditor Assessment and Independence**

The Audit Committee has reviewed EY's independence policies and procedures including quality assurance procedures. It was considered that those policies and procedures remained fit for purpose.

Calum Thomson
**Chairman, Board Audit Committee**
20 March 2019

# REMUNERATION REPORT

**Statement from the Chairman of the Board Remuneration Committee**

**Remuneration Committee Members**
Joanne Hindle – Chairman
Michael Williams – INED
David Williams – INED
Calum Thomson - INED
Sheikh Abdullah Jaber Al Ahmed Al Sabah – NED

**Remuneration Committee Guests**
Giles Cunningham – CEO
Tracey Carlton – Head of HR
Gordon Clark – Advisor from Mercer LLC

The Committee met five times during 2018. The composition of the Committee changed as a result of the retirement of Neil Holden from the Board on 14 May 2018. Michael Williams took over as Chairman of the Committee and Calum Thomson joined the Committee on 14 May. Joanne Hindle joined the Committee when she joined the Board on 1 July and subsequently took over as Chairman of the Committee on 13 December.

**Role of the Remuneration Committee**

The Remuneration Committee's main functions are to:

- Decide and report to the Board on the framework for remuneration including the overall level of salary reviews, share and other incentive awards, pension and contractual arrangements;
- Oversee compliance with regulations, including the FCA's Remuneration Code;
- Set the remuneration of the Chairman of the Board, the CEO, and the CFO;
- Monitor and review the remuneration of senior executive management (being all material risk-takers, all direct reports to the CEO, and all other highly paid staff), and
- Directly oversee the remuneration of the senior managers in the Risk and Compliance functions.

**Remuneration policy**

Our ability to deliver against our strategy requires us to attract and retain high calibre staff and align their interest with our shareholders to which our Remuneration Framework is designed to support the strategy. This includes discouraging inappropriate risk taking and is guided by the following principles:

- Remuneration is set at appropriate levels and is benchmarked against the external market place;
- A total remuneration philosophy is operated wherein the Bank seeks to balance short term considerations against alignment of the interest of shareholders;
- Remuneration is designed to promote effective risk management, consistent with the Group's stated risk appetite;
- Any breaches of risk appetite or conduct failures are considered by the Committee when determining both the overall bonus pool and individual executive remuneration;
- Performance measures and targets contain both financial and non-financial metrics and are cascaded from the Group's strategy to the CEO metrics and downwards. They are aligned with shareholder interests and consistent with the business strategy and objectives;
- Compliance with the regulatory environment is mandatory.

**2018 activity**

The Committee's activity during the year included:

- Approval of updates to the regulatory Remuneration Policy Statement and categorisation of Material Risk Takers;
- Annual review of staff salaries in conjunction with a salary benchmarking survey and considering total remuneration;
- Review of the enhanced benefits package offered to employees which aim to support their physical, mental, family and financial wellbeing
- Review and approval of Executive Directors, Material Risk Takers and other higher-paid staff remuneration;
- Review and approval of the remuneration of the Chairman of the Board;
- Approval of a Policy for Risk Adjustment of the Annual Bonus Pool;
- Review and challenge of the 'good/bad leaver' definition and treatment of deferred bonus awards

- Approval of the 2018 bonus pool payable in 2019 including the discretionary bonuses for senior staff and material risk takers with mandatory deferral applied above a threshold of £25,000;
- Review and approval of the cash deferral portions due to be paid out in 2019 (from the 2017 bonus year awards)
- Review and approval of share option awards for executives, senior and key staff to reinforce value growth for our shareholders over a longer vesting profile of 50% vesting after 3 years, 25% vesting after 4 years and 25% vesting after 5 years;
- Review of initial gender pay gap results (although the Group is not required to formally report on this).

**Remuneration report**

In order to set remuneration levels the Group assesses the extent to which targets have been met and performance achieved. Total remuneration includes salary, car allowance, annual discretionary bonus, pension contributions or pensions allowance and potentially long-term incentives. In line with the Group's Remuneration and Benefits Policy performance measures and targets are linked to business objectives.

Long-term incentives are designed with external independent expert advice and in keeping with relevant industry best practice. The Group does not apply a formulaic approach to remuneration on the grounds that this could encourage inappropriate risk taking. The pay-out levels depend on the performance of the Group, the relevant business units and the individual; forfeiture and claw-back mechanisms operate where appropriate and consistent with Sharia'a law.

A discretionary bonus forms part of the Group's remuneration package. For senior executives and staff designated as Material Risk Takers a portion of the annual discretionary bonus is deferred over a three year period and is subject to forfeiture relating to malus, gross misconduct or leaving to join a direct competitor.

The Group has Shareholder approval to make awards up to an aggregate maximum of 10% of the parent Company's issued share capital over a 10 year period from the date of the Nasdaq Dubai listing in October 2013. In order to align and retain the Senior Management team and key staff across the Bank with the strategy, the Remuneration Committee approve the award of options under the Bank's ASOP and USOP schemes to senior management and key staff. Such awards are generally subject to vesting over a 5 year period dependent on the Committee's assessment of the underlying performance of the Group and will also be subject to the Committee's discretionary assessment as to whether performance has been achieved within the risk appetite of the firm, based on feedback from the Chief Risk Officer, the Chief Compliance Officer and the Board Risk Committee.

Awards made in 2018 across all equity-settled share schemes totalled the equivalent of 0.6% of the issued share capital with voting rights (2017: 4.9%) and the total number of equity-settled options in issue as at 31 December 2018, less options issued prior to the Nasdaq Dubai listing and less shares already held by the EBT, represented 9.1% of the issued share capital with voting rights (31 December 2017: 9.2%).

Joanne Hindle
**Chairman, Board Remuneration Committee**
20 March 2019

*Additional information on the structure of our share-based payment schemes and all awards made under these schemes is provided in the Share-based payments note on pages 73 to 76.*

# 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 Group and the Parent Company financial statements, in accordance with applicable laws and regulations.

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

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

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

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

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group'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 BLME Holdings plc**

## Opinion

In our opinion:

- BLME Holdings plc's (the "Company", the "Group") consolidated financial statements and Parent Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2018 and of the Group's profit for the year then ended;

- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU");

- the Parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 2006; and

- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of BLME Holdings plc which comprise:

| Group | Parent Company |
|---|---|
| Consolidated income statement for the year ended 31 December 2018 | |
| Consolidated statement of comprehensive income for the year ended 31 December 2018 | |
| Consolidated statement of financial position as at 31 December 2018 | Statement of financial position as at 31 December 2018 |
| Consolidated statement of cash flows for the year ended 31 December 2018 | Statement of cash flows for the year ended 31 December 2018 |
| Consolidated statement of changes in equity for the year ended 31 December 2018 | Statement of changes in equity for the year ended 31 December 2018 |
| Related notes 1 to 36 to the financial statements, including a summary of significant accounting policies, except for note 36e marked as unaudited | Related notes 1 to 36 to the financial statements including a summary of significant accounting policies, except for note 36e marked as unaudited |

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the EU and, as regards the Parent Company financial statements, as applied in accordance with the provisions 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 Group and Parent Company 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 Group's or the Parent Company'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 | • Group - Improper recognition of income<br><br>• Group – Adequacy and appropriateness of the allowance for expected credit losses<br><br>• Parent Company - Adequacy and appropriateness of the provision made in relation to the investment in Bank of London and the Middle East plc |
| Audit scope | • We performed an audit of the complete financial information of the Group and Parent Company<br><br>• Our Group audit scope included all operating subsidiaries of BLME Holdings plc, all of which are audited by the engagement team |
| Materiality | • Overall Group materiality of £2.3million 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 financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included 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 (Group)* 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 (Group)**<br><br>**Income from financing and investing activities: £51.3 million (2017: £41.7 million).**<br><br>**Income from fees and commissions: £2.4 million (2017 £1.9 million).**<br><br>*Refer to the Accounting policies (page 59); and Note 5 of the Consolidated Financial Statements (page 70)*<br><br>The key risks of improper recognition of income arises from:<br><br>(i) Income recorded from financing and investing activities might not be complete and accurate, and<br><br>(ii) Fees and commissions can require judgment as to the amount and timing of recognition.<br><br>The risk has neither increased nor decreased in the current year. | Our approach focussed on:<br><br>• Understanding processes and controls related to revenue recognition and testing the design and operating effectiveness of these controls with the assistance, where required, of EY IT audit professionals.<br>• Performing analytical procedures to identify trends and corroborating movements not in line with our expectations.<br>• Recalculating, on a sample basis, the income recognised across different product classes to ensure it has been calculated in accordance with the underlying transaction documentation. We increased our standard sample size for transactional testing to correspond to the increased risk in this area.<br>• 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.<br>• Performing year end cut-off testing to ensure that revenue was recognised in the correct period.<br>• Checking to supporting evidence any adjustments to the accounting records that we have identified that have characteristics that could indicate unusual or inappropriate adjustments.<br>• Assessing the appropriateness of the revenue recognition accounting policies adopted 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 (Group)**<br><br>**Financing arrangements**<br><br>**2018: £737.5 million** *(under IFRS 9 – ECL provision £10.3 million)*<br>**2017: £567.8 million** *(under IAS 39 - specific provision £9.6 million, collective provision £1.7 million)*<br><br>**Finance lease receivables**<br>**2018: £256.2 million** *(under IFRS 9 – ECL Provision £4.7 million)*<br>**2017: £170.5 million** *(under IAS 39 - specific provision £3.2 million, collective provision £1.5 million)*<br><br>**Off balance sheet exposures £137 million** *(under IFRS 9 – ECL Provision £0.2 million)*<br>**2017: £135 million** *(under IAS 39 collective and specific provision - NIL)*<br><br>*Refer to the Accounting policies (page 51); and Note 14 of the Consolidated Financial Statements (page 78)*<br><br>IFRS 9 *Financial Instruments* became effective on 1 January 2018. The implementation of IFRS 9 resulted in substantial changes to three aspects of the Group's financial reporting: classification and measurement, allowance for expected credit losses, and associated disclosures.<br><br>With respect to allowances for expected credit losses, the adoption of IFRS 9 has fundamentally changed the Group's accounting for credit impairments by | Our approach focused on:<br><br>• 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;<br>• Checking the Group's classification and measurement policy and allowance for expected credit losses policy;<br>• Testing the data flow of the underlying records of the Group's input into the ECL model for completeness and accuracy;<br>• With the 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 Group 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;<br>• 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 Group. We increased our standard sample size to respond to the increased risk in this area;<br>• For all assets in stage 3, testing the individual impairment and the evidence supporting the assumptions made by the Group by forming an independent view, using our valuation specialists, of collateral or exit values, cash | As a result of the procedures performed, we are satisfied that financial instruments are classified and measured in accordance with IFRS 9, that the Group'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. |

| | | |
|---|---|---|
| replacing IAS 39's incurred loss approach with a forward looking expected credit loss ("ECL") approach.<br><br>ECL applies for all financial assets that are held at 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.<br><br>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.<br><br>Finally, given the extensive new disclosure requirements, there is a risk that the disclosures in the financial statements are inaccurate or incomplete.<br><br>The risk has increased in 2018 due to it being the first year of IFRS 9 adoption. | flow assumptions and exit strategies;<br>• 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 losses, focusing on areas where significant estimation is involved. To respond to the increased risk in this area we lowered our testing threshold for items on the watchlist;<br>• Checking the opening balance sheet adjustment for first time adoption of IFRS 9 by reperforming underlying calculations; and<br>• Assessing the adequacy and appropriateness of disclosures for compliance with IFRSs including disclosure of transition from IAS 39. | |

| | | |
|---|---|---|
| **Adequacy and appropriateness of the provision made in relation to the investment in Bank of London and the Middle East plc (Parent Company)**<br><br>**Investment in subsidiary £101.3 million, 2017: £111.3 million, following provision for impairment of £10 million.**<br><br>*Refer to the Accounting policies (page 65); and Note 19 of the Consolidated Financial Statements (page 83)*<br><br>The Company holds a significant investment in Bank of London and the Middle East plc. We have determined this to be a key audit matter due to the quantum of the investment as at 31 December 2018, and the involvement of significant judgement by management in the valuation of the investment, and consequent risk of misstatement.<br><br>The risk has neither increased nor decreased in the current year. | Our approach focused on:<br>• Confirming our understanding of the impairment assessment process and evaluating the design effectiveness of key controls over the process.<br>• Reviewing and challenging management's impairment assessment and the estimation of the recoverable amount.<br>• Comparing the underlying calculation with the budget approved by the Board and re-performing the value in use and fair value less costs of disposal calculations independently.<br>• With the assistance of EY valuation specialists, critically assessing the assumptions used by management such as risk-free discount rate, weighted average growth rate and terminal value used with reference to our understanding of the business and comparison to other similar companies and broader market considerations.<br>• Performing sensitivity analysis on the cash flow forecasts and key assumptions to the model to understand the impact that reasonably possible changes to key assumptions would have on the overall carrying value of the investment at the balance sheet date. | Based on the work performed we conclude that the recoverable amount of the investment in Bank of London and the Middle East plc included in the Statement of financial position as at 31 December 2018 is fairly stated. |

**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 our audit scope for each entity within the Group. Taken together, this enables us to form an opinion on the consolidated financial statements. We take into account size, risk profile, the organisation of the Group and effectiveness of group-wide controls, changes in the business environment and other factors such as recent internal audit results when assessing the level of work to be performed at each entity. All audit work performed for the purposes of the audit was undertaken by the Group audit 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 Group to be £2.3m (£2017: £2.4m), 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 Group's profitability is low relative to the balance sheet size, and also our expectation is that the main users of the financial statements, including the members of the Company, view capital restoration as a key consideration as the Group has only become profitable since 2017.

We determined materiality for the Parent Company to be £1.0m (2017:£0.9m) 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 Parent Company is not profitable and also our expectation is that the main users of the financial statements, including the members, view capital restoration 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 Group'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 Group and the Parent Company 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 by the Group and Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Group and Parent Company 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 27, 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 Group and Parent Company'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 Group or the Parent Company 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 Group 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 Group and determined that the most significant are Companies Act 2006, Financial Services and Markets Act 2000, Financial Services Act 2012, Capital Requirements Regulation, Markets in Financial Instruments Directives and relevant Prudential Regulation Authority and Financial Conduct Authority regulations.
- We understood how the Group 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 Group 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 Group's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Bank has established to address risks

identified by the Bank, or that otherwise seek to prevent, deter, or detect fraud. We also considered performance incentives and their potential to influence management to manage earnings.

- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures included inquiries of management, internal audit, and those responsible for legal and compliance matters; as well as focused testing as referred to in the Key Audit Matters section above. In addition we performed procedures to identify any significant items inappropriately held in suspense and also any significant inappropriate adjustments made to the accounting records.
- As the audit of banks requires specialised audit skills, the senior statutory auditor considered the experience and expertise of the audit team to ensure that the team had the appropriate competence and capabilities, and included the use of specialists where appropriate.

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

**Other matters we are required to address**

- We were appointed 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 Group or the Parent Company and we remain independent of the Group and the Parent Company in conducting the audit.

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

**Use of our report**

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an 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 company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

*Kenneth Eglinton (Senior statutory auditor)*
*for and on behalf of Ernst & Young LLP, Statutory Auditor*
*London*
*March 2019*

Notes:

1. The maintenance and integrity of the Group's 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.

# CONSOLIDATED 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* | 51,266 | 41,708 |
| Returns to financial institutions and customers | *6* | (17,551) | (16,284) |
| **Net margin** | | **33,715** | **25,424** |
| | | | |
| Fee and commission income | *5b* | 2,444 | 1,909 |
| Fee and commission expense | | (417) | (494) |
| **Net fee and commission income** | | **2,027** | **1,415** |
| | | | |
| Net investment losses | *7* | (256) | (2,330) |
| Credit impairment (losses) / gains | *14* | (2,287) | 3,305 |
| Operating lease income | | 8,477 | 6,443 |
| Other operating income | *8* | 831 | 6,897 |
| **Net operating income** | | **42,507** | **41,154** |
| | | | |
| **Expenses** | | | |
| Personnel expenses | *10* | (16,233) | (15,647) |
| Operating lease depreciation | *23* | (6,443) | (4,858) |
| Other depreciation and amortisation | *22, 24* | (1,070) | (1,517) |
| Other operating expenses | *12* | (10,336) | (13,324) |
| **Total operating expenses** | | **(34,082)** | **(35,346)** |
| | | | |
| **Profit before tax** | | **8,425** | **5,808** |
| | | | |
| Tax credit / (expense) | *15* | 2,817 | (75) |
| | | | |
| **Profit for the year** | | **11,242** | **5,733** |
| **Attributable to:** | | | |
| Owners of the parent | | 10,793 | 5,284 |
| Non controlling interest | | 449 | 449 |
| | | **11,242** | **5,733** |
| | | | |
| **Earnings per share** | | **Pence** | **Pence** |
| Basic earnings per share | *16* | 5.59 | 2.73 |
| Diluted earnings per share | *16* | 5.09 | 2.71 |

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

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

**For the year 1 January 2018 to 31 December 2018**

| | Note | 2018<br>£000 | 2017<br>£000 |
|---|---|---|---|
| **Income** | | | |
| Profit for the year | | 11,242 | 5,733 |
| **Other comprehensive income** | | | |
| **Items that may be reclassified subsequently to profit or loss if specific conditions are met:** | | | |
| Foreign currency translation differences for foreign operations | | 73 | (46) |
| Fair value reserve recycled to the income statement | | - | 506 |
| Net losses in fair value of FVOCI debt instruments | | (70) | |
| Net losses in fair value of available-for-sale financial assets taken to equity | | - | (452) |
| Income tax credit / (expense) on other comprehensive income | *15* | 135 | (105) |
| | | **138** | **(97)** |
| **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 Parent company** | | **11,806** | **5,636** |
| **Attributable to:** | | | |
| Owners of the parent | | 11,357 | 5,187 |
| Non Controlling Interest | | 449 | 449 |
| | | **11,806** | **5,636** |

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

**As at 31 December 2018**

| | Note | 2018 £000 | 2017 £000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks | | 104,339 | 96,780 |
| Due from financial institutions | 18 | 8,045 | 28,544 |
| Due from customers | 18 | 14,612 | 9,027 |
| Investment securities | 19 | 103,872 | 114,930 |
| Financing arrangements | 20 | 737,522 | 567,820 |
| Finance lease receivables | 21 | 256,198 | 170,546 |
| Operating lease assets | 23 | 43,378 | 34,922 |
| Profit rate swaps | 9 | 73 | - |
| Property and equipment | 22 | 488 | 987 |
| Intangible assets | 24 | 266 | 837 |
| Other assets | 25 | 6,641 | 3,141 |
| Deferred tax asset | 15 | 3,514 | - |
| **Total assets** | | **1,278,948** | **1,027,534** |
| **Liabilities** | | | |
| Due to financial institutions | 26 | 672,240 | 514,392 |
| Due to customers | 27 | 357,353 | 277,341 |
| Profit rate swaps | 9 | 469 | 636 |
| Other liabilities | 28 | 12,710 | 12,032 |
| Current tax liability | | 482 | 251 |
| **Total liabilities** | | **1,043,254** | **804,652** |
| **Equity** | | | |
| Share capital | 31 | 48,933 | 48,933 |
| Other reserve | | 15,226 | 15,226 |
| Capital redemption reserve | | 50 | 50 |
| Fair value reserve | | (715) | (382) |
| Non Controlling Interest | | 5,221 | 280 |
| Share-based payment reserve | | 2,207 | 1,911 |
| Foreign currency translation reserve | | 43 | (30) |
| Retained earnings | | 164,729 | 156,894 |
| **Total equity attributable to equity holders of the Parent company** | | **235,694** | **222,882** |
| **Total liabilities and equity** | | **1,278,948** | **1,027,534** |

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**

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# COMPANY STATEMENT OF FINANCIAL POSITION

**As at 31 December 2018**

| | Note | 2018<br>£000 | 2017<br>£000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks | | 73 | - |
| Investment in subsidiary | *19* | 101,310 | 111,318 |
| **Total assets** | | **101,383** | **111,318** |
| **Liabilities** | | | |
| Other liabilities | | 1 | 1 |
| **Total liabilities** | | **1** | **1** |
| **Equity** | | | |
| Share capital | *31* | 48,933 | 48,933 |
| Share-based payment reserve | | 2,206 | 1,911 |
| Retained earnings | | 50,243 | 60,473 |
| **Total equity attributable to equity holders of the Parent Company** | | **101,382** | **111,317** |
| **Total liabilities and equity** | | **101,383** | **111,318** |

The company loss for the year ended 31 December 2018 was £6.55 million (2017: £21.8 million profit). The current year loss includes a dividend of £3.75m paid by BLME plc and impairment loss on investment in subsidiary of £10.30m. As permitted by section 408 of the Companies Act 2006, a separate profit and loss account of the parent has not been presented.

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: 08503102

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# CONSOLIDATED 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 | 8,425 | 5,808 |
| Adjusted for: | | |
| Exchange differences | (189) | (1,745) |
| Fair value (gain)/loss on investment securities | 252 | 2,302 |
| Provision for impairment | 2,287 | (3,305) |
| Depreciation and amortisation | 7,513 | 6,375 |
| Share-based payment awards | 293 | 307 |
| Mark-to-market movement in profit rate swaps | 363 | 114 |
| | **18,944** | **9,856** |
| **Net decrease / (increase) in operating assets:** | | |
| Due from financial institutions | 21,288 | 77,138 |
| Due from customers | (5,585) | (9,027) |
| Financing arrangements | (171,285) | (87,201) |
| Finance lease receivables | (86,255) | 65,377 |
| Operating lease assets | (14,899) | (14,947) |
| Other assets | (3,481) | 4,897 |
| | **(260,217)** | **36,237** |
| **Net increase / (decrease) in operating liabilities:** | | |
| Due to financial institutions | 152,564 | (67,650) |
| Due to customers | 80,095 | 63,682 |
| Third party interest in consolidated funds | - | (436) |
| Other liabilities | 1,776 | (2,539) |
| Non-controlling interests | - | (170) |
| | **234,435** | **(7,113)** |
| Corporation tax paid | (457) | - |
| **Net cash inflow/(outflow) from operating activities** | **(7,295)** | **38,980** |
| **Cashflow from investing activities** | | |
| Purchase of property and equipment | - | (8) |
| Purchase of intangible assets | - | (118) |
| Purchase of investments | (8,881) | (77,720) |
| Sale of investments | 24,771 | 62,408 |
| **Net cash inflow/(outflow) from investing activities** | **15,890** | **(15,438)** |
| **Cash flows from financing activities** | | |
| Dividend paid by a subsidiary to a Non-controlling interest | (508) | - |
| Sale of investments in Non-controlling interest | 5,000 | - |
| Purchase of treasury shares | (3,677) | - |
| **Net cash inflow from financing activities** | **815** | **-** |
| **Net change in cash and cash equivalents** | **9,410** | **23,542** |
| Cash and cash equivalents at the beginning of the period | 96,780 | 71,152 |
| Exchange differences in respect of cash and cash equivalents | (1,851) | 2,086 |
| **Cash and cash equivalents at the end of the period** | **104,339** | **96,780** |

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# COMPANY STATEMENT OF CASH FLOWS

**For the year 1 January 2018 to 31 December 2018**

| | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| **Cash flows from operating activities** | | |
| (Loss) / profit for the year before tax | (6,553) | 21,815 |
| Adjusted for: | | |
| Impairment loss / (reversal) on subsidiary | 10,303 | (21,815) |
| | 3,750 | - |
| **Net increase in operating liabilities** | | |
| Other liabilities | - | - |
| | - | - |
| **Cash flows from financing activities** | | |
| Purchase of treasury shares | (3,677) | - |
| **Net cash (outflow) / inflow from financing activities** | (3,677) | - |
| **Net change in cash and cash equivalents** | **73** | - |
| Cash and cash equivalents at the beginning of the period | - | - |
| **Cash and cash equivalents at the end of the period** | **73** | **-** |

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| For the year ended 31 December 2018 | Share capital | Other reserve | Capital redemption reserve | Fair value reserve | Share-based payment reserve | Retained earnings | Foreign currency translation reserve | Total | Non-Controlling Interest | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** |
| Balance at 31 December 2017 | 48,933 | 15,226 | 50 | (382) | 1,911 | 156,894 | (30) | 222,602 | 280 | 222,882 |
| Changes on initial application of IFRS 9 | - | - | - | - | - | 25 | - | 25 | - | 25 |
| **Restated balance at 1 January 2018** | **48,933** | **15,226** | **50** | **(382)** | **1,911** | **156,919** | **(30)** | **222,627** | **280** | **222,907** |
| Profit for the year | **-** | **-** | **-** | **-** | **-** | 10,793 | **-** | **10,793** | 449 | **11,242** |
| **Other comprehensive income / (expense)** | | | | | | | | | | |
| Foreign currency translation | - | - | - | - | - | - | 73 | 73 | - | 73 |
| Net change in fair value of equity/debt instrument at FVOCI | - | - | - | 356 | - | - | - | 356 | - | 356 |
| Tax on items transferred directly to equity | - | - | - | 135 | - | - | - | 135 | - | 135 |
| **Total other comprehensive income / (expense)** | **-** | **-** | **-** | **491** | **-** | **-** | **73** | **564** | **-** | **564** |
| **Total comprehensive income / (expense) for the year** | **-** | **-** | **-** | **491** | **-** | **10,793** | **73** | **11,357** | **449** | **11,806** |
| **Contributions by and distributions to owners** | | | | | | | | | | |
| Dividend paid by a subsidiary to a Non-controlling interest | - | - | - | - | - | - | - | - | (508) | (508) |
| Funding from non-controlling interest | - | - | - | - | - | - | - | - | 5,000 | 5,000 |
| Net increase in treasury shares | - | - | - | - | - | (3,677) | - | (3,677) | - | (3,677) |
| Sale of equity instrument at FVOCI | - | - | - | (824) | - | 824 | | - | - | - |
| Equity-settled Share-based payment awards | - | - | - | - | 266 | 27 | - | 293 | - | 293 |
| Tax on items transferred directly to equity | - | - | - | - | 30 | (157) | - | (127) | - | (127) |
| **Total transactions with owners** | **-** | **-** | **- -** | **824** | **296** | **(2,983)** | **-** | **(3,511)** | **4,492** | **981** |
| **Balance at 31 December 2018** | **48,933** | **15,226** | **50** | **(715)** | **2,207** | **164,729** | **43** | **230,473** | **5,221** | **235,694** |

**FVOCI** – Fair value through other comprehensive income

**Treasury shares -** £3,569,622 was paid to repurchase 10,357,374 ordinary shares. Transaction costs capitalised include £89,169 for brokerage commission and £17,850 paid to HMRC for stamp duty.

**Fair value reserve** includes the cumulative net change in fair value of FVOCI instruments until the investment is either derecognised or becomes impaired.

**Share-based payment reserve** represents the amortised portion of the fair value of equity instruments issued under the BLME and the Company's share incentive schemes and accounted for as equity-settled share-based payments.

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.

**Foreign currency translation reserve** comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations.

The **Capital redemption reserve** arose on 26 June 2014 following the redemption of 50,000 preference shares of £1 each and the repurchase of one A ordinary share of £1.

**Non-Controlling Interest** relates to the minority shareholders in MKL Construction Equipment Finance Limited and Aspenway Limited.

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| For the year ended 31 December 2017 | Share capital | Other reserve | Capital redemption reserve | Fair value reserve | Share-based payment reserve | Retained earnings | Foreign currency translation reserve | Total | Non Controlling Interest | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| Balance at 31 December 2016 | 48,933 | 15,226 | 50 | (331) | 1,604 | 151,610 | 16 | 217,108 | 192 | 217,300 |
| **Profit for the year** | **-** | **-** | **-** | **-** | **-** | **5,284** | **-** | **5,284** | **449** | **5,733** |
| **Other comprehensive income / (expense)** | | | | | | | | | | |
| Foreign currency translation | - | - | - | - | - | - | (46) | (46) | - | (46) |
| Change in fair value of AFS financial assets | - | - | - | (452) | - | - | - | (452) | - | (452) |
| Fair value reserve recycled to Income Statement | - | - | - | 506 | - | - | - | 506 | - | 506 |
| Tax on change in fair value of AFS financial assets | - | - | - | (105) | - | - | - | (105) | - | (105) |
| **Total other comprehensive income/(expense)** | **-** | **-** | **-** | **(51)** | **-** | **-** | **(46)** | **(97)** | **-** | **(97)** |
| **Total comprehensive income/(expense) for the period** | **-** | **-** | **-** | **(51)** | **-** | **5,284** | **(46)** | **5,187** | **449** | **5,636** |
| **Contributions by and distributions to owners** | | | | | | | | | | |
| Dividend paid by a subsidiary to a Non-controlling interest | - | - | - | - | - | - | - | - | (361) | (361) |
| Equity-settled Share-based payment awards | - | - | - | - | 307 | - | - | 307 | - | 307 |
| **Total transactions with owners** | **-** | **-** | **-** | **-** | **307** | **-** | **-** | **307** | **(361)** | **(54)** |
| **Balance at 31 December 2017** | **48,933** | **15,226** | **50** | **(382)** | **1,911** | **156,894** | **(30)** | **222,602** | **280** | **222,882** |

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

## COMPANY STATEMENT OF CHANGES IN EQUITY

| For the year ended 31 December 2018 | Share capital | Share-based payment reserve | Retained earnings | Total |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Balance at 31 December 2017 | **48,933** | **1,911** | **60,473** | **111,317** |
| **Loss for the year** | - | - | (6,553) | (6,553) |
| **Other comprehensive income / (expense)** | - | - | - | - |
| **Total comprehensive income for the period** | **-** | **-** | **(6,553)** | **(6,553)** |
| **Contributions by and distributions to owners** | | | | |
| Net increase in treasury shares | - | - | (3,677) | (3,677) |
| Equity-settled share-based payment awards | - | 293 | - | 293 |
| **Total transactions with owners** | **-** | **293** | **(3,677)** | **(3,384)** |
| **Balance at 31 December 2018** | **48,933** | **2,204** | **50,243** | **101,380** |

**Share-based payment reserve**

The share-based payment reserve represents the amortised portion of the fair value of equity instruments issued under the BLME and the Company's share incentive schemes and accounted for as equity-settled share-based payments. Pursuant to the BLME Scheme of Arrangement, which took effect on 2 October 2013, the obligations under all of the BLME share incentive schemes were assumed by the Company for nil consideration. This assumption of liability during 2013 was treated as an injection of equity and recognised as a capital contribution within the financial statements of BLME.

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

## COMPANY STATEMENT OF CHANGES IN EQUITY

**For the year ended 31 December 2017**

| | Share capital | Share-based payment reserve | Retained earnings | Total |
|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** |
| Balance at 31 December 2016 | **48,933** | **1,604** | **38,658** | **89,195** |
| **Profit for the year** | - | - | 21,815 | 21,815 |
| **Other comprehensive income / (expense)** | - | - | - | - |
| **Total comprehensive income for the period** | **-** | **-** | **21,815** | **21,815** |
| **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** | **1,911** | **60,473** | **111,317** |

The notes on pages 47 to 117 are an integral part of these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1. REPORTING ENTITY

BLME Holdings plc ("the Company") 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. The Company's principal activity is to act as a holding Company for Bank of London and The Middle East plc ("the Bank" or "BLME") and its subsidiaries, which is an independent wholesale bank involved in investment, commercial finance, private client banking and wealth management. The consolidated financial statements of the Group are presented as at and for the year ended 31 December 2018 and comprise BLME Holdings plc and its subsidiaries (together referenced as "the Group").

The Company was inserted as a holding Company of the Bank during 2013 pursuant to a Scheme of Arrangement. The transaction was outside the scope of IFRS 3 and therefore no business combination occurred.

The Company is a limited company incorporated and domiciled in England and whose shares are publicly traded.

## 2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

### a. Presentation of financial statements

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

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, deferred taxes, consolidation assessments and impairment of subsidiary. 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 Group'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 Group 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 Group 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 consolidated financial statements of the Group. The Group 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 Group has adopted the requirements of IFRS 15 for the first time. The Group'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 Group'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 Group has adopted the requirements of IFRS 9 for the first time. The Group elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39.

The Group 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 viii IFRS 9 Transition Disclosures below.

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

From 1 January 2018, the Group 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 Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Group'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 Group's assessment.

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

As a second step of its classification process the Group 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 Group 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 Group 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 Group'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 Group 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 Group 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 Group's policies for determining if there has been a significant increase in credit risk are set out in page 52.

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 Group'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 Group 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 Group 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 Group records an allowance for the LTECLs.

- **The calculation of ECLs**

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

When estimating the ECLs, the Group 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 Group 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 Group 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 Group 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 Group 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.

The Group 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 Group also considers whether the counterparty payment performance is deteriorating (i.e. payments are 30-days past due and the counterparty is added to the watchlist).

- **Default**

Refer to page 96 of the Financial Risk Management note for the definition of default.

**vi) Forward looking information**

In its ECL models, the Group 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 Group 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**

BLME 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 Group's material portfolios.

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

Best-case: The stress test is based on the Group'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 Group'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 Group 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 | | | | 01-Jan-18 | |
|---|---|---|---|---|---|---|
| | IAS 39 measurement | | Re-Measuremen | Re-Measurement | IFRS 9 | |
| | Category | Amount | | 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 Group'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 Group'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 Group 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 Group recognised an additional impairment on the Group's Finance Lease Receivables of £150,000 and a reduction in impairment on the Group'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 | | | Re-measurement | 01-Jan-18 IFRS 9 ECLs | | | |
|---|---|---|---|---|---|---|---|---|
| | Collective | Specific | Total | | 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 |
|---|---|
| Retained Earnings | **Amount £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 (01 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 Group's financial statements are disclosed below. The Group 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 Group plans to adopt IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 January 2019. The Group 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 Group will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

The Group 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 Group 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) | 4,847 |
| Prepaid rent | (301) |
| | 4,546 |
| ***Liabilities*** | |
| Lease liabilities | 6,130 |
| Other liabilities | (1,347) |
| | 4,783 |

Impact on opening retained earnings as at 1 January 2019:

| | £000 |
|---|---|
| ***Retained earnings*** | |
| Closing balance under IFRS 17 (31 December 2018) | 164,729 |
| Impact of adopting IFRS 16 | (237) |
| Opening balance under IFRS 16 (1 January 2019) | 164,492 |

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 29 | 6,889 |
| Operating lease obligations at 31 December 2018 not disclosed due to low value | 32 |
| **Gross lease liabilities at 1 January 2019** | **6,921** |
| Discounting | (791) |
| **Additional lease liabilities as a result of the initial application of IFRS 16 as at 1 January 2019** | **6,130** |

**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 group, not expected to have any impact or it is not feasible to determine whether there will be an impact to the Group's consolidated financial statements.

**f. Basis of consolidation**

**i. Subsidiaries**

Subsidiaries are investees controlled by the Company. The Company 'controls' an investee if it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of the subsidiaries are included in the consolidated financial statements from the date the control commences until the date control ceases (see Note 32).

ii. **Structured Entities ("SE")**

An SE is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only, and key activities are directed by contractual agreement. Structured entities often have restricted activities and a narrow and well defined objective (see Note 32).

iii. **Employee Benefit Trust ("EBT")**

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

iv. **Loss of control**

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interest (NCI) and other components of equity. Any resulting gain or loss is recognised in the income statement.

**g. Consolidation of foreign operations**

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

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

**h. 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.

**i. Functional and presentation currency**

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

**j. 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.

## k. 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 Group 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 Group 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 Group'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 Group 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. Off-setting 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 Group has transferred its contractual right to receive the cash flows of the financial assets and either:

- substantially all the risks and rewards of ownership have been transferred; or
- substantially all the risks and rewards have neither been retained nor transferred but control is not retained.

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

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

Refer to Note 2(d)(v) (on pages 50 to 52) 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 104 to 105 in Note 36.

### ix. Financial liabilities

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

- **Fair value hedge**

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

**l. Collateral and netting**

The Group 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.

**m. 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.

## n. Intangible assets

Intangible assets consist of computer licences and software development costs. Intangible assets acquired by the Group 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.

## o. 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.

## p. 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.

## q. 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.

**r. Employee benefits**

The Group operates a defined contribution pension scheme for all staff. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity, and where the Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The Group pays contributions to Standard Life. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

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

**s. Share-based payments**

The Group operates equity-settled share-based incentive schemes for employees. The cost of equity-settled share-based payment arrangements is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight line basis over the vesting period. 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.

**t. Own shares**

Own shares comprise:

- Own shares held by the EBT that have not vested unconditionally to employees of the Group; and
- Treasury shares held by the Company purchased from equity.

Consideration received when treasury shares held are re-issued is recognised directly as a change in equity and no gain or loss is recognised.

Own shares are recorded at cost and are deducted from Group retained earnings.

**u. Provisions**

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

**v. 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.

**w. Cash and cash equivalents**

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

**x. Other receivables**

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

**y. Segmental information**

Segment results that are reported to the Group'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.

**z. Earnings per share**

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss that is attributable to ordinary Shareholders of the Company by the weighted average number of ordinary shares outstanding during the period after excluding shares held by the Employee Benefit Trust (EBT) at the balance sheet date. Diluted EPS is calculated by adjusting the profit or loss that is attributable to ordinary Shareholders and the weighted-average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

**aa. Investment in subsidiary undertaking**

The investment in subsidiary undertaking in the Company's financial statements is stated at the IFRS net asset value of the Bank at the effective date of the BLME Scheme of Arrangement (which becomes the effective 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 Company only income statement. Where the recoverable amount is an excess of the carrying amount, the reversal of previous impairment is recognised in the Company only income statement. The reversal is limited to the previous impairment recognised.

**bb. Business combinations**

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired.

## 3. USE OF CRITICAL ACCOUNTING ESTIMATES AND 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 Group'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 Group's internal credit grading model, which assigns PDs to the individual grades.
- The Group'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 Group's accounting policy on fair value measurement is in accordance with IFRS 13 Fair Value Measurement and is discussed in Note 36.

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

**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.

**e. Consolidation assessments**

The Group consolidates subsidiaries and structured entities when Management considers the Group to have power and control over the investee. Judgement has been applied in determining whether control has been established by considering if the Company is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

**f. Impairment of subsidiary**

Under IAS 36, an investment is impaired if the cost of investment is greater than the recoverable amount. The recoverable amount has been calculated based on the Bank's value in use, determined by discounting future cash flows based on five-year budgets, adjusted for non-cash items such as share-based payments and depreciation. A pre-tax discount rate of 14.2% (2017: 14.9%) and a terminal growth rate of 1.5% (2017: 1.5%) from 2023 were used in the calculation. The 2017 discount rate was estimated using a five-year risk-free rate plus adjustments for variations in the amounts and timings of cash flows and uncertainty inherent in the asset. The 2018 discount rate was calculated by adjusting only the risk free rate for the UK government yield curve to achieve the pre-tax discount rate that gets to the same post-tax value in use. The terminal growth rate is based on a weighted average of a strong, moderate and weak growth rate environment. For sensitivity analysis, refer to note 19.

**4. SEGMENTAL INFORMATION**

The Group has three operating segments as described in the group strategic report on page 8, which are based on the Group's strategic business divisions. The strategic business divisions offer different products and services and are managed separately based on the Group's management and internal reporting structure.

Information regarding the results of the Group'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 Group 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 Group'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 | 17,097 | 13,966 | - | 33,715 |
| Operating lease income | 1,079 | 7,398 | - | - | 8,477 |
| Net fee income | 24 | 1,316 | 687 | - | 2,027 |
| Net impairment credit/(charge) | (24) | (2,022) | (241) | - | (2,287) |
| Net fair value (losses)/gains | (278) | - | 22 | - | (256) |
| Other operating income | 173 | 560 | 98 | - | 831 |
| **Total operating income** | **3,626** | **24,349** | **14,532** | **-** | **42,507** |
| Directly attributable segment expenses | (1,298) | (4,733) | (2,313) | - | (8,344) |
| Operating lease depreciation | - | (6,443) | - | - | (6,443) |
| **Net segment contribution** | **2,328** | **13,173** | **12,219** | **-** | **27,720** |
| Common costs not directly attributable to segments | | | | | (19,295) |
| **Net operating profit before tax** | | | | | **8,425** |
| **Reportable segment assets** | **240,638** | **655,346** | **375,136** | **7,828** | **1,278,948** |

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

The Treasury Division manages the Group's liquidity as a whole. The Group'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 | 12,828 | 12,137 | - | 25,424 |
| Operating lease income | 857 | 5,586 | - | - | 6,443 |
| Net fee income | 37 | 1,057 | 321 | - | 1,415 |
| Net fair value losses on investments | (2,330) | - | - | - | (2,330) |
| Other operating income | 1,745 | 5,135 | 17 | - | 6,897 |
| **Total operating income** | **768** | **24,606** | **12,475** | **-** | **37,849** |
| Directly attributable segment expenses | (1,832) | (4,687) | (2,295) | - | (8,814) |
| Operating lease depreciation | - | (4,858) | - | - | (4,858) |
| Net impairment credit/(charge) on financial assets and operating | 11 | 3,466 | (172) | - | 3,305 |
| **Net segment contribution** | **(1,053)** | **18,527** | **10,008** | **-** | **27,482** |
| Common costs not directly attributable to segments | | | | | (21,674) |
| **Net operating profit before tax** | | | | | **5,808** |
| **Reportable segment assets** | **240,701** | **533,024** | **249,771** | **4,038** | **1,027,534** |

**Entity wide disclosures**

**Geographical analysis of non-current assets**

| | 31 December 2018 £000 | 31 December 2017 £000 |
|---|---|---|
| United Arab Emirates | 48 | 32 |
| Luxembourg | - | 32 |
| United Kingdom | 54,276 | 38,865 |
| USA | 37 | 958 |
| **Total** | **54,361** | **39,887** |

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 activties: | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Due from financial institutions: | | |
| Murabaha income | 469 | 386 |
| Wakala income | 681 | 330 |
| Finance lease receivables: | | |
| Finance lease income | 6,171 | 4,750 |
| Hire Purchase income | 4,794 | 4,762 |
| Istisna and Ijara income | 247 | 184 |
| Financing arrangements: | | |
| Murabaha income | 36,018 | 27,578 |
| Musharaka income | - | 19 |
| Wakala income | 405 | 285 |
| Investment securities: | | |
| Sukuk income | 2,481 | 3,414 |
| | **51,266** | **41,708** |

| 5(b) Fee and commission income | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Fees - letters of credit and uncommitted facilities | 1,048 | 849 |
| Management fees | 498 | 483 |
| Acquisition and structuring transaction fees | 460 | 265 |
| Other | 438 | 312 |
| | **2,444** | **1,909** |

## 6. RETURNS TO FINANCIAL INSTITUTIONS AND CUSTOMERS

| | 2018<br>£000 | 2017<br>£000 |
|---|---|---|
| Customer deposits | 6,307 | 5,288 |
| Murabaha | 9,152 | 9,604 |
| Wakala | 2,092 | 1,392 |
| | **17,551** | **16,284** |

## 7. NET FAIR VALUE LOSSES ON INVESTMENTS

| | 2018<br>£000 | 2017<br>£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 | 188 | 1,745 |
| Gain on leased asset sales | 560 | 1,805 |
| Other | 83 | 3,347 |
| | **831** | **6,897** |

In the other income line above, £57k relates to gains on fixed asset sales (2017: £3.3m relates to a receipt from an insurance claim in respect of an earlier year).

## 9. PROFIT RATE SWAPS

The Group 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 income statement. The Group 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 for hedging purposes by product type:

**Group**

| | 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 |
| | **-** | **15,000** | **50,000** | **20,000** |

**Group**

| | 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**

The Group'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 Group'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:**

| **Group** | **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:**

| **Group** | **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 | 12,755 | 12,040 |
| Social security costs | 1,481 | 1,695 |
| Defined contribution pension scheme costs | 1,051 | 1,061 |
| Recruitment costs | 127 | 398 |
| Other staff costs | 819 | 453 |
| | **16,233** | **15,647** |

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

| | 2018 Number | 2017 Number |
|---|---|---|
| Period end | 121 | 117 |
| Average for the period - management | 11 | 10 |
| Average for the period - non-management | 109 | 109 |

**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 (2017: one, as disclosed in Note 34).

**12. OTHER OPERATING EXPENSES**

| | 2018 £000 | 2017 £000 |
|---|---|---|
| Advertising and market development | 133 | 90 |
| Board and SSB related expenses | 610 | 408 |
| Communications and IT costs | 1,656 | 1,783 |
| Consultancy | 907 | 1,673 |
| Legal and professional fees | 2,715 | 3,994 |
| Other operating charges | 2,943 | 3,635 |
| Rent and other occupancy costs | 1,372 | 1,741 |
| | **10,336** | **13,324** |

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

| | 2018 £000 | 2017 £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 Group'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 BLME 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 | 18.00 | 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** | **Weighted average excercise price (pence)** | **Number of options** | **Weighted average excercise price (pence)** |
|---|---|---|---|---|
| | **2018** | **2018** | **2017** | **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** | **Number of options** |
|---|---|---|
| | **2018** | **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 Group. 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 Group in 2015 with participation open to all Group 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 | - | 0 |
| 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 | - | - |
| Recognised under matched award | 282,107 | 321,529 |
| 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 | Stage 2 Collective | Stage 3 Specific | Total |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| Financing arrangements | 710 | 1,697 | 7,927 | 10,334 |
| Finance lease receivables | 595 | 2,728 | 1,349 | 4,672 |
| **Total Impairment** | **1,305** | **4,425** | **9,276** | **15,006** |

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) | 2,287 |
| **Total Impairment Loss** | **2,287** |

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

| | Stage 1 Collective | Stage 2 Collective | Stage 3 Specific | Total |
|---|---|---|---|---|
| | £000 | £000 | £000 | £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 | (302) | 2,287 |
| Write-offs from specific provisions | - | - | (3,593) | (3,593) |
| Foreign currency translation adjustments | - | - | 350 | 350 |
| **Balance at 31 December 2018** | **1,305** | **4,425** | **9,276** | **15,006** |

| Group | | | 2017 |
|---|---|---|---|
| | Specific | Collective | Total |
| **Impairments of financial assets:** | **£000** | **£000** | **£000** |
| Balance at 1 January 2017 | 19,018 | 4,145 | 23,163 |
| Exchange translation and other movements | (549) | - | (549) |
| **Income statement:** | | | |
| Gross impairment charge for the year | 8,247 | - | 8,247 |
| Amount recovered during the year | (10,573) | (979) | (11,552) |
| **Net impairment (credit)/charge for the year** | **(2,326)** | **(979)** | **(3,305)** |
| Amounts written off during the year | (3,322) | - | (3,322) |
| **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 |
| | **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.

## 15. TAXATION

| Group | 2018 | 2017 |
|---|---|---|
| | **£000** | **£000** |
| UK Corporation Tax | | |
| - current tax for the year | 407 | 180 |
| - adjustments in respect of prior years | 114 | (105) |
| | 521 | 75 |
| Overseas tax for the year | - | - |
| Deferred tax for the year | (3,338) | - |
| **Tax (credit) / charge in income statement** | **(2,817)** | **75** |

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

| **Group** | **2018** | **2017** |
|---|---|---|
| | **£000** | **£000** |
| **Reconciliation of effective tax rate** | | |
| Profit/ (Loss) for the year before tax | 8,425 | 5,809 |
| Profit/ (Loss) for the year multiplied by standard rate of corporation tax in the UK of 19% (2017: 19.25%) | 1,601 | 1,118 |
| Recognition of deferred tax asset | (3,338) | - |
| Movement in unrecognised deferred tax | (1,262) | (668) |
| Expenses not deductible for tax purposes | 39 | (156) |
| Tax on controlled foreign companies | 200 | - |
| Tax exempt income | (240) | (114) |
| Prior year adjustment | 114 | (105) |
| Effect of change in tax rates | 69 | - |
| **Tax credit in income statement** | **(2,817)** | **75** |

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**

| **Group** | **2018** | **2017** |
|---|---|---|
| | **£000** | **£000** |
| Fair value reserve | (135) | 105 |
| | **(135)** | **105** |

**Tax recognised directly in equity**

| **Group** | **2018** | **2017** |
|---|---|---|
| | **£000** | **£000** |
| Share based-payment 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 (net) (2017: nil).

**Movements in deferred tax balances (net)**

| **Group - 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)**

| Group | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| Accelerated depreciation | 13,106 | 15,231 |
| Tax losses carried forward | 6,701 | 24,461 |
| Other temporary differences | 25 | 4,080 |
| **Deferred tax assets** | **19,832** | **43,772** |

## 16. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to Ordinary shareholders and the number of basic weighted average ordinary shares. When calculating the diluted earnings per share, the weighted average number of shares in issue is adjusted for the dilutive effects of all dilutive share options and awards.

| | 2018 | 2017 |
|---|---|---|
| **Earnings per share** | **pence** | **pence** |
| Basic | 5.59 | 2.73 |
| Diluted | 5.09 | 2.71 |

| | 2018 | 2017 |
|---|---|---|
| **Profit attributable to ordinary shareholders** | **£000** | **£000** |
| Profit attributable to shareholders (basic) | 10,793 | 5,284 |
| Profit attributable to shareholders (diluted) | 10,793 | 5,284 |

| | 2018 | 2017 |
|---|---|---|
| **Weighted average number of ordinary shares** | **Number** | **Number** |
| Number of ordinary shares of 25p in issue | 195,733,691 | 195,733,691 |
| Share held by the BLME Holdings EBT | (2,192,029) | (2,258,915) |
| Treasury shares repurchased in December 2018 | (10,357,374) | - |
| Weighted average number of shares (basic) at 31 December | 193,106,893 | 193,474,776 |
| Effect of dilutive share options in issue | 19,096,265 | 1,515,521 |
| Weighted average number of shares (diluted) at 31 December | 212,203,158 | 194,990,297 |

## 17. CHANGES IN LIABILITIES FROM FINANCING ACTIVITIES

| Group | 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) | (80,094) | 82 | - | - | (357,353) |
| Profit Rate Swaps | (636) | - | (2) | 216 | 26 | (396) |
| **Total** | (792,369) | (232,718) | (5,144) | 216 | 26 | (1,029,989) |

| Group | 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) | (63,682) | 145 | - | - | (277,341) |
| Profit Rate Swaps | (1,305) | | 29 | 589 | 51 | (636) |
| **Total** | (802,073) | 3,968 | 5,096 | 589 | 51 | (792,369) |

## 18. DUE FROM FINANCIAL INSTITUTIONS AND CUSTOMERS

**Due from financial 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 financial 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** |

**19. INVESTMENT SECURITIES**

| | | | **2018** |
|---|---|---|---|
| **Group** | **Listed** | **Unlisted** | **Total** |
| | **£000** | **£000** | **£000** |
| **Fair value through other comprehensive income** | | | |
| Equity | - | 341 | 341 |
| Sukuk | 93,894 | - | 93,894 |
| **Amortised cost** | | | |
| Sukuk | 9,637 | - | 9,637 |
| | **103,531** | **341** | **103,872** |

| | | | **2017** |
|---|---|---|---|
| **Group** | **Listed** | **Unlisted** | **Total** |
| | **£000** | **£000** | **£000** |
| **Available-for-sale** | | | |
| Equity | - | 973 | 973 |
| Sukuk | 104,882 | - | 104,882 |
| **Held to Maturity** | | | |
| Sukuk | 9,075 | - | 9,075 |
| | **113,957** | **973** | **114,930** |

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.*

| Company | Listed | Unlisted | 2018 Total |
|---|---|---|---|
| | £000 | £000 | £000 |
| **Investment in subsidiary** | | | |
| Bank of London and The Middle East plc | - | 101,310 | 101,310 |

| Company | Listed | Unlisted | 2017 Total |
|---|---|---|---|
| | £000 | £000 | £000 |
| **Investment in subsidiary** | | | |
| Bank of London and The Middle East plc | - | 111,318 | 111,318 |

The Company was inserted as a holding Company of the Bank during 2013 pursuant to a Scheme of Arrangement. The transaction was outside the scope of IFRS 3 and therefore no business combination occurred. As a result, acquisition accounting using fair value was not mandatory and the Company's investment in the Bank was recognised at the IFRS net asset value of the Bank at the effective date of the BLME Scheme of Arrangement (which became the effective cost of investment).

Pursuant to the scheme and as explained in Note 13, all existing options under the Bank's share incentive plans lapsed and replacement options were offered on substantially the same terms and conditions. Furthermore, the Bank was relieved of its obligations under the share incentive plans and those responsibilities were assumed by the Company for no consideration. As this transaction was a non-monetary transaction for no consideration with a parent Company, it was in effect additional investment in the Bank by the Company.

| Company | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| **Investment in subsidiary** | | |
| Opening balance | 111,318 | 89,196 |
| Equity-settled share-based payment awards | 295 | 307 |
| Impairment (loss) / reversal | (10,303) | 21,815 |
| **Closing balance at 31 December** | **101,310** | **111,318** |

A provision for an impairment charge of £10.3 million was recognised in 2018 in the income statement of the Parent Company. A reversal of £21.8 million of the impairment charge incurred in 2016 was recognised in 2017 in the income statement of the Parent Company. Under IAS 36, an investment is impaired if the cost of investment is greater than the recoverable amount. The recoverable amount of £101.3 million in 2018 (2017: £111.3 million) has been calculated based on the Bank's fair value less costs to sell. The fair value less costs to sell exceeded the value in use which was calculated using the same methodology as 2017 of discounting future cash flows based on five-year budgets, adjusted for non-cash items such as share-based payments and depreciation.

Management has performed a sensitivity analysis which shows that a 1% increase/decrease in the discount rate results in a £5m decrease/£6m increase in the valuation. A 1% increase in the growth percentage rate decreases the valuation by £12m while a 1% decrease in the same rate increases the valuation by £10m.

## 20. FINANCING ARRANGEMENTS

| Group | Less than 1 year £000 | 1 - 5 years £000 | Over 5 years £000 | 2018 Total £000 |
|---|---|---|---|---|
| Murabaha | 692,456 | 50,686 | - | 743,142 |
| Mudaraba | 3,642 | - | - | 3,642 |
| Participation agreement | 141 | - | - | 141 |
| Sukuk | 931 | - | - | 931 |
| | **697,170** | **50,686** | **-** | **747,856** |
| Provision for impairment | | | | (10,334) |
| | | | | **737,522** |
| 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.

| Group | Less than 1 year £000 | 1 - 5 years £000 | Over 5 years £000 | 2017 Total £000 |
|---|---|---|---|---|
| Murabaha | 498,075 | 74,070 | - | 572,145 |
| Mudaraba | 3,425 | - | - | 3,425 |
| Sukuk | 945 | 2,537 | - | 3,482 |
| | **502,445** | **76,607** | **-** | **579,052** |
| Provision for impairment | | | | (11,232) |
| | | | | **567,820** |
| Collective Impairment | | | | (1,674) |
| Specific Impairment | | | | (9,558) |
| | | | | **(11,232)** |

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

**21. FINANCE LEASE RECEIVABLES**

| Group | 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 | (10,974) | (7,868) |
| Unearned future income on hire purchase | (8,270) | (5,446) |
| IFRS 9 Stage 1 & 2 ECL | (3,323) | (1,492) |
| IFRS 9 Stage 3 ECL | (1,349) | (3,190) |
| **Net investment in finance leases and hire purchase** | **256,198** | **170,546** |
| **The net investment in finance leases comprises:** | | |
| Within one year | 41,840 | 24,444 |
| One to five years | 77,652 | 39,209 |
| Over five years | 4,596 | 6,273 |
| | **124,088** | **69,926** |
| **The net investment in hire purchase comprises:** | | |
| Within one year | 56,140 | 50,577 |
| One to five years | 75,783 | 50,043 |
| Over five years | 187 | - |
| | **132,110** | **100,620** |
| | **256,198** | **170,546** |

These tables represent contractual maturities. The Group'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.

## 22. PROPERTY AND EQUIPMENT

| | Computer Equipment | Office Equipment | Fixtures & Fittings | Total |
|---|---|---|---|---|
| | £000 | £000 | £000 | £000 |
| **Cost** | | | | |
| At 1 January 2018 | 541 | 69 | 2,185 | 2,795 |
| Additions | - | - | - | - |
| Disposals | - | - | - | - |
| **At 31 December 2018** | 541 | 69 | 2,185 | **2,795** |
| At 1 January 2017 | 534 | 69 | 2,185 | 2,788 |
| Additions | 7 | - | - | 7 |
| Disposals | - | - | - | - |
| **At 31 December 2017** | **541** | **69** | **2,185** | **2,795** |
| **Depreciation** | | | | |
| At 1 January 2018 | 515 | 61 | 1,232 | 1,808 |
| Charge for the year | 19 | 6 | 474 | 499 |
| Disposals | - | - | - | - |
| **At 31 December 2018** | 534 | 67 | 1,706 | **2,307** |
| At 1 January 2017 | 478 | 55 | 732 | 1,265 |
| Charge for the year | 37 | 6 | 500 | 543 |
| Disposals | - | - | - | - |
| **At 31 December 2017** | **515** | **61** | **1,232** | **1,808** |
| **Net Book Value** | | | | |
| At 1 January 2018 | 26 | 8 | 953 | 987 |
| **At 31 December 2018** | 7 | 2 | 479 | **488** |
| **At 31 December 2017** | **26** | **8** | **953** | **987** |

## 23. OPERATING LEASE ASSETS

| **Group** | **At 31 December 2017** | **Additions 2018** | **Disposals 2018** | **Depreciation 2018** | **Translation differences 2018** | **At 31 December 2018** |
|---|---|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** |
| Gross carrying amount | 47,798 | 27,846 | (19,327) | - | 346 | 56,663 |
| Less depreciation | (12,876) | - | 6,339 | (6,443) | (305) | (13,285) |
| | **34,922** | **27,846** | **(12,988)** | **(6,443)** | **41** | **43,378** |

| **Group** | **At 31 December 2016** | **Additions 2017** | **Disposals 2017** | **Depreciation 2017** | **Translation differences 2017** | **At 31 December 2017** |
|---|---|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** | **£000** | **£000** |
| Gross carrying amount | 45,325 | 27,830 | (23,969) | - | (1,388) | 47,798 |
| Less depreciation | (20,131) | - | 10,938 | (4,858) | 1,175 | (12,876) |
| | **25,194** | **27,830** | **(13,031)** | **(4,858)** | **(213)** | **34,922** |

| **Rental receipts under operating leases** | **2018** | **2017** |
|---|---|---|
| Future rentals are as follows: | **£000** | **£000** |
| Less than one year | 8,291 | 3,294 |
| Between one and five years | 19,076 | 13,815 |
| More than five years | 2,671 | 1,971 |
| | **30,038** | **19,080** |

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

### 24. INTANGIBLE ASSETS

| **Group** | **2018** | **2017** |
|---|---|---|
| **Cost** | **£000** | **£000** |
| Opening balance | 5,645 | 5,528 |
| Additions | - | 117 |
| Disposals | - | - |
| **Closing balance** | **5,645** | **5,645** |
| | | |
| **Amortisation and impairment losses** | | |
| Opening balance | 4,808 | 3,835 |
| Charge for the year | 571 | 973 |
| Disposals | - | - |
| **Closing balance** | **5,379** | **4,808** |
| | | |
| **Net Book Value** | **266** | **837** |

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

### 25. OTHER ASSETS

| **Group** | **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** | 2,442 | 681 |
| | **6,641** | **3,141** |

* Per IFRS 15 *Revenue from Contracts with Customers*, a contract asset (accrued income) or a contract liability (deferred income, see Note 28 on the next page) is recognised for difference between the cumulative revenue recognised and the cumulative amounts billed for a contract.

** The Group 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).

## 26. DUE TO FINANCIAL INSTITUTIONS

| Group | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| Reverse Murabaha | 544,843 | 391,186 |
| Wakala | 127,397 | 123,206 |
| | **672,240** | **514,392** |

## 27. DUE TO CUSTOMERS

| Group | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| Customer deposits | 353,569 | 270,645 |
| Security deposits | 3,784 | 6,696 |
| | **357,353** | **277,341** |

## 28. OTHER LIABILITIES

| Group | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| Trade payables | 18 | 176 |
| Contract liability | 5 | 48 |
| Social security and income tax | 334 | 354 |
| Accruals | 10,814 | 8,210 |
| Other creditors* | 1,539 | 3,244 |
| | **12,710** | **12,032** |

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

## 29. 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 Group has three more non-cancellable operating lease agreements in relation to two other UK office premises and a motor vehicle. The future minimum lease rental for these three leases is £0.032 million (2017: £0.019 million). During the year an expense of £0.038 million (2017: £0.037 million) was recognised in the income statement in respect of these operating leases.

## 30. CONTINGENT LIABILITIES

There are no contingent liabilities as at 31 December 2018 to be disclosed.

## 31. SHARE CAPITAL

| Group | Number of shares | Share capital £000 |
|---|---|---|
| **Allotted, called up and fully paid 25p per Ordinary share** | | |
| **At 31 December 2017** | 195,733,691 | 48,933 |
| Less: Shares repurchased (treasury shares) | (10,357,374) | - |
| **At 31 December 2018** | **185,376,317** | **48,933** |

More information regarding the purchase of treasury shares is included in Note 34.

## 32. SUBSIDIARIES AND OTHER ENTITIES

| 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 |

As the Group owns the majority of the equity capital of the above entities, it is exposed, and has rights, to variable returns from its involvement with the investees and has the ability to affect those returns through its power over the investees. Consequently, the results of the subsidiaries above have been consolidated in these financial statements.

The business activities of BLME Umbrella Fund Management S.a.r.l., the General Partner of the BLME Sharia'a Umbrella Fund SICAV-SIF, ceased on 31st October 2017. The Company was dissolved on 20 March 2018.

There is one active structured entity ("SE") (2017: two) that does not qualify as a subsidiary under UK law but which is consolidated under IFRS 10 as the substance of the relationship is that the entity is deemed to be controlled by the Group. This entity is deemed to be controlled by the Group because the relationship between the Group and the SE is governed by a participation agreement which allows the Group to exercise power over the SE in addition to being exposed to, and having rights over, the variable returns from its involvement with the SE. Furthermore, the Group has the ability to use its power to affect its returns from its involvement in the SE.

The one structured entity is as follows:

- DMJ 2 LLC (USA) – Operating leases

Lease assets owned by the SE are reported as Group operating lease assets amounting to £0.1 million (2017: £0.7 million).

The BLME Holdings Employee Benefit Trust ('EBT') holds a stock of own shares acquired at a cumulative cost of £3.5 million (31 December 2017: £3.7 million) which has been deducted from retained earnings in the Condensed Consolidated Statement of Changes in Equity. The EBT did not purchase any Company shares during the year ended 31 December 2018 (31 December 2017: Nil). No stamp duty costs were incurred by the Group on behalf of the BLME Holdings EBT (Year ended 31 December 2017: Nil).

- **Significant restrictions**

The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities other than those resulting from the supervisory frameworks within which banking subsidiaries operate. The supervisory frameworks require banking subsidiaries to keep certain levels of regulatory capital and liquid assets, limit their exposure to other parts of the Group and comply with other ratios. The carrying amounts of Bank of London and The Middle East Plc's assets and liabilities are £1,273 million and £1,045 million respectively (2017: £1,026 million and £805 million respectively).

- **Interests in unconsolidated structured entities**

The Group does not have any interests in unconsolidated structured entities.

- **Contractual arrangements and financial support**

The Group does not have any contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated or unconsolidated structured entity (2017: none).

Except for a letter of support provided to MKL Construction Equipment Finance Limited, the Group did not provide financial support to any of its consolidated or unconsolidated structured entities during 2018 (2017: nil) and does not have any current intentions to provide such support (2017: none).

**33. NON-CONTROLLING INTEREST**

The group holds a 60% and 56% shareholding in MKL Construction Equipment Finance Limited and Aspenway Limited respectively, and consolidates them as subsidiaries under IFRS 10. The non-controlling interest represents the minority shareholders of 40% and 44% respectively.

**34. RELATED PARTIES**

During the year the Group entered into transactions, other than those included in Notes 11 and 26 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 |
| NBK Banque Privée (Suisse) SA | Fellow subsidiary of | | |
| Brokerage fees* | Shareholder | 89 | - |
| Aspenway Limited | Subsidiary | | |
| Due to financial institutions | | 6,300 | 11,300 |
| AQ1 Limited | Subsidiary | | |
| Due to financial institutions | | 24,870 | - |

*The Company conducted a share repurchase programme on the Nasdaq Dubai Stock exchange over eight trading days commencing on Monday 10 December 2018. Boubyan Bank K.S.C.P. and the directors of the Company did not participate in the programme. The total number of shares purchased was 10,357,374 for a total consideration of $4.510m (£3.57m) at an average price paid per share of $0.4354 (£0.3446). On 9 January 2019 the Company repurchased the 10,357,374 shares from NBK Banque Privée (Suisse) SA and these shares are now held in treasury as disclosed in Note 31.

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

| Included within: | 2018 £000 | 2017 £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 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.

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 Group'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 Group 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.

## 35.SUBSEQUENT EVENTS

The Directors are not aware of any matters or circumstances that have occurred since the end of the financial year that have significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group in subsequent financial years.

## 36. FINANCIAL RISK MANAGEMENT

The Group has 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 conduct and cyber risk)
- capital risk

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

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 Group'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 Group'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 has been 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 Group 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 Group 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 Group exposed to a loss if the market has moved adversely. The Group 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 the Group 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 Group's total identified risk as outlined in the Group's ICAAP. This is therefore considered to be the key risk undertaken by the Group.

  The Group 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 consequently resulting in concerns the Group could be faced with a non-performing finance ("NPF") situation. The Group 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 Group'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

The Group's 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 Group 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 Group's Credit Risk Management Policy. The Group 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 Group manages credit risk by the use of Portfolio Limits and Commercial Guidelines ("CGs") within the Group's Credit Risk Management Policy. These sector and business based expressions of credit risk appetite provide guidance on the acceptable level of credit exposure by counterparty rating, country and sector, including the adequacy of collateral. Credit risks are monitored on a daily basis and are 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 Group'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 Group in the management of credit risk

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

The Group also employs a credit grading system, to facilitate monitoring of the quality of the overall portfolio and individual segments.

### ii. Exposure by Statement of Financial Position line

The tables below present the Group's exposure to credit risk on 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.

| **Group** | **2018** | **2017** |
|---|---|---|
| | **£000** | **£000** |
| Cash and balances with banks | 104,339 | 96,780 |
| Due from financial institutions | | |
| Murabaha | - | 24,844 |
| Wakala | 8,045 | 3,700 |
| Due from customers | 14,612 | 9,027 |
| Investment securities | 103,872 | 114,930 |
| Financing arrangements | 737,522 | 567,820 |
| Finance lease receivables | 256,198 | 170,546 |
| Other assets (Foreign exchange forward deals) | 1,154 | - |
| Profit rate swaps | 73 | - |
| **Total credit exposure** | **1,225,815** | **987,647** |

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

| Group | 2018 | 2017 |
|---|---|---|
| | £000 | £000 |
| **GCC countries** | | |
| Bahrain | 8,744 | 8,464 |
| Kuwait | 94,292 | 94,017 |
| Qatar | 41,890 | 14,008 |
| Saudi Arabia | 77,829 | 92,570 |
| United Arab Emirates | 8,200 | 16,064 |
| **EEA countries** | | |
| Belgium | 633 | - |
| Netherlands | 2,398 | - |
| United Kingdom | 864,490 | 674,891 |
| **Other countries** | | |
| Cayman Islands | 5,669 | 6,097 |
| Canada | 230 | - |
| Guernsey | - | 15,491 |
| Switzerland | 16,716 | 866 |
| Jordan | 36,691 | 1,369 |
| Isle of Man | - | 16,234 |
| Jersey | 1,589 | 11,891 |
| New Zealand | 2,103 | - |
| USA | 64,341 | 35,685 |
| **Total credit exposure** | **1,225,815** | **987,647** |

### iv. Exposure by economic sector

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

| Group | 2018 £000 | 2017 £000 |
|---|---|---|
| Financial services | | |
| GCC financial institutions | 147,257 | 141,042 |
| UK financial institutions | 129,946 | 126,235 |
| Other financial institutions | 49,646 | 46,244 |
| Mining and quarrying | 4,808 | 4,147 |
| Manufacturing | 50,508 | 31,101 |
| Real estate | 309,877 | 295,181 |
| Transportation and storage | 41,059 | 38,447 |
| Government | 46,486 | 40,788 |
| Wholesale / Retail | 127,555 | 84,700 |
| Commodities | 86,047 | 66,886 |
| Energy | 13,247 | 14,072 |
| Construction | 117,409 | 45,151 |
| Others | 96,074 | 53,653 |
| **Total credit exposure** | **1,219,919** | **987,647** |

### v. Credit risk quality

The Group'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 Group 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.

## Group

| 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 | 104,339 | - | - | - | - | - | - | 104,339 |
| 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 | - | - | - | 62,396 |
| **AC** | | | | | | | | |
| Government debt securities | 3,953 | 5,684 | - | - | - | - | - | 9,637 |
| Other Investment securities | - | - | - | - | - | - | - | - |
| Financing arrangements | 21,538 | - | 384,676 | 251,615 | 50,660 | 22,510 | 6,523 | 737,522 |
| Finance lease receivables | - | - | 103,662 | 139,418 | 5,327 | 552 | 7,239 | 256,198 |
| Other assets (Foreign exchange forward deals) | - | - | 1,149 | 5 | - | - | - | 1,154 |
| Profit rate swaps | 73 | - | - | - | - | - | - | 73 |
| **Total credit exposure** | **223,797** | **5,684** | **512,144** | **391,379** | **55,987** | **23,062** | **13,762** | **1,225,815** |

## Group

| 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 | 96,780 | - | - | - | - | - | - | 96,780 |
| 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 | 31,712 | - | - | - | - | - | - | 31,712 |
| Other Investment securities | 73,170 | - | - | 973 | - | - | - | 74,143 |
| **Investment Hold to Maturity (HTM)** | | | | | | | | |
| Government debt securities | 3,718 | 5,357 | - | - | - | - | - | 9,075 |
| Other Investment securities | - | - | - | - | - | - | - | - |
| Financing arrangements | 4,762 | - | 301,908 | 184,127 | 12,141 | 40,256 | 24,626 | 567,820 |
| 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** | **235,086** | **5,357** | **378,491** | **271,132** | **16,602** | **40,735** | **40,244** | **987,647** |

The Group'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**

| Group | Financing arrangements | | Finance Leases | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | £000 | £000 | £000 | £000 |
| Neither past due nor impaired | 716,416 | 512,496 | 249,756 | 157,639 |
| Past due but not impaired | 22,510 | 40,255 | 552 | 479 |
| Gross exposure associated with impairment provision | 6,523 | 24,626 | 7,239 | 15,618 |
| Less: allowance for impairments | (7,927) | (9,558) | (1,349) | (3,190) |
| **Total** | **737,522** | **567,819** | **256,198** | **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 Group 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 Group. 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 the commercial guidelines, this does not necessarily mean that any granting of facilities that fall outside 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 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 (i.e. the debtor meets the conditions of the contract) 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: sixteen):

- where the Group waived material financial covenants or agreed to temporary relaxation of payment terms which were subsequently cured;
- where the Group agreed to provide temporary facilities beyond the terms upon which the facilities were intended to operate; and/or
- where the Group 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 Group's total assets (2017: £37.2 million and 4%). The Stage 1 and 2 ECLs relating to these forborne exposures was £1,228k.

- **Allowance for impairment**

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

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

### vi. Collateral

The Group monitors the market value of its collateral on an on-going basis which, dependent upon the collateral type, can vary from monthly to yearly. The Group 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 Group 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 Group 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.

| **Group** | **2018 On balance sheet exposure** | **2018 Collateral** | **2017 On balance sheet exposure** | **2017 Collateral** |
|---|---|---|---|---|
| | **£000** | **£000** | **£000** | **£000** |
| Cash and balances with banks | 104,339 | - | 96,780 | - |
| Due from financial institutions | 8,045 | - | 28,544 | - |
| Due from customers | 14,612 | 7,188 | 9,027 | - |
| Investment securities | 103,872 | - | 114,930 | - |
| Financing arrangements | 737,522 | 578,599 | 567,820 | 405,535 |
| Finance lease receivables | 256,198 | 236,350 | 170,546 | 131,339 |
| Other assets (Foreign exchange forward deals) | 1,154 | - | - | - |
| Profit rate swaps | 73 | - | - | - |
| **Total credit exposure** | **1,225,815** | **822,137** | **987,647** | **536,874** |

As at 31 December 2018, collateral represented 67% (2017: 54%) of the Group's total credit exposure.

| **Group 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 Group 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 Group'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.

| **Group** | Note | **Fair value hierarchy** | **2018 Carrying value £000** | **2018 Fair value £000** | **2017 Carrying value £000** | **2017 Fair value £000** |
|---|---|---|---|---|---|---|
| Cash and balances with banks | | 1 | 104,339 | * | 96,780 | * |
| 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** | 103,872 | 103,872 | 114,930 | 114,930 |
| Financing arrangements | iii | 3 | 737,522 | 728,785 | 567,820 | 561,199 |
| Finance lease receivables | iii | 3 | 256,198 | 254,419 | 170,546 | 170,262 |
| Profit rate swaps asset | ii | 2 | 73 | 73 | - | - |
| Other assets (Foreign exchange forward deals) | iv | 2 | 1,154 | 1,154 | - | - |
| Due to financial institutions | iii | 3 | 672,240 | 653,319 | 514,392 | 511,278 |
| Due to customers | iii | 3 | 357,353 | 352,616 | 277,341 | 275,261 |
| Profit rate swaps liability | ii | 2 | 469 | 469 | 636 | 636 |
| 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 Group'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.

| **Group** | **2018 Level 1 £000** | **2018 Level 2 £000** | **2018 Level 3 £000** | **2018 Total £000** |
|---|---|---|---|---|
| Investment securities | 93,894 | - | 341 | 94,235 |
| Profit rate swaps (asset) | - | 73 | - | 73 |
| Foreign exchange forward deals (assets) | - | 1,154 | - | 1,154 |
| Profit rate swaps (liability) | - | 469 | - | 469 |
| Foreign exchange forward deals (liabilities) | - | 237 | - | 237 |

| **Group** | **2017 Level 1 £000** | **2017 Level 2 £000** | **2017 Level 3 £000** | **2017 Total £000** |
|---|---|---|---|---|
| Investment securities | 104,882 | - | 973 | 105,855 |
| Profit rate swaps (asset) | - | - | - | - |
| Profit rate swaps (liability) | - | 636 | - | 636 |
| Foreign exchange forward deals (assets) | - | 982 | - | 982 |
| 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 would 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.

| Group | 2018 | 2017 |
|---|---|---|
| **Investment securities** | **£000** | **£000** |
| Balance at 1 January | 973 | 3,170 |
| Total gains / (losses) recognised in: | | |
| - profit or loss* | 20 | (1,770) |
| - other comprehensive income** | (195) | (427) |
| Purchases | - | - |
| Sales | (457) | - |
| Balance at 31 December | **341** | **973** |

** 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 19.

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:

| Group | | | | 31 December 2017 |
|---|---|---|---|---|
| | Income statement | | Other comprehensive income | |
| | Increase | Decrease | Increase | Decrease |
| | £000 | £000 | £000 | £000 |
| Valuation adjustment +30% | - | - | 292 | - |
| Valuation adjustment -30% | - | (7) | - | (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.

| Group | 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 | - | - | 104,339 | 104,339 |
| 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 |
| Financing arrangements | - | - | 737,522 | 737,522 |
| Finance lease receivables | - | - | 256,198 | 256,198 |
| Other assets | 1,154 | - | - | 1,154 |
| Profit rate swaps | 73 | - | - | 73 |
| **Total financial assets** | **1,227** | **94,235** | **1,130,353** | **1,225,815** |

| Group | 2018 Fair value through profit and loss | 2018 Other Profit Rate Swaps | 2018 Financial liabilities at amortised cost | 2018 Total |
|---|---|---|---|---|
| **Liabilities** | **£000** | **£000** | **£000** | **£000** |
| Due to financial institutions | - | - | 672,240 | 672,240 |
| Due to customers | - | - | 357,353 | 357,353 |
| Profit rate swaps | 469 | - | - | 469 |
| Other liabilities (Foreign exchange forward deals) | 237 | - | - | 237 |
| **Total financial liabilities** | **706** | **-** | **1,029,593** | **1,030,299** |

| Group | 2017 Fair value through profit and loss | 2017 Available-for-sale | 2017 Financial assets at amortised cost | 2017 Total |
|---|---|---|---|---|
| **Assets** | **£000** | **£000** | **£000** | **£000** |
| Cash and balances with banks | - | - | 96,780 | 96,780 |
| Due from financial institutions | - | - | 28,544 | 28,544 |
| Due from customers | - | - | 9,027 | 9,027 |
| Investment securities: | | | | |
| Sukuk | - | 104,882 | 9,075 | 113,957 |
| Equity | - | 973 | - | 973 |
| Financing arrangements | - | - | 567,820 | 567,820 |
| Finance lease receivables | - | - | 170,546 | 170,546 |
| **Total financial assets** | **-** | **105,855** | **881,792** | **987,647** |

| Group | 2017<br>Fair value through profit and loss | 2017<br>Other Profit Rate Swaps | 2017<br>Financial liabilities at amortised cost | 2017<br>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 Group will encounter difficulty in meeting its financial obligations as they fall due, arising from the differing maturity profile of its assets and liabilities. This risk is managed by ensuring that the Group 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 Group'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 Group'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 Group 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**

| Group | 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 | 104,339 | - | - | - | - | 104,339 |
| Due from financial institutions | - | 8,218 | - | - | - | 8,218 |
| Due from customers | 14,627 | - | - | - | - | 14,627 |
| Investment securities | 456 | 40,133 | 29,370 | 38,789 | 146 | 108,894 |
| Financing arrangements | 408,511 | 239,617 | 67,256 | 34,858 | - | 750,242 |
| Finance lease receivables | 6,847 | 17,505 | 83,064 | 162,921 | 5,105 | 275,442 |
| Other assets (Foreign exchange forward deals) | 336 | 819 | - | - | - | 1,155 |
| Profit rate swaps (asset) | 64 | 59,777 | 94 | 15,415 | - | 75,350 |
| | **535,180** | **366,069** | **179,784** | **251,983** | **5,251** | **1,338,267** |

| Group | 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 | 96,780 | - | - | - | - | 96,780 |
| Due from financial institutions | 18,489 | - | 10,090 | - | - | 28,579 |
| Due from customers | 9,042 | - | - | - | - | 9,042 |
| Investment securities | 1,966 | 745 | 19,506 | 93,924 | 5,498 | 121,639 |
| Financing arrangements | 327,360 | 131,351 | 37,034 | 83,455 | - | 579,200 |
| Finance lease receivables | 12,941 | 16,151 | 52,524 | 95,615 | 6,547 | 183,778 |
| Other assets (Foreign exchange forward deals) | - | - | - | - | - | - |
| | **466,578** | **148,247** | **119,154** | **272,994** | **12,045** | **1,019,018** |

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

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

**Residual contractual maturities of financial liabilities**

| Group | 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** |

| Group | 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 Group'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 Group's liquidity reserve:

| Group | 2018 £000 | 2017 £000 |
|---|---|---|
| Cash and cash equivalents | 104,339 | 96,780 |
| Highly liquid securities (including LAB) | 93,893 | 104,882 |
| **Total** | **198,232** | **201,662** |

As at 31 December 2018, there are no limitations on the use of the liquidity reserve held by the Group (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 Group's Market Risk Management Policy, ALCO is responsible for reviewing all classes of market price risk and positions, sanctioning dealing limits and approving the Group's stress testing program in accordance with its Stress Testing and Scenario 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 Group manages such risks through the use of time based limits that measure the profit rate sensitivity to changes in profit rates.

As at 31 December 2018, the Group's net profit rate sensitivity to profit and loss on its fixed and variable rate assets, and its capital and reserves, as measured by the discounted value of a one basis point change in market rates, was £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 (loss) / 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 for the period | 173 | 1,746 |

### iii. Equity price risk

Equity prices are monitored by the Group's Assets & Liabilities Committee ("ALCO") but the sensitivity risk is not currently significant in relation to the overall results and financial position of the Group.

## 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 Group has calculated to be £6.2 million using the Basic Indicator Approach (2017: £7.0 million) (unaudited).

## e. Capital adequacy

The Company is not subject to regulatory capital requirements therefore the Bank's regulatory position has been set out below. 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 regulatory capital position of BLME 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 BLME'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, BLME adopted the Standardised Approach to Credit Risk and the Basic Indicator Approach to Operational Risk. Counterparty Credit Risk ("CCR") is measured using the CCR mark-to-market method, and Market Risk is determined using the standard Position Risk Requirement ("PRR") rules.

BLME's overall minimum capital resource requirement under Pillar 1 is calculated by adding the credit risk charge to that required for Operational Risk, for Market Risk and for CCR.

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

| | 2018<br>£000<br>(unaudited) | 2017<br>£000<br>(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** |

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

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

BLME 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 BLME'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 .

BLME 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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