BRITISH ARAB COMMERCIAL BANK plc
YOUR PARTNER IN ARAB FINANCE WORLDWIDE

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

Registered Number 1047302

Financial Highlights

12 months ended/as at 31 December Thousands of Pounds Sterling (unless otherwise stated)		**2011**	2010	2009	2008	2007
Profit before provisions		**18,732**	23,577	34,311	32,757	19,910
Impairment losses on loans and advances		**(18,523)**	(4,583)	(29,456)	(825)	1,525
Profit before tax		**209**	18,994	4,855	31,932	21,435
Income tax		**29**	(5,222)	(1,763)	(9,474)	(6,614)
Profit after tax		**238**	13,772	3,092	22,458	14,821
Dividends declared	†	**0**	0	0	7,000	6,500
Earnings per share (p)		**0.2**	12.8	2.9	20.9	13.1
Dividends per share (p)		**0.0**	0.0	0.0	6.5	5.8
Shareholders' Funds		**178,887**	178,954	169,273	175,413	169,118
Total Assets		**2,936,355**	3,350,126	3,302,692	3,093,327	2,527,602
Capital / Risk Weighted Assets	#	**26%**	21%	18%	16%	15%
Dollar / sterling exchange rate						
Year end		**$1.55**	$1.55	$1.61	$1.46	$2.01
Average		**$1.60**	$1.54	$1.56	$1.83	$2.01
Numbers of Shares (Actual)		**107,376,684**				

† Dividends are accounted for in the year in which they are paid, not the year in respect of which they are declared.

Unaudited. For the years to 31 December 2007 risk weighted assets were determined using Basel 1 weighting rules. From 1 January 2008 the Group has determined this value by reference to the total Pillar 1 capital requirement.

In this document the bank's name is shortened to "BACB" in narrative text. The expression "the Bank" refers to the parent company, British Arab Commercial Bank plc, while the expression "the Group" refers to the parent company and its subsidiaries. See Note 1.

SHAREHOLDERS

Shareholder	%
LIBYAN FOREIGN BANK	83.48%
BANQUE EXTÉRIEURE D'ALGÉRIE	8.26%
BANQUE CENTRALE POPULAIRE	8.26%
	100.00%

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BOARD OF DIRECTORS

Mr Robert Douglas Dowie Chairman (independent non-executive director)
Appointed 24 April 2009.

Dr Khaled Zentuti Vice Chairman (non-executive director)
Appointed 22 July 2004.

Dr Mohamed Bait-Elmal (non-executive director)
Appointed 21 July 2006.

Mr Mohamed Benchaaboun (non-executive director)
Appointed 1 May 2010.

Mr Mohamed Loukal (non-executive director)
Appointed 26 May 2005.

Dr Khaled Kagigi (non-executive director)
Appointed 25 February 2006.

Mr Michael Parr Chief Executive (executive director)
Appointed 27 September 2002.

Mr Michael Stevenson (independent non-executive director)
Appointed 25 March 2011.

EXECUTIVE MANAGEMENT

Michael Parr	CHIEF EXECUTIVE
Layth Al Falaki	HEAD OF RISK MANAGEMENT & COMPLIANCE
Gary Bishop	HEAD OF OPERATIONS
David Crew	HEAD OF HUMAN RESOURCES
Crispian Denby	CHIEF FINANCIAL OFFICER & COMPANY SECRETARY
Malcolm Himsworth	HEAD OF INTERNAL AUDIT
George Kimber	ASSISTANT GENERAL MANAGER – HEAD OF INSTITUTIONAL & CORPORATE BANKING

CHAIRMAN'S STATEMENT

BACB's results in 2011 were dominated by events in the MENA region, and also affected by events in the eurozone. The turmoil in Libya diminished the Group's operating revenues, compounded as the year progressed by unrest in Syria and the ongoing problems in Europe. Overall revenues fell by 13% against the prior year.

Given that these were challenging circumstances and despite lower revenues, BACB's trade finance, treasury markets and banking services businesses all performed creditably well. By the end of the financial year net operating income of £18,732,000 was achieved, compared with £23,577,000 the previous year.

Throughout the period, costs were tightly controlled and declined by £1,190,000 as a result of actions taken by Management to reflect lower levels of activity. Some additional costs were however incurred as a result of international sanctions which resulted in the UK authorities requiring that the Group agree a voluntary variation of the Bank's operating licence. This variation was rescinded on 21 December 2011, after which date the Group's operations returned to normal as before. The arrangements agreed with the FSA were in line with those applying to other international Libyan financial institutions operating in London, and similar to those applied to other Libyan institutions operating across Europe.

Regrettably in 2011 the Group has been obliged to raise impairment provisions through the profit and loss account of £18,523,000 *(2010: £4,583,000)* which have undermined what otherwise would have been a satisfactory result for the year given the circumstances. The main part of these provisions related to exposures to customers in countries where unrest has damaged business activity. Strenuous efforts continue to recover the Group's claims in these countries.

At the same time as dealing with the impact of events in Libya and other MENA countries, the banking regulatory framework continued to grow in extent and complexity. BACB is continuing to meet these challenges through investment in control and regulatory infrastructure including improved transactional due diligence systems, and anti-fraud and anti-money laundering procedures. The Group is also working on the implementation of a Recovery and Resolution Plan, on the new Basel 3 Accord and on developing procedures relating to the new UK Bribery and Corruption Act amongst others.

A strategic review of the Group's operations was undertaken in 2011 which is now being implemented with a view to driving the longer term development of the business.

I would like to place on record the gratitude of the Board to the many BACB staff who worked tirelessly throughout the Libyan crisis to support the bank and ensure its smooth operations during these challenging times. BACB's shareholders also maintained a constructive role, and I wish to place on record our gratitude for their support during an exceptional period in the history of the Group.

R D Dowie
Chairman

OPERATING AND FINANCIAL REVIEW

RESULTS (AUDITED)

BACB's operating income for 2011 was lower than that achieved in 2010. The Group's operations were impacted by political and social events across the Middle East and North African (MENA) region, including the outbreak of conflict in Libya, the country of domicile of the Group's principal shareholder.

	2011	*2010*
	£'000	*£'000*
Trade Finance	16,953	*20,483*
Banking Services	4,055	*4,023*
Lending	5,769	*7,094*
Treasury	13,046	*15,743*
Other	(567)	*(2,052)*
Total operating income	**39,256**	***45,291***
General and administrative expenses	(20,524)	*(21,714)*
Net operating income	**18,732**	***23,577***
Impairments	(18,523)	*(4,583)*
Profit before tax	**209**	***18,994***
Cost / Income ratio	52%	*48%*

Operating income

In what was an unusually challenging year, the Group's operations continued satisfactorily across much of the MENA region with the notable exception of Libya, and later in the year, Syria. The imposition of financial and other sanctions against Libya early in the financial year resulted in a cessation of new business from the country for a significant part of the year. Existing commitments and transactions remained in place, and the Group continued to earn income thereon, albeit in declining amounts as those commitments matured, and as transaction volumes declined. Revenues attributable to customers located in Libya declined by £4,243,000 over the year (Note 34).

International sanctions on Libya were released on a graduated basis during the final quarter of the year, and business and transaction volumes from that country began rapidly to recover. See also Note 36.

Despite these major political and social events the Group continued to focus on its core business, which is the provision of trade services facilities and correspondent banking products to the Group's customers across the MENA region, and to those companies and other institutions who undertake business there. The operating result, which has been achieved, is regarded as being satisfactory in light of the regional background.

Interest earnings were similar to the previous year. Global interest rates remained very low during 2011, undermining the Group's ability to earn spreads on deposit balances. On the asset side of the balance sheet the Group increased its holdings of low risk but low yielding government securities which also mitigated against increasing interest earnings. Countering this to some extent was an increase in credit spreads for risk assets, not least in the context of global money markets which became increasingly distressed as the year progressed.

Trade Finance earnings fell back from the previous year with business volumes disrupted by the regional events referred to above. However, volumes from markets not directly impacted by these events remained strong, and the overall Trade Finance result was considered to be satisfactory.

In the Banking department the Group was able to maintain its relationships with customers directly impacted by regional events throughout 2011, and expects to continue to do so in the future. As a result earnings from banking services were maintained despite the very significant operational and business issues which arose during the year. The Group provides correspondent services to banks and other institutions in its niche markets looking for an efficient, trusted and committed counterparty able to provide access to the international financial markets.

With the situation in Libya, volumes of customer business in treasury undertaken in the year were sharply lower than in previous years. However, Treasury remained active in the international professional markets, and with customer deposits frozen in the Group's balance sheet, one of the challenges was to find acceptable counterparties with whom to place excess funds against a background of increasingly stressed markets.

Other income included net funding costs for the Group's structural funding positions. These included the margins payable on issued subordinated deposits, and the margin gap between the cost of deposits, and the yields available on government debt securities held for liquidity purposes. Such costs have generally been increasing, though in 2011 were offset by other gains.

Administrative costs

Overall, general administrative costs were lower than in 2010. Staff numbers were reduced during the year generating net cost reductions. Additional costs were incurred by way of professional fees, not least in connection with events during the year (including the need to enhance transactional due diligence procedures), but these were offset by lower performance awards for staff in the context of the Group's reduced profits for the year. The cost/ income ratio was higher on reduced revenues.

An analysis of such costs is set out in Note 10.

Impairments

Impairments during 2011 undermined the operating result. The impairment charge amounted to £18,523,000 *(2010: £4,583,000)* of which £14,863,000 arose from newly impaired facilities for customers located in countries affected by the regional events referred to above. The balance of the charge amounting to £3,660,000 related to adjustments to previously impaired items.

The adjustments to previously impaired facilities included the increase of impairments in certain cases to 100% in advance of writing off the provisions against the exposures. In all 7 previously impaired facilities totalling £40,169,000 were written off during 2011.

At the end of 2011, a further 7 facilities (including the three newly impaired items noted above) totalling £39,174,000 were regarded as being impaired, against which individual impairment provisions amounted to £19,041,000 *(2010: 11 facilities totalling £68,828,000 against which individual impairment provisions were £41,319,000).* The Group does not maintain any collective impairment provisions in view of the nature of its activities (see Note 11).

The Group is active in pursuing its claims under these impairments.

Balance sheet

Balance sheet totals were as follows:-

	2011 £'000s	*2010* *£'000s*
Professional market placements, debt securities and derivatives	2,411,790	*2,794,301*
Commercial term lending	437,551	*470,237*
Other	87,014	*85,588*
Balance sheet footings	2,936,355	*3,350,126*
Contingent liabilities	118,143	*194,288*
Other commitments	611,958	*753,473*

The Group holds deposits placed with it by its customers, both by way of on-demand current accounts in the Banking department, but also as term deposits in the Treasury. These deposits are placed in professional markets on similar terms, or used to purchase liquid debt securities. Their overall impact is to make the Group a net placer of funds in professional markets, and to secure the Group's overall liquidity position. The total amount of the deposits can fluctuate over time, but as placements are on similar terms, the net effect is that the Group's balance sheet can rise and fall without materially impacting either the overall liquidity position, or its net interest revenues.

During 2011 as a result of international sanctions against Libya a material part of the deposits placed with the Group by its customers became frozen. The Group was able to roll over these deposits, and to add interest to the totals, but was only permitted to pay funds away under official licences issued by the competent UK authorities. Various such licences were issued during the period of the sanctions with the result that deposit balances declined. In the final months of the year, sanctions were progressively eased, and deposits began to flow back to the Group from those customers, reversing the downward trend in deposit totals.

Overall deposit balances held by the Group declined from £3,082,973,000 to £2,681,546,000: a reduction of £401,427,000. As a result balance sheet footings fell by a similar amount.

At 31 December 2011 some of the sanctions had not been completely released, and consequently £264,118,000 of customer deposits remained frozen with the Group.

Responding to circumstances during the year, the Group became more conservative in its strategy for the deployment of customer deposits into professional markets. Holdings of high quality OECD government securities (or securities guaranteed by OECD Governments) were increased from £279,676,000 at 31 December 2010 to £577,167,000 by 31 December 2011.

Commercial lending balances declined with repayments exceeding new lending.

Capital adequacy

At 31 December 2011 and throughout the year, the Group exceeded the capital requirements as set out by the Financial Services Authority (the 'FSA'). Regional events referred to elsewhere in this report did not result in any erosion or other restriction of the amount of capital available to support the Group's operations. Indeed, overall capital adequacy was improved as investments were made in lower risk asset classes.

The Group's regulatory capital base at 31 December was as follows:

	2011 £'000s	*2010* *£'000s*
Tier 1 Capital	179,330	*182,942*
Tier 2 Capital	63,276	*62,610*
Total eligible capital at 31 December	242,606	*245,552*

The amounts of regulatory capital shown above differ from the balances shown in the Group's Statement of Financial Position after adjustments in respect of certain reserves, which arise on the application of IFRS. They also differ from the amounts reported to the FSA as at 31 December as the total above includes the retained profits and reserve movements for 2011 which cannot be included in the amounts reported to the FSA until such time as the financial statements for the subject year are approved.

Tier 1 capital comprises share capital and reserves (as adjusted). Tier 2 capital comprises mainly issued term subordinated debt.

The following table shows both the Group's overall minimum capital requirement and capital adequacy position calculated in accordance with regulatory rules (the "Pillar 1 requirement") at 31 December[1].

[1] Unaudited

	2011	*2010*
	£'000	*£'000*
Credit risk	74,206	*90,717*
Market risk		
Interest rate PRR	519	*888*
Foreign exchange PRR	35	*63*
	554	*951*
Counterparty risk capital component	2,507	*941*
Operational risk	6,616	*6,622*
Total Pillar 1 capital requirement	83,883	*99,231*
Capital in place	242,606	*245,552*
Excess of capital in place over minimum requirement under Pillar 1	158,723	*146,321*

PRR - Position Risk Requirement

The Group undertakes an internal assessment of the amount of capital which it requires to support its activities (the "ICAAP" process). This assessment has identified a number of other risks faced by the Group which do not attract capital under the Pillar 1 rules. The Group has allocated additional capital for these (the "Pillar 2" risks) totalling £37,746,000[1] at 31 December 2011 *(2010: £42,004,000[1])*. The total capital requirement of the Group is determined as the sum of the Pillar 1 and the Pillar 2 capital requirements.

The policy of the Group is to maintain a degree of headroom above the total required capital level (Pillar 1 plus Pillar 2). A minimum margin of 10% will be maintained at all times and the actual headroom of £120,977,000[1] at 31 December 2011 leaves some scope to accommodate growth in risk weighted assets ('RWAs') as part of the Group's overall growth strategy.

The Group has agreed with the FSA an Individual Capital Guidance ('ICG') requirement somewhat higher than the assessment set out above and the Group manages its capital in accordance with this latter requirement. The Group was in compliance with the ICG requirement throughout the year.

The Board's policy is to utilise the Group's capital efficiently within its operations, ensuring that capital-consuming activities do not grow ahead of forecast capital resources, but also seeking to avoid excessive growth of surplus capital resources.

RWAs fell during the year on lower balance sheet totals, but also in light of increased holdings of lower risk weighted assets, including increased holdings of OECD sovereign debt securities referred to above.

Further information regarding the Group's approach to risk management, and its capital adequacy and liquidity are contained in the unaudited disclosures made under the requirements of Basel 2 Pillar 3 (the Pillar 3 disclosures). These disclosures are published on the Group's website, www.bacb.co.uk.

[1] Unaudited

Liquidity

The regional events during 2011 had significant implications for the Group's approach to the management of liquidity. The imposition of sanctions against the Group's principal shareholder resulted, inter-alia, in a reduction of the Group's external credit rating (awarded by Fitch Ratings) from BBB to BB. Combined with enhanced compliance concerns in counterparty institutions, the Group lost significant access to funded market credit from sources outside its customer base.

Tactical changes to the approach to liquidity management were required as external events unfolded with an increased focus on the balance of long term assets requiring funding, and the extent of long term sources of funding, including deposits which may have been contractually due, but which because of the operation of financial sanctions could not be removed. As these events unfolded attention was given to various scenarios for changes in the behaviour of those funds once the sanctions were released. The overall impact of these events was to accelerate the previous trend towards a reduction of liquidity risk in the Group's balance sheet.

Specifically, and as noted elsewhere, holdings of highly liquid assets were increased (OECD government securities increased from £279,676,000 to £577,167,000). Separately, maturity mismatches were reduced: as disclosed in Note 4 to these accounts, term assets with a residual maturity greater than 1 year fell from being £325,719,000 in excess of term liabilities at the end of 2010 to an excess of £185,984,000 at the end of 2011: an amount more easily underpinned by net undated (permanent) funds.

As 2011 progressed, the increased distress in the international debt and money markets also required attention. The systemic reduction of interbank money trading did not greatly affect the Group as it already had only limited access to deposit markets. The Group's concerns centred on the need to manage its own placements of surplus funds to an increasingly small group of names regarded as being of near-undoubted covenant. These difficulties have been exacerbated by new regulatory rules limiting the size of individual exposures which the Group is permitted to undertake (to €150 million), and thus challenging the Group to find a wider range of credit receiving institutions.

Exposures to the European Union

As disclosed in Note 4, at 31 December 2011, the Group had exposures to the institutions and governments of the European Union. The Group utilises the standardised approach to credit risk described in the Basel II methodology which involves the allocation of credit exposures into credit quality steps, themselves informed by credit ratings awarded by accredited rating agencies. The tables below set out the Group's exposures in accordance with that Basel II methodology. Specifically, the Group had no exposures to either the governments of, or the institutions or corporates in Greece, Portugal or any other country which would fall to be included in any credit step lower than 3. It may however have exposures to institutions which are at lower rating than their country of residence.

The Group has been seeking to improve the credit quality of its exposures to institutions within this geographic region by replacing maturing assets with those of generally better quality, and expects to continue in this regard during 2012.

The Group's exposures to counterparties resident in the European Union at 31 December 2011 were as follows:-

Credit quality step	S&P rating	Moody's rating	Contingent liabilities and other commitments	Cash, loans and advances, debt securities and derivatives	Gross exposure
			£'000	£'000	£'000
Central Governments or Central Banks					
1	*AAA to AA-*	Aaa to Aa3	0	109,944	109,944
			0	109,944	109,944
Institutions					
1	*AAA to AA-*	Aaa to Aa3	51,851	691,095	742,946
2	*A+ to A-*	A1 to A3	6,303	227,095	233,398
3	*BBB+ to BBB-*	Baa1 to Baa3	0	4,044	4,044
4	*BB+ to BB-*	Ba1 to Ba3	0	363	363
Unrated			464	0	464
			58,618	922,597	981,215
Corporates					
3	*BBB+ to BBB-*	Baa1 to Baa3	6,349	0	6,349
4	*BB+ to BB-*	Ba1 to Ba3	22,830	0	22,830
Unrated			19,342	932	20,274
			48,521	932	49,453
			107,139	**1,033,473**	**1,140,612**

Being:	
Debt securities	185,391
Loans and advances to banks	834,481
Loans and advances to customers	13,536
Derivatives	65
Contingent Liabilities and other commitments	107,139
	1,140,612

The Group has not considered it necessary to enter into any derivative or other hedging type of arrangements for the purpose of protecting the Group from credit exposures to borrowers resident in this region.

MANAGEMENT REVIEW (UNAUDITED)

This review describes the Group's activities during 2011. The Group's activities have been affected by events in the MENA region.

Trade Finance

Trade Finance business remained satisfactory given the exceptional circumstances during the year in the Group's niche markets. Total turnover of confirmed business in 2011 was £1,328,000 against £1,570,000 in 2010: an 8% reduction in volumes.

International sanctions directed against Libya meant that no new Libyan business was booked between February and November 2011. In 2010, Libyan business accounted for 32% of confirmed letter of credit turnover. Contact was retained with the Group's customers in Libya throughout the period of the conflict, and business resumed as soon as the situation in the country began to stabilise.

Despite the conflict in Libya, demand for BACB's services continued to be strong in other core markets. Several countries experienced double-digit growth in volumes of letters of credit routed to BACB as demand for food and other commodities remained high, and as governments spent on equipment and materials for vital infrastructure projects. The Group's strategy of careful expansion into selected tropical African countries also continued, contributing to the financial results for the year.

The Group received substantial and growing volumes of Libyan trade-related business in the final weeks of 2011 and into the early part of 2012, which is encouraging for the year ahead. Volumes of business achievable in 2012 should be greatly influenced by the speed and breadth of Libya's rehabilitation. In the immediate future, opportunities for the Group are likely to arise from urgent import requirements, especially for foodstuffs, other commodities and vital equipment for the oil industry.

Banking

Overall 2011 income at £4,055,000 was slightly ahead of prior year despite regional events. During the year two previously impaired overdraft balances totalling £2,725,000 were written off.

Payment business on behalf of Libyan customers was significantly impacted by conflict in that country, and the ensuing sanctions. The Group worked closely with the UK authorities to obtain licences to permit legitimate Libyan transactions to proceed during the period of those sanctions. The Group introduced comprehensive due diligence procedures to monitor and analyse payments in accordance with licence permissions. These exceptional procedures resulted in additional costs offsetting any potential overhead savings from the fall in core business volumes.

The number of customer accounts grew by 7% during the year. Average balances held in accounts also grew during the middle part of the year as early sanction restrictions limited customers' ability to deploy their balances, declining thereafter as permissions were obtained to utilise funds more efficiently. The higher average balances held with the Group, together

with some instances of overdrafts, meant that interest income was ahead of prior year, offsetting lower transactional fee income.

The Group's electronic banking portal, BACB*e* saw a 34% increase in volumes, albeit from a modest base, with steadily increasing utilisation by existing customers. Work was also progressed during the year in extending this service to encompass Trade Services products.

Commercial Term Lending

Term lending declined during 2011 with only modest amounts of new lending undertaken, with the result that repayments exceeded new additions. Five previously impaired loans totalling £37,444,000 were written off in the year.

The book comprises facilities to Middle East and North African ('MENA') borrowers, and includes oil, gas and power-related project financings, loans to sovereign-related institutions together with holdings of sovereign paper. In addition, the Group continued to make available short-term trade-related discountings and refinancing facilities to both exporters and importers in support of the Group's trade finance business.

	2011	*2010*
	£'000	*£'000*
Short term commercial advances	27,496	*12,523*
Project finance	154,729	*162,838*
Agency guaranteed loans	17,267	*23,015*
Asset and Islamic finance	50,834	*46,840*
Other trade and term loans	162,946	*197,673*
Unimpaired loans	413,272	*442,889*
Impaired loans		
Loans subject to restructuring on terms which give rise to impairment	27,224	*27,737*
Other impaired loans	5,464	*37,101*
	32,688	*64,838*
Impairments	(8,409)	*(37,490)*
Total term lending	437,551	*470,237*
Comprising:		
Loans and advances to banks	84,017	*57,324*
Loans and advances to customers	361,943	*450,403*
Impairments	(8,409)	*(37,490)*
	437,551	*470,237*

The Group's plan for 2012 envisages that new lending, focussing on shorter tenor trade related transactions, will take place during 2012.

Treasury

Treasury played a central role in managing the Group's financial resources through the difficulties which it faced through 2011. The management of the Group's own liquidity position was a primary focus, but there was also a continuing obligation to give fair value to depositors and customers, even though some of them had been temporarily disenfranchised from control over their funds due to international sanctions.

The Group's approach to the management of liquidity is described in more detail above. In addition to the various (and at times significant) operational challenges faced by the Group during 2011, an important objective was to maintain a dialogue with the Group's counterparties in professional markets through the year. There was a natural reaction from the Group's counterparties to exercise caution in their dealings with it, not least in the light of the imposition of international sanctions on the principal shareholder, and the related reduction in the Group's external credit rating. Despite this, Treasury reported good successes in retaining adequate dealing lines, albeit at a lower level of business than in previous years. The Group is grateful to those counterparties who supported the Group through this period.

The imposition of international sanctions against Libya also disrupted the efficiency of global settlement operations as institutions generally sought to undertake additional due diligence checks, and to satisfy themselves that the transactions they were being asked to undertake were in compliance with complex regulations. The Group's ability to move its own funds became hampered, particularly in the early stage of the sanctions regime. By year end, with the lifting of sanctions, the Group's business operations had largely returned to normal.

Despite this challenging background, Treasury continued to trade profitably throughout the period across its traditional markets. The easing of Libyan sanctions at the end of the year and the release of the restrictions under which the Group had been operating, should result in trading reverting to previous levels.

As well as maintaining relations with professional counterparties, Treasury was also successful in maintaining good communication with its customers. As the restrictions relating to their accounts have been eased, Treasury quickly re-established its relations with them, and is pleased with the resumption of business which is now taking place.

In addition to the challenges of international sanctions on Libya, trading during 2011 was against the background of considerable stress in the debt and money markets particularly emanating from the economic difficulties of the Eurozone. The Group had no requirement to raise funds from professional markets during 2011, and therefore the freezing of these markets which took place during the year had only moderate impact on the Group's ability to manage the liability side of its balance sheet. On the asset side, the challenge for the Group was (and continues) to be to deploy surplus funds in a prudent fashion, while always seeking to protect overall income levels. In light of the uncertainties occasioned both by the Group's own position, but also in the context of the wider market stress, risk was reduced in the Group's balance sheet both by moving placement strategy into better credit asset classes, but also by reducing maturity transformation. Both of these strategies carried costs which have been borne through earnings in 2011.

Risk Management and Compliance

Political and social events in the Group's niche markets, combined with the emergence of Eurozone stresses had a significant effect on credit markets in 2011. The Group reacted by restricting exposure to higher risk counterparties whilst continuing to give attention to working out problem credits.

The processes utilised to manage credit risk are subject to continual evolution as best practice develops, and in the light of experience. A new credit rating, analysis and management tool was implemented during 2011 which ascribes probability of default values to credit lines

based on detailed data analysis. This tool will bolster credit analysis and help with the early identification of incipient credit problems.

From a compliance perspective, the year was dominated by regional events and particular the outbreak of conflict in Libya. The FSA imposed additional due diligence requirements over the Group's operations by way of a variation of its permissions at the outset of the Libyan sanctions, and comprehensive procedures were put in place to ensure that the Group complied with those sanctions and the FSA requirements. A separate sanctions unit was created staffed by employees with a combination of risk management and operational experience and tasked with conducting all due diligence and sanctions monitoring work. It is intended that this unit will continue to form a part of the Group's operations in the longer term notwithstanding the relaxing of the Libyan sanctions at the end of the year.

The Group's anti-money laundering and financial crime prevention processes continued to be strengthened, and improved sanction filtering and behavioural monitoring systems are due to be implemented during 2012. Staff training is a key defence in this risk area and the Group continued to ensure that training levels were well above the minimum regulatory requirement.

Regulatory compliance remained a focus during 2011. Key compliance milestones included implementation of a new bribery and corruption policy, alterations to the bank's remuneration policy, improvements in complaints handling and the creation of working parties to oversee the development of a recovery and resolution plan and to assess the longer term impact of changes in capital and liquidity requirements resulting from the Basel 3 Accord. Appropriate controls and oversight continued to be exercised in this area and no significant regulatory or compliance breaches occurred during the year.

Information Management

During the year the Board reviewed the Group's approach to the use of technology to support its operations. The Board committed itself to reducing the extent of customisation, and to reducing complexity, both of which carry with them risks to the Group's ability to maintain operations in the longer term. In particular, the Board recognised the benefits of updating the Group's core hardware and related operating systems as this increases resilience against failure, and ensures that the Group can be an early adopter of new technology solutions.

The principal project commenced during 2011, which should be concluded during 2012, was to implement a replacement to the Group's payment, sanctions checking and real time authorisations systems. This represented a major project for the Group as its payment system lies at the heart of its banking operations, and significant resources are being directed at this work.

A project to rationalise the use of computer servers through the use of state of the art "virtualisation" techniques continued through 2011. During 2012 this should be extended to the users "desktop". Once complete this will represent a significant improvement in network resilience, and will greatly simplify its management.

Internal Audit

The Head of Audit reports to the Chairman of the Audit & Risk Committee and day-to-day to the Chief Executive. As an independent member of Executive Management, the Head of Audit has open access to the business and operations of the Group.

Internal Audit is fully independent of the business and undertakes a risk-based audit programme to review the internal controls, regulatory and risk management processes of the Group. The audit programme is reviewed and approved by the Audit & Risk Committee which receives regular detailed reports on all Internal Audit activity. Executive Management is responsible for ensuring that agreed recommendations made by the Internal Audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to Internal Audit and evidence of completion is sought.

During 2011, the Internal Audit programme for the year was completed successfully despite the difficult trading conditions.

Facilities Management

The Group takes seriously its responsibilities for health and safety, both for its employees and third parties. The Group is also committed to reducing the environmental impact of its operations, both through recycling and waste minimisation, and reduced energy consumption, and is prepared to invest in energy and other management systems confident that these will deliver both financial and environmental returns in the longer term.

In January 2011, the Group received a runner-up Platinum award in its category in the City Corporation Clean City Award competition for its efforts in this area during 2010.

Human Resources

The total staffing headcount fell during 2011 from 147 at the start of the year to 134 at the end of the year. The managed reduction in staff numbers was due mainly to decreases in overall business volumes associated with the political unrest in some of the Group's niche markets.

With the exception of a period of uncertainty during the second quarter of the year, the Group has continued to benefit from a pattern of low staff turnover levels with the result that experienced staff have been retained, ensuring consistent delivery of high levels of service to the Group's customers. An emphasis on internal training and development, together with a reliance on superior technology, also ensures that the Group is able to grow its business without a commensurate increase in headcount.

Staff remuneration within the banking industry, and in particular the performance related element, was the subject of continuing public debate and regulatory focus during 2011, with a new FSA Remuneration Code ('the Code') taking effect from the beginning of the year. Certain qualitative and quantitative disclosures are required by the Code and the Group has included these in its Pillar 3 disclosures document, available on the Group's website at www.bacb.co.uk.

The Group continued to operate a performance award scheme for the benefit of its employees. The scheme's awards are closely linked to risk adjusted shareholder returns, and the amounts awarded in respect of 2011 were sharply reduced in light of the results for the year.

Following the departure of HSBC as a shareholder, the Group needed to establish new arrangements for defined contribution pensions and employee life cover and these were completed in the second quarter of the year. An actuarial valuation of the Group's defined

benefit pension scheme at 31 December 2010 identified a deficit. A deficit reduction scheme was agreed with the trustees of the scheme, and payments were made under that agreement during 2011 as described in Note 25.

Corporate Governance and Committee Structure

The governance arrangements followed by the Bank's board of directors (the Board) are mandated in a formal agreement between its shareholders (the Shareholders' Agreement) and in its Articles of Association for the Bank.

These documents and agreements provide that certain shareholders of the Bank may appoint directors in accordance with their shareholdings. They also provide for the appointment of the Chairman and the Chief Executive, and for the formation of certain committees to oversee the day-to-day running of the Group. A Schedule of Reserved Matters specifies matters which must be decided by the Board (rather than by Executive Management), with a separate schedule detailing matters reserved for approval and decision by shareholders. The Shareholders' Agreement sets out the arrangements for changes in shareholding.

Board arrangements

The Board comprises the individuals listed on page 2 who served throughout the year. The Board includes two independent non-executive directors, one of whom is the Chairman of the Board, and the other the chairman of the Audit and Risk Committee. The Chief Executive (CEO), who is a full time employee of the Bank, is the only director regarded as being an Executive Director. All of the other directors are regarded as being Non-Executive Directors. The Board met seven times during 2011.

During the period of sanctions against Libya the Group operated under revised governance arrangements.

With guidance and agreement from the FSA and in consultation with HM Treasury, both of whom were managing the UK's response to the international sanctions on Libya, the Group voluntarily agreed to secure that it operated independently from the Libyan Government or any other institutions of the Libyan state during the period of Libyan conflict, and the associated sanctions. In this regard, and with the acquiescence of its principal shareholder, and the agreement of its Libyan directors, the Group disenfranchised and/or removed from all positions of influence all persons (including directors) who had, or may have had, connections with sanctioned entities. Libyan directors did not attend any meetings of the Board of directors during this period, nor gave any instructions for the strategic or operational directions of the Group or of the Bank. The remaining (non Libyan) directors (listed on page 2) undertook the full range of governing tasks of the Board in their place.

These restrictions were lifted on 21 December 2011, and from that date the full Board has resumed its previous responsibilities. These arrangements are described below.

The Board has appointed a number of committees consisting of certain directors and senior executives. The following are the principal committees:

Board Executive Committee
Chaired by the Chairman, this committee carries the authority of the Board other than for a number of specified matters requiring consideration by the full Board. The Board Executive Committee normally meets four times a year, and exercises the powers and authorities of the Board in so far as they concern the management and day-to-day running of the Group in accordance with the policies and directions determined by the Board. The CEO serves as a member of this committee. During 2011 the committee met once (in January). Thereafter scheduled meetings of the Board Executive Committee were replaced by meetings of the Board in its reduced form as described above.

External Credit Committee
The Board has delegated authority to approve the granting of credit applications to the CEO subject to certain limits. The CEO has constituted an Internal Credit Committee which exercises that authority. Applications above those limits must be referred to the External Credit Committee for their consideration and approval. The committee does not meet, but instead considers applications as they arise. Decisions of the committee must be unanimous to be valid.

Audit & Risk Committee
Non-Executive Directors are eligible to sit on the Audit & Risk Committee. The committee meets four times a year to consider the Group's financial reporting, the nature and scope of audit reviews, and the effectiveness of the systems of internal control, compliance and risk management. The Group's external auditors, together with the senior financial, compliance and audit executives attend meetings of the Audit & Risk Committee.

During 2011 a part of the work of the committee was undertaken in meetings of the reduced Board. The committee met separately from the Board three times during 2011.

Compensation Committee
The Compensation Committee meets as required to agree the remuneration and employment policies of the Group.

Executive Management
Led by the CEO, Executive Management comprises the executive managers identified on page 3 who are responsible for the day-to-day operations and management of the Group. Reporting to the CEO, these managers have authority delegated by the Board in writing to enter into transactions, and to extend credit (within authorised limits) in the ordinary course of the Group's business. The Executive Management has itself constituted a number of sub-committees to manage particular aspects of the Group's business, including Asset and Liability Committee (ALCO), Risk Committee and Systems Steering Committee. Other managers and staff within the Group carry authority to bind the Group under "A and B Signature Authority" arrangements handed down by the Board.

The Head of Audit is a member of Executive Management and attends relevant meetings, but with limited delegated authorities due to the independent nature of the role.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

In respect of the annual report and the financial statements

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare both the group and the parent company financial statements in accordance with IFRSs as adopted by the 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 financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the 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 company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

DIRECTORS' REPORT

for the year ended 31 December 2011

The directors present their annual report and the audited financial statements for the year ended 31 December 2011. These financial statements have been prepared in accordance with the Companies Act 2006 and applicable accounting standards.

Activities

The Group is authorised under the terms of the Financial Services and Markets Act 2000 and is regulated by the Financial Services Authority.

The Group continued to transact its international banking business in the areas of treasury markets, commercial and correspondent banking and medium-term lending. All of the Group's activities are conducted through the parent company ('the Bank').

Financial risk management objectives and policies

The Group is subject to various operational and market risks in its day-to-day operations.

The Group's objectives and policies with regard to financial risk, including the policy for hedging, are set out in Note 4 to the financial statements and an indication of the exposure to financial risk is provided both there and in Notes 5, 21, 31 and 32.

Results

The profit after taxation for the year amounted to £238,000. The Directors do not recommend a dividend in respect of this profit and accordingly this amount will be retained in the Profit and Loss Account. *(2010: No dividend was paid).*

Going concern basis of accounting

These Financial Statements have been prepared on a going concern basis, as the Directors are satisfied that the Group has the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions. Information relevant to this assessment regarding the Group's principal activities, strategic direction and challenges and uncertainties are described in the Operating and Financial Review on pages 5 to 18 That review includes a review of the income statement and financial position, and describes the Group's objectives, policies and processes for managing credit, liquidity and market risk. Further information regarding the risks assumed by the Group is set out in Note 4.

In addition, the Directors have considered future projections of profitability, cash flows and capital resources in making their assessment.

DIRECTORS' REPORT

for the year ended 31 December 2011 (continued)

Business review

Commentary on the Group's financial performance in the year is provided in the Operating and Financial Review set out on pages 5 to 18 (the 'Results' section has been audited except where clearly marked).

Company name and number

British Arab Commercial Bank plc is an unlisted public company registered in England and Wales. The company number is 1047302.

Charitable donations

Charitable donations during the year amounted to £36,000, including £30,000 for the benefit of the medical relief charity, "World for Libya".

Directors and their interests

A list of the directors who served during the year is shown on page 2. None of the directors holds or has held shares in the Group. All of the directors benefited from qualifying third party indemnity provisions in place during the financial year and at the date of this report.

Directors' representation

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they each are aware, there is no relevant audit information of which the Group's auditors are unaware; and each director has taken all steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

Auditors

KPMG Audit Plc was appointed to act as the Group's auditors for the year ended 31 December 2011.

KPMG Audit Plc have expressed their willingness to continue in office as auditors and a resolution proposing their re-appointment will be presented at the forthcoming annual general meeting.

Crispian Denby
Secretary
By order of the Board
24 February 2012

INDEPENDENT AUDITOR'S REPORT

to the members of British Arab Commercial Bank plc

We have audited the financial statements of British Arab Commercial Bank plc for the year ended 31 December 2011 set out on pages 24 to 86. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (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.

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 auditors' 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.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 19, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- 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 2011 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and 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.

INDEPENDENT AUDITORS' REPORT (continued)

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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.

Paul Furneaux
Senior Statutory Auditor
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
London
24 February 2012

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2011

	Note	**2011**	***2010***
Interest and similar income	7	33,300	*33,477*
Less: Interest expense and similar charges	7	(18,693)	*(18,339)*
Net interest income		14,607	*15,138*
Fee and commission income	8	18,228	*22,448*
Less: Fee and commission expense	8	(1,141)	*(1,376)*
Net fee and commission income		17,087	*21,072*
Net trading income	9	7,188	*8,728*
Other operating income		374	*353*
Total operating income		39,256	*45,291*
General administrative expenses	10	(20,524)	*(21,714)*
Net charge for impairment losses on loans and advances	11	(18,523)	*(4,583)*
		(39,047)	*(26,297)*
Profit before income tax		209	*18,994*
Income tax credit / (expense)	12	29	*(5,222)*
Profit for the year		238	*13,772*
Other comprehensive income			
Actuarial gains/(losses) on pension fund	25	429	*(3,555)*
Change in fair value of available for sale financial assets	12	(818)	*(1,784)*
Effective portion of changes in fair value of cash flow hedges	12	17	*(17)*
Change in fair value of cash flow hedges transferred to income statement	12	0	*(261)*
Income tax on other comprehensive income	12	67	*1,526*
Other comprehensive loss for the period, net of tax		(305)	*(4,091)*
Total comprehensive (loss) / income for the period		(67)	*9,681*

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

The Notes on pages 28 to 86 form part of these financial statements.

STATEMENTS OF FINANCIAL POSITION

As at 31 December 2011

	Note	**Group 2011**	**Bank 2011**	***Group 2010***	***Bank 2010***
Assets					
Cash, notes and coin		448	448	*380*	*380*
Debt securities	14	840,223	840,223	*834,543*	*834,543*
Loans and advances to banks	15	1,676,078	1,676,078	*1,959,108*	*1,959,108*
Loans and advances to customers	16	381,302	381,302	*513,330*	*513,330*
Equity shares and investments	17	10,050	10,050	*7,308*	*7,308*
Shares in group undertakings	18	0	1	*0*	*1*
Property, plant and equipment	19	9,232	9,232	*9,520*	*9,520*
Intangible assets	19	1,209	1,209	*1,174*	*1,174*
Deferred taxation	20	406	406	*0*	*0*
Derivatives	21	1,581	1,581	*5,122*	*5,122*
Corporation tax receivable		2,334	2,334	*0*	*0*
Prepayments, accrued income and other debtors	22	13,492	13,492	*19,641*	*19,641*
Total assets		**2,936,355**	**2,936,356**	***3,350,126***	***3,350,127***
Liabilities					
Deposits from banks	23	1,864,028	1,864,028	*2,124,629*	*2,124,629*
Other deposits	23	817,518	817,519	*958,344*	*958,345*
Other liabilities, accruals and deferred income	24	9,487	9,487	*11,498*	*11,498*
Deferred taxation	20	0	0	*93*	*93*
Derivatives	21	3,225	3,225	*9,301*	*9,301*
Corporation tax payable		0	0	*1,722*	*1,722*
Net pension liability	25	2,073	2,073	*4,649*	*4,649*
Subordinated liabilities	26	61,137	61,137	*60,936*	*60,936*
		2,757,468	2,757,469	*3,171,172*	*3,171,173*
Called up share capital	27	79,453	79,453	*79,453*	*79,453*
Capital redemption reserve	28	4,104	4,104	*4,104*	*4,104*
Other reserves	28	95,330	95,330	*95,397*	*95,397*
Capital and reserves attributable to the Group's equity holders	28	178,887	178,887	*178,954*	*178,954*
Total liabilities and equity		**2,936,355**	**2,936,356**	***3,350,126***	***3,350,127***

The Notes on pages 28 to 86 form part of these financial statements.

Signed:

Mr RD Dowie
Chairman

Dr K Zentuti
Vice Chairman

M J Parr
Director and Chief Executive

24 February 2012

STATEMENTS OF CHANGES IN EQUITY

For the year ended 31 December 2011

Group	Share capital	Reserves attributable to equity holders					Total
		AFS reserve	Cash flow hedging reserve	Capital redemption reserve	Retained earnings	Total reserves	
Balance at 31 December 2009	**79,453**	**1,382**	**188**	**4,104**	**84,146**	**89,820**	**169,273**
Profit for 2010	0	0	0	0	13,772	13,772	13,772
Other comprehensive income / (expense) for 2010	0	(1,268)	(200)	0	(2,623)	(4,091)	(4,091)
Balance at 31 December 2010	**79,453**	**114**	**(12)**	**4,104**	**95,295**	**99,501**	**178,954**
Profit for 2011	0	0	0	0	238	238	238
Other comprehensive income / (expense) for 2011	0	(559)	12	0	242	(305)	(305)
Balance at 31 December 2011	**79,453**	**(445)**	**0**	**4,104**	**95,775**	**99,434**	**178,887**

Bank	Share capital	Reserves attributable to equity holders					Total
		AFS reserve	Cash flow hedging reserve	Capital redemption reserve	Retained earnings	Total reserves	
Balance at 31 December 2009	**79,453**	**1,440**	**188**	**4,104**	**84,083**	**89,815**	**169,268**
Profit for 2010	0	0	0	0	13,835	13,835	13,835
Other comprehensive income / (expense) for 2010	0	(1,326)	(200)	0	(2,623)	(4,149)	(4,149)
Balance at 31 December 2010	**79,453**	**114**	**(12)**	**4,104**	**95,295**	**99,501**	**178,954**
Profit for 2011	0	0	0	0	238	238	238
Other comprehensive income / (expense) for 2011	0	(559)	12	0	242	(305)	(305)
Balance at 31 December 2011	**79,453**	**(445)**	**0**	**4,104**	**95,775**	**99,434**	**178,887**

STATEMENTS OF CASH FLOW

For the year ended 31 December 2011

	Group and Bank 2011	*Group 2010*	*Bank 2010*
Net cash flow from operating activities			
Profit before taxation	209	*18,994*	*19,080*
Adjustments for:			
Loan impairment losses	18,523	*4,583*	*4,583*
Provisions utilised	(40,169)	*0*	*0*
Depreciation and amortisation	1,081	*877*	*877*
Loss/(Profit) on sale of fixed assets	7	*(4)*	*(4)*
Non-cash items included in net profit	(20,558)	*5,456*	*5,456*
Loans, advances and other debt securities other than cash and cash equivalents	51,539	*360,995*	*367,100*
Other debtors and prepayments	9,725	*2,953*	*2,953*
Change in operating assets	61,264	*363,948*	*370,053*
Customer accounts and deposits by banks	(375,289)	*110,905*	*110,901*
Other liabilities	(11,285)	*3,906*	*(124,799)*
Change in operating liabilties	(386,574)	*114,811*	*(13,898)*
Tax paid	(3,429)	*(4,536)*	*(4,536)*
Net cash from operating activities	(349,088)	*498,673*	*376,155*
Cash flow from investing activities:			
Purchases of equity shares and investments	(2,143)	*0*	*0*
Proceeds of redemptions of equity shares and investments	0	*369*	*369*
Proceeds on sale of fixed assets	27	*5*	*5*
Purchase of tangible assets	(250)	*(391)*	*(391)*
Purchase of intangible assets	(612)	*(552)*	*(552)*
Net cash used in investing activities	(2,978)	*(569)*	*(569)*
Cash flows from financing activities			
Repayment of debt securities in issue	0	*(122,518)*	*0*
Issue of subordinated debt	0	*60,936*	*60,936*
Repayment of subordinated debt	0	*(60,936)*	*(60,936)*
Net cash flows used in financing activities	0	*(122,518)*	*0*
Net (reduction)/increase in cash and cash equivalents	**(352,066)**	***375,586***	***375,586***
Cash equivalents at the beginning of the year	2,286,866	*1,886,723*	*1,886,723*
Effect of exchange rate change on cash and cash equivalents	(17,931)	*24,557*	*24,557*
Cash and cash equivalents at the end of the year	1,916,869	*2,286,866*	*2,286,866*
Cash and cash equivalents comprise			
Cash, notes and coin	448	*380*	*380*
Loans and advances to banks of original maturity three months or less	1,563,550	*1,874,479*	*1,874,479*
Certificates of deposit and other debt securities of three months original maturity or less	352,871	*412,007*	*412,007*
	1,916,869	*2,286,866*	*2,286,866*

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2011

1. General information

British Arab Commercial Bank plc ('the Bank') is a public company, limited by shares. The Bank was incorporated in England and Wales on 23 March 1972 as UBAF Limited. The Bank's name was changed to UBAF Bank Limited on 4 January 1977, and to British Arab Commercial Bank Limited on 4 March 1996. On 2 June 2009, the Bank was re-registered as a public company, and its name changed to the current style. The Bank's registered office (and principal place of business) is situated in England, and is currently at 8-10 Mansion House Place, London EC4N 8BJ.

The consolidated financial statements of the Group for the year ended 31 December 2011 comprise the Bank and its subsidiaries (together referred to as 'the Group').

The Group carries on the business of international banking, and its worldwide activities are regulated by the Financial Services Authority.

The financial statements were authorised for issue by the board of directors on 24 February 2012.

2. Basis of preparation

The Group has prepared its consolidated financial statements on a going concern basis in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU and effective for the Group's reporting for the year ended 31 December 2011. IFRS comprise accounting standards issued by the International Accounting Standards Board ('IASB') and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

The financial statements have been prepared in the Group's functional and presentation currency, sterling, rounded to the nearest thousand. They are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments held at fair value through the profit and loss account, financial instruments classified as being available-for-sale and the defined benefit pension fund.

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 ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 6.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a) Basis of consolidation

i. Subsidiaries
Subsidiaries are entities controlled by the Bank. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

ii. Associates
Associates are those entities in which the Group has significant influence, but no control over the financial and operating policies.
In the opinion of the Directors, the Group has no Associates.

iii. Transactions eliminated on consolidation
Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Under section 408(3) of the Companies Act 2006 the Bank is exempt from the requirements to present its own income statement.

b) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in *Interest and similar income* and *Interest expense and similar charges* in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts. Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the carrying amount as reduced by any allowance for impairment.

c) Fee and commission income

The Group earns fee income from a diverse range of services it provides to its customers. Fee income is accounted for as follows:

i. if the income is earned on the execution of a significant act, it is recognised as revenue when the significant act has been completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of securities);
ii. if the income is earned as services are provided, it is recognised as revenue as the services are provided (for example, documentary credit confirmation fees, custody and banking service fees); and
iii. if the income is an integral part of the effective interest rate of a financial instrument, it is recognised as an adjustment to the effective interest rate (for example, loan origination fees) and recorded in interest income (See Note 3b).

The Group provides certain guarantee facilities which are dependant on uncertain future events. These facilities include surety, fidelity, performance, bid and advance payment bonds. In each case, the guarantees given by the Group are covered by matching counter-indemnities provided by a third party. Fees and commissions arising from the provision of such services are recognised rateably over the period for which the service is provided.

d) Foreign currencies

The Directors regard Sterling as the currency of the primary economic environment in which the Bank operates. Accordingly, Sterling is regarded as being the functional currency of the Bank, which is also the reporting currency of the Group.

Transactions in foreign currencies are recorded in sterling at the rate of exchange prevailing at the end of the month in which the transaction arose. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction.

e) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes and foreign exchange differences. Interest received on securities held for dealing purposes, and associated funding costs, are included within Interest and similar income, and Interest expense and similar charges.

f) Income tax

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in shareholders' equity, in which case it is recognised in shareholders' equity.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantially enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the Group intends to settle on a net basis and the legal right to set off exists.

Deferred tax is recognised on temporary differences between the carrying amount of assets and liabilities in the statement of financial position and the amount attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled.

Deferred tax relating to actuarial gains and losses arising from post-employment benefit plans which are recognised directly in equity, is also credited or charged directly to equity.

Deferred tax relating to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

g) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values are obtained from quoted market prices in active markets, or by using valuation techniques, including recent market transactions, where an active market does not exist. Valuation techniques include discounted cash flow models and option pricing models as appropriate. All derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative.

In the normal course of business, the fair value of a derivative on initial recognition is considered to be the transaction price (i.e. the fair value of the consideration given or received). However, in certain circumstances the fair value of an instrument will be evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets, including interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading profit or loss on inception of the derivative. If observable market data is not available, the initial increase in fair value indicated by the valuation model, but based on unobservable inputs, is not recognised immediately in the income statement but is recognised over the life of the transaction on an appropriate basis, or recognised in the income statement when the inputs become observable, or when the transaction matures or is closed out.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract, the embedded derivative meets the definition of a derivative, and the combined contract is not designated at fair value through profit and loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists, and the cash flows are intended to be settled on a net basis, and assets and liabilities are realised and settled simultaneously.

The method of recognising fair value gains or losses depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if so, the nature of the risk being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. Where derivatives are designated as hedges, the Group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedge'); or (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedge'). Hedge accounting is applied to derivatives designated as hedging instruments provided certain criteria are met.

Hedge accounting

It is the Group's policy to document, at the inception of a hedging relationship, the relationship between the hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking the hedge. Such policies also require documentation of the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks. Interest on designated qualifying hedges is included in Net interest income.

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 in Interest and similar income, together with changes in the fair value of the asset or liability or portfolio thereof that are attributable to the hedged risk.

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 interest method is used is amortised to the income statement over the residual period to maturity. Where the adjustment relates to the carrying amount of a hedged available-for-sale equity security, this remains in equity until the disposal of the equity security.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. Any gain or loss relating to an ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Hedge effectiveness testing

To qualify for hedge accounting, IAS39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method adopted by the Group for assessing hedge effectiveness will depend on its risk management strategy.

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, the changes in fair value or cash flows must offset each other in the range of 80% to 125% for the hedge to be deemed effective.

Derivatives that do not qualify for hedge accounting

All gains and losses arising from changes in the fair value of any derivative that does not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in Interest and similar income.

h) Financial assets

The Group has classified its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management has determined the classification of its investments at 1 January 2005, and thereafter on initial recognition.

i. Financial assets at fair value through profit and loss
   This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit and loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges.

ii. Loans and receivables
   Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. They arise when the Group provides money, goods or services to a debtor with no intention of trading the receivable.

iii. Held-to-maturity
   Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale.

   The Group's management has not identified any assets as falling within this category.

iv. Available-for-sale
   Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Purchases and sales of financial assets held to maturity and available-for-sale are recognised on settlement date, being the date on which the Group makes payment to receive the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus directly attributable transaction costs for all financial assets not carried at fair value through profit or loss. Derivatives and financial assets at fair value through profit and loss are recognised on trade date, being the date on which an irrevocable commitment to enter into a contract is executed.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in income to the extent that the change in value arises from a fair value hedging relationship (Note 3g) with the balance recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in profit and loss. However, interest calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

i) Offsetting financial instruments

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.

j) De-recognition of financial assets and liabilities

Financial assets are de-recognised 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:
i. substantially all the risks and rewards of ownership have been transferred; or
ii. substantially all the risks and rewards have neither been retained nor transferred but control is not retained.
Financial liabilities are de-recognised when they are extinguished, i.e. when the obligation is discharged or cancelled or expires.

k) Impairment of financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or portfolio of financial assets is impaired. A financial asset or a portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or portfolio of financial assets that can be reliably estimated. Objective evidence that a financial asset or portfolio of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:
i. significant financial difficulty of the issuer or obligor;
ii. a breach of contract, such as default or delinquency in interest or principal payments;
iii. the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
iv. it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
v. the disappearance of an active market for that financial asset because of financial difficulties; or
vi. observable data indicating that there is a measurable decrease in the estimated future cashflows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - adverse changes in the payment status of borrowers in the portfolio; or
 - national or local economic conditions that correlate with defaults on the assets in the portfolio.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a portfolio of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Once a financial asset or portfolio of similar assets has been written down as a result of an impairment loss, interest income is thereafter recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the loss.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a portfolio of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the portfolio and their magnitude). These estimates also take into account the extent to which individual assets within the portfolio have been subjected to specific review. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

If in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the income statement.

Available-for-sale assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the

acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

l) Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation calculated on a straight line basis to write off the assets over their estimated useful lives as follows:

Long leasehold premises and improvements	
Leasehold improvements	10 years
Leasehold premises	50 years
Other assets	
Equipment	3 or 5 years
Motor vehicles	5 years
Furniture, fixtures and fittings	10 years

Leasehold premises and leasehold land (see Note 3n) comprises the Bank's principal office in London. All property plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the income statement.

m) Intangible assets

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software, including directly incurred internal costs. Costs associated with maintaining computer software programs are recognised as an expense as incurred.

The capitalised cost of computer software is amortised over 3 or 5 years. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

n) Prepayments and accrued income

The cost of leasehold land is amortised as a rental prepayment over the life of the lease (147 years and 1 month) on a straight-line basis. At 31 December 2011, the lease had 135 years and 2 months remaining.

o) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents include unrestricted highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash, notes and coin, treasury bills and other eligible bills, professional market placements to banks, amounts held at correspondents and certificates of deposit.

p) Provisions

Provisions for restructuring costs and legal claims are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are determined by discounting the expected future cash flows at a pre-tax discount rate that reflects the current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Where the Bank enters into financial guarantee contracts to guarantee the indebtedness of other companies within the Group, the Bank considers these to be insurance arrangements and accounts for them as such. In this respect, the Bank treats the guarantee contract as a contingent liability until such time as it becomes probable that the Bank will be required to make a payment under the guarantee.

q) Employee benefits

The Group provides both a defined benefit and a defined contribution pension plan for its staff. In each case, the assets of the schemes are held separately from those of the Group. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. 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 net asset or liability recognised in the statement of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows. The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of the Group's obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to retained earnings. Other gains and losses are taken to the income statement.

For the defined contribution plan, the Group pays contributions to the BACB Defined Contribution Retirement Benefit Scheme. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as 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.

r) Debt securities in issue

Debt securities in issue are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Borrowings are subsequently stated at amortised cost and any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

If the Group purchases its own debt, it is removed from the statement of financial position and the difference between the carrying amount of a liability and the consideration paid is included in net trading income.

s) Share capital

Share issue costs

Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

Dividends on ordinary share*s*

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Company's shareholders.

t) Segmental reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other segments. All operating segments are reviewed regularly by the Group's Executive Management to make decisions about resources to be allocated to the segment, and to assess its performance, and for which discrete financial information is available.

u) Earnings per share

The Group presents earnings per share data for its ordinary shares by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding in the period.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

4. Risk management

The Group has an established risk management culture, long-standing written policies and procedures, and follows a documented control framework, the maintenance of which falls within the general responsibility of the Group's Audit & Risk Committee, a sub-committee of the Board of Directors ('the Board').

The Board has overall responsibility for the determination of the risk appetite of the Group. It determines the high level risk framework, monitors the utilisation of limits and the operation of the control processes. Risks are measured, controlled and limited through clear governance structures, supported by written policies and procedures.

Key elements within these controls are the Internal Audit and the Risk Management departments.

The Internal Audit department undertakes an ongoing risk based review programme covering all areas of the Group's operations. The Head of Internal Audit reports to the Audit & Risk Committee and to the Chief Executive.

The Risk Management department is responsible for identifying, monitoring and managing the risks faced by the Group. The department is also responsible for the implementation of appropriate policies and monitoring programmes to manage the Group's exposure to potential losses arising in all areas of risk. Risk Management also has responsibility for review and amendment of the Group's internal credit gradings, market and operational risk management practices.

The principal risks faced by the Group are described below, together with details of how these risks are managed, and 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 period.

CREDIT RISK

The Group is exposed to credit risk in its on and off-balance sheet activities, and in its daily settlements. The Group manages credit risk by establishing country and individual counterparty limits and limits for closely related counterparties, based upon an independent assessment by the Group's Risk Management and Institutional & Corporate Banking departments of relevant political, economic and financial information. Once approved, such limits are subject to annual credit review by these departments and submitted for re-approval under delegated credit authorities.

The Group takes cash collateral and employs other credit mitigants in appropriate circumstances. The Group ensures that relevant documentation for such facilities is in place and has obtained opinions from external legal counsel that such documentation is legally enforceable in all relevant jurisdictions. At 31 December 2011 the value of cash collateral held by the Group on terms under which set off can be applied in the event of default by the counterparty was £220,171,000 (*2010: £300,418,000).* Collateral may also be taken in the form of personal guarantees given by individuals associated with the obligating counterparty, but no value is ascribed in these circumstances.

The Group is a third-party member of the Continuous Linked Settlement ('CLS') system, which eliminates counterparty settlement risk on eligible trades.

The Group also employs a credit grading system, to facilitate monitoring of the quality of the overall portfolio and individual segments thereof, including movements in the portfolio over time. Credit risks assessed in accordance with that methodology were as follows:

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Group and Bank 31 December 2011	**Contingent liabilities and other commitments**	**Cash, loans and advances, debt securities and derivatives**	**Maximum exposure to credit risk**	**Cash collateral**	**Net credit exposure**
Low	130,514	2,217,255	2,347,769	(2,750)	2,345,019
Satisfactory	361,574	409,791	771,365	(126,086)	645,279
Fair	197,476	201,336	398,812	(91,290)	307,522
Less: impairments	0	(483)	(483)	0	(483)
Watchlist	39,196	22,853	62,049	0	62,049
Substandard	0	22,238	22,238	0	22,238
Less: impairments	0	(2,785)	(2,785)	0	(2,785)
Doubtful	1,341	16,691	18,032	(45)	17,987
Less: impairments	0	(15,774)	(15,774)	0	(15,774)
Loss	0	0	0	0	0
Total credit exposures	730,101	2,871,122	3,601,223	(220,171)	3,381,052

Group and Bank 31 December 2010	***Contingent liabilities and other commitments***	***Cash, loans and advances, debt securities and derivatives***	***Maximum exposure to credit risk***	***Cash collateral***	***Net credit exposure***
Low	*97,455*	*2,496,262*	*2,593,717*	*(30)*	*2,593,687*
Satisfactory	*516,288*	*471,095*	*987,383*	*(121,372)*	*866,011*
Fair	*317,183*	*259,179*	*576,362*	*(178,971)*	*397,391*
Watchlist	*16,600*	*31,179*	*47,779*	*0*	*47,779*
Substandard	*21*	*27,737*	*27,758*	*0*	*27,758*
Less: impairments	*0*	*(2,499)*	*(2,499)*	*0*	*(2,499)*
Doubtful	*214*	*41,894*	*42,108*	*(45)*	*42,063*
Less: impairments	*0*	*(38,820)*	*(38,820)*	*0*	*(38,820)*
Loss	*0*	*0*	*0*	*0*	*0*
Total credit exposures	*947,761*	*3,286,027*	*4,233,788*	*(300,418)*	*3,933,370*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

The Group's Risk Committee, of which the Chief Executive and other executive managers are members, meets quarterly to consider high-level policies and country limits, whilst a monthly Credit Forum provides more regular opportunities to review credit exposures and to serve as an additional point of reference and challenge regarding the assumption of additional credit and country risk.

The Group provides facilities to 394 counterparties encompassing exposure to 63 countries and territories *(2010: 432 counterparties in 60 countries).* Regional concentrations of credit risk arising from operations were as follows:

Group and Bank 31 December 2011	**Contingent liabilities and other commitments**	**Cash, loans and advances, debt securities and derivatives**	**Total**
United Kingdom	24,519	885,718	910,237
Other European Union	107,139	1,033,473	1,140,612
Middle East and Africa	556,300	508,767	1,065,067
Other Countries	42,143	462,205	504,348
Impairments	0	(19,041)	(19,041)
Maximum exposure to credit risk	730,101	2,871,122	3,601,223
Group and Bank 31 December 2010			
United Kingdom	*38,004*	*1,303,430*	*1,341,434*
Other European Union	*113,249*	*1,114,629*	*1,227,878*
Middle East and Africa	*726,320*	*611,410*	*1,337,730*
Other Countries	*70,188*	*297,877*	*368,065*
Impairments	*0*	*(41,319)*	*(41,319)*
Maximum exposure to credit risk	*947,761*	*3,286,027*	*4,233,788*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

By industry, concentrations of credit risk were as follows:

	Group and Bank	
	2011	***2010***
Financial institutions (including central banks)		
Banks	2,910,739	*3,306,198*
UK building societies	97,377	*129,568*
Multilateral financial institutions	3,937	*12,951*
Other financial intermediaries	30,478	*48,088*
	3,042,531	*3,496,805*
Corporates		
Commodities	13,016	*8,908*
Construction and engineering	39,608	*55,291*
Energy	197,980	*349,535*
Non-bank credit grantors	41,266	*65,179*
Transport and storage	47,761	*80,765*
Other	168,603	*186,853*
	508,234	*746,531*
Public administration	69,499	*31,771*
Impairments	(19,041)	*(41,319)*
Maximum exposure to credit risk	**3,601,223**	***4,233,788***

Maximum exposure to credit risk comprises:

	Group and Bank	
	2011	***2010***
Cash, notes and coin	448	*380*
Debt securities	840,223	*834,543*
Loans and advances to banks	1,676,078	*1,959,108*
Less bills discounted (Note 15) *	(28,510)	*(26,456)*
Loans and advances to customers	381,302	*513,330*
Derivatives (Note 21)	1,581	*5,122*
	2,871,122	*3,286,027*
Contingent liabilities (Note 29)	118,143	*194,288*
Other commitments (Note 30)	611,958	*753,473*
	730,101	*947,761*
	3,601,223	***4,233,788***

* Note: Bills discounted represent a prepayment of Group obligations and therefore do not give rise to credit risk.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

MARKET RISKS

Banking and trading

As part of its banking activities, and for the purpose of providing efficient services to its customers, the Group holds and issues financial instruments including derivative contracts. The Group's objectives in holding such instruments, or entering into such contracts, may either be characterised as being in pursuance of its principal banking activities, or as a trading activity carried on as an adjunct to its banking activities.

The Group's trading activities are accounted for on a mark-to-market basis, and financial assets, financial liabilities and derivatives which form part of such activities are accounted for at fair value through the profit and loss account. In identifying activities to be accounted for on this basis, the Group takes into consideration the following factors:

- The Group's motive for trading that instrument, and in particular where the purpose is to sell or repurchase in the short term, or
- where the instruments formed part of a portfolio for which there is evidence of a recent actual pattern of short term profit-taking, or
- where it is a derivative other than a financial guarantee contract, or a designated and effective hedging instrument.

The Group's trading activities are limited to transactions in financial instruments, mainly comprising the trading of foreign exchange and debt securities. Market risk is primarily to exchange and interest rates. Exposures to those markets, together with a description of the risk management policies arising from both banking and trading activities are set out below. Market risk exposures are measured and monitored daily and are formally reviewed monthly by the Group's Asset and Liability Committee.

Exchange rate risk

The Group makes loans, and takes deposits, in a number of currencies. Payments made on behalf of customers in one currency may be met from balances held in another currency. Further, the Group is active in the international foreign exchange markets, both for own account trading, and for the management of Group assets and liabilities. Note 32 sets out the concentrations of currency assets and liabilities in the Group's statement of financial position.

The Group manages its exposures to foreign exchange risk by way of limits on the size of permitted positions, both intra-day and overnight. Overnight positions are protected by stop-loss orders placed with reputable correspondent banks. The size of the position limits is consistent with the amount of profit that the Group is prepared to place at risk in the foreign exchange markets.

The Group's overall net short position at 31 December 2011 (being the sterling equivalent value of all the currencies where the currency obligations were higher than currency receivables) was £366,000 *(2010: £781,000).* Were these currencies to strengthen by 5% against the remaining currencies, then the Group would lose £18,000 *(2010: £39,000).* Positions as determined daily were as follows:

	2011	*2010*
	£	*£*
Maximum	6,895	*4,282*
Minimum	294	*312*
Average	1,259	*1,579*

Interest rate risk

The Group is exposed to changes in interest rates in various currencies arising from gaps in the future dates of repricing of assets, liabilities and derivative instruments. The Group manages that risk by calculating sensitivity of changes in the present value of committed future cash flows to a 0.01% change

in interest rates using a methodology called the Present Value of a Basis Point ('PVBP'). Limits are placed on the overall amount of calculated PVBP, and the size of those limits is consistent with the amount of profit that the Group is prepared to place at risk in the interest rate market. The Group considers the impact of changes in future interest rates on its future income streams by reference to these interest rate gaps.

As at 31 December 2011, PVBP amounted to £10,967 *(2009: £2,920).* PVBP (calculated on a daily basis) was as follows:

	2011	*2010*
	£	*£*
Maximum	14,698	*16,095*
Minimum	2,265	*2,104*
Average	7,871	*9,163*

Hedges

Derivative contracts are used in both the banking and trading books to modify market risk exposures in the light of perceptions about future movements in those markets. In the banking book, in particular, derivative contracts are used to reduce market risk exposure arising from banking book positions, which in the absence of those contracts, would result in unwanted exposures, or excesses to market risk limits. Such contracts are described as hedges. Hedge transactions are documented as such at inception, and the positions being hedged are clearly identified at the outset. Hedge accounting is applied in accordance with IAS39, and hedges are not generally entered into which would not qualify as such in accordance with the rules in that standard. The majority of derivative hedges are designated as fair value hedges (see also Note 3g).

The repricing characteristics of the Group's statement of financial position are set out below:

Group 31 December 2011	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Debt securities	318,414	265,055	241,555	15,993	0	(794)	840,223
Loans and advances to banks	1,511,362	111,583	52,765	0	0	368	1,676,078
Loans and advances to customers	71,048	153,906	145,434	14,853	4,686	(8,625)	381,302
Other assets	0	0	0	0	0	38,752	38,752
Total assets	**1,900,824**	**530,544**	**439,754**	**30,846**	**4,686**	**29,701**	**2,936,355**
Deposits from banks	1,413,812	262,398	187,810	0	0	8	1,864,028
Other deposits	717,311	65,990	33,821	0	0	396	817,518
Subordinated liabilities	0	61,137	0	0	0	0	61,137
Other liabilities and shareholders' funds	0	0	0	0	0	193,672	193,672
Total equity and liabilities	**2,131,123**	**389,525**	**221,631**	**0**	**0**	**194,076**	**2,936,355**
Derivatives (at contract value)							
Receivable	5,824	65,290	31,410	6,471	0	0	
Payable	3,236	44,826	21,613	34,700	4,620	0	
Overall gap	(227,711)	161,483	227,920	2,617	66	(164,375)	
Reverse Cumulative gap	**164,375**	**392,086**	**230,603**	**2,683**	**66**	**(164,375)**	

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Group 31 December 2010	*Up to 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Non-interest bearing*	*Total*
Debt securities	*447,456*	*268,890*	*81,593*	*38,018*	*0*	*(1,414)*	*834,543*
Loans and advances to banks	*1,824,194*	*81,920*	*29,363*	*21,542*	*0*	*2,089*	*1,959,108*
Loans and advances to customers	*177,869*	*175,782*	*148,974*	*10,459*	*0*	*246*	*513,330*
Other assets	*0*	*0*	*0*	*0*	*0*	*43,145*	*43,145*
Total assets	***2,449,519***	***526,592***	***259,930***	***70,019***	***0***	***44,066***	***3,350,126***
Deposits from banks	*1,791,123*	*173,162*	*124,870*	*35,474*	*0*	*0*	*2,124,629*
Other deposits	*775,054*	*145,303*	*37,987*	*0*	*0*	*0*	*958,344*
Subordinated liabilities	*0*	*0*	*60,936*	*0*	*0*	*0*	*60,936*
Other liabilities and shareholders' funds	*0*	*0*	*0*	*0*	*0*	*206,217*	*206,217*
Total equity and liabilities	***2,566,177***	***318,465***	***223,793***	***35,474***	***0***	***206,217***	***3,350,126***
Derivatives (at contract value)							
Receivable	*64,687*	*67,365*	*40,891*	*9,675*	*0*	*0*	
Payable	*54,823*	*15,072*	*95,598*	*17,124*	*0*	*0*	
Overall gap	*(106,794)*	*260,420*	*(18,570)*	*27,096*	*0*	*(162,151)*	
Reverse Cumulative gap	***162,152***	***268,946***	***8,526***	***27,096***	***0***	***(162,151)***	

Bank 31 December 2011	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Debt securities	318,414	265,055	241,555	15,993	0	(794)	840,223
Loans and advances to banks	1,511,362	111,583	52,765	0	0	368	1,676,078
Loans and advances to customers	71,048	153,906	145,434	14,853	4,686	(8,625)	381,302
Other assets	0	0	0	0	0	38,753	38,753
Total assets	**1,900,824**	**530,544**	**439,754**	**30,846**	**4,686**	**29,702**	**2,936,356**
Deposits from banks	1,413,812	262,398	187,810	0	0	8	1,864,028
Other deposits	717,311	65,990	33,821	0	0	396	817,518
Subordinated liabilities	0	61,137	0	0	0	0	61,137
Other liabilities and shareholders' funds	0	0	0	0	0	193,673	193,673
Total equity and liabilities	**2,131,123**	**389,525**	**221,631**	**0**	**0**	**194,077**	**2,936,356**
Derivatives (at contract value)							
Receivable	5,824	65,290	31,410	6,471	0	0	
Payable	3,236	44,826	21,613	34,700	4,620	0	
Overall gap	(227,711)	161,483	227,920	2,617	66	(164,375)	
Reverse Cumulative gap	**164,375**	**392,086**	**230,603**	**2,683**	**66**	**(164,375)**	

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Bank 31 December 2010	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Debt securities	447,456	268,890	81,593	38,018	0	(1,414)	834,543
Loans and advances to banks	1,824,194	81,920	29,363	21,542	0	2,089	1,959,108
Loans and advances to customers	177,869	175,782	148,974	10,459	0	246	513,330
Other assets	0	0	0	0	0	43,146	43,146
Total assets	**2,449,519**	**526,592**	**259,930**	**70,019**	**0**	**44,067**	**3,350,127**
Deposits from banks	1,791,123	173,162	124,870	35,474	0	0	2,124,629
Other deposits	775,054	145,303	37,987	0	0	1	958,345
Subordinated liabilities	0	0	60,936	0	0	0	60,936
Other liabilities and shareholders' funds	0	0	0	0	0	206,217	206,217
Total equity and liabilities	**2,566,177**	**318,465**	**223,793**	**35,474**	**0**	**206,218**	**3,350,127**
Derivatives (at contract value)							
Receivable	64,687	67,365	40,891	9,675	0	0	
Payable	54,823	15,072	95,598	17,124	0	0	
Overall gap	(106,794)	260,420	(18,570)	27,096	0	(162,151)	
Reverse Cumulative gap	**162,152**	**268,946**	**8,526**	**27,096**	**0**	**(162,151)**	

Non-interest bearing items comprise share capital, accumulated impairments, tangible and intangible assets and other sundry debtors and creditors not subject to interest. Such net non-interest bearing liabilities are used to fund the Group's assets by way of internal placements, and give rise to a structural interest rate position. Gap limits available to the Group's dealers for the management of interest rate risk in the banking book are stated net of these placements.

A simultaneous increase in interest rates of 0.5% in all currencies, and in all maturities on 1 January 2012 would reduce the present value of the gaps in the banking book by £568,000. However, earnings from the financial assets associated with the non-interest bearing liabilities would increase during 2012 by £1,002,000 *(2010: a 0.5% increase in interest rates would have reduced the present value of the gaps by £150,000, but earnings in 2011 would have been increased by £666,000).*

Derivatives include interest rate and currency swap transactions, the purpose of which are to reduce economic exposure to interest rate risk, whether formally qualifying as hedges or otherwise. The purpose of such hedges is to ensure that longer dated interest rate repricings, such as typically arise from fixed rate loans or deposits, are converted into shorter periods as can be accommodated within the gap limits.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

OTHER RISKS

Liquidity management
The Group is exposed to the risk that it will be unable to meet its obligations as they fall due, arising from the differing maturity profiles of its assets and liabilities. The Group controls that risk by placing limits on the mismatch of maturity dates, and by holding stocks of liquid assets which could be sold at short notice if the need arose. The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The table is derived from an analysis of principal amounts starting from the carrying values of those assets and liabilities at 31 December, and excludes cash flows arising from interest payments or receipts. Management ignores interest flows in the daily management of liquidity risk on the grounds that inflows and outflows will normally result in a net inflow in each maturity timeband, the amount of which is expected to be small in relation to maturing principal amounts.

Group **At 31 December 2011**	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Undated**	**Total**
Debt securities	270,251	201,932	309,558	59,276	0	(794)	840,223
Loans and advances to banks	1,496,570	90,200	88,940	0	0	368	1,676,078
Loans and advances to customers	19,925	38,331	46,761	142,184	142,726	(8,625)	381,302
Other assets	0	0	0	0	0	38,752	38,752
Total assets	**1,786,746**	**330,463**	**445,259**	**201,460**	**142,726**	**29,701**	**2,936,355**
Deposits from banks	1,316,747	262,398	187,810	97,065	0	8	1,864,028
Other deposits	717,310	65,990	33,822	0	0	396	817,518
Subordinated liabilities	0	0	0	0	61,137	0	61,137
Other liabilities and shareholders' funds	0	0	0	0	0	193,672	193,672
Total equity and liabilities	**2,034,057**	**328,388**	**221,632**	**97,065**	**61,137**	**194,076**	**2,936,355**
Net liquidity gap	**(247,311)**	**2,075**	**223,627**	**104,395**	**81,589**	**(164,375)**	

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Group At 31 December 2010	*Up to 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Undated*	*Total*
Debt securities	*407,503*	*215,055*	*146,620*	*66,779*	*0*	*(1,414)*	*834,543*
Loans and advances to banks	*1,820,120*	*77,334*	*33,468*	*26,097*	*0*	*2,089*	*1,959,108*
Loans and advances to customers	*101,492*	*27,421*	*54,918*	*138,548*	*190,705*	*246*	*513,330*
Other assets	*0*	*0*	*0*	*0*	*0*	*43,145*	*43,145*
Total assets	***2,329,115***	***319,810***	***235,006***	***231,424***	***190,705***	***44,066***	***3,350,126***
Deposits from banks	*1,791,121*	*173,163*	*124,871*	*35,474*	*0*	*0*	*2,124,629*
Other deposits	*775,054*	*145,303*	*37,987*	*0*	*0*	*0*	*958,344*
Subordinated liabilities	*0*	*0*	*0*	*0*	*60,936*	*0*	*60,936*
Other liabilities and shareholders' funds	*0*	*0*	*0*	*0*	*0*	*206,217*	*206,217*
Total equity and liabilities	***2,566,175***	***318,466***	***162,858***	***35,474***	***60,936***	***206,217***	***3,350,126***
Net liquidity gap	***(237,060)***	***1,344***	***72,148***	***195,950***	***129,769***	***(162,151)***	

Bank At 31 December 2011	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Undated**	**Total**
Debt securities	270,251	201,932	309,558	59,276	0	(794)	840,223
Loans and advances to banks	1,496,570	90,200	88,940	0	0	368	1,676,078
Loans and advances to customers	19,925	38,331	46,761	142,184	142,726	(8,625)	381,302
Other assets	0	0	0	0	0	38,753	38,753
Total assets	**1,786,746**	**330,463**	**445,259**	**201,460**	**142,726**	**29,702**	**2,936,356**
Deposits from banks	1,316,747	262,398	187,810	97,065	0	8	1,864,028
Other deposits	717,310	65,990	26,445	7,377	0	396	817,518
Subordinated liabilities	0	0	0	0	61,137	0	61,137
Other liabilities and shareholders' funds	0	0	0	0	0	193,673	193,673
Total equity and liabilities	**2,034,057**	**328,388**	**214,255**	**104,442**	**61,137**	**194,077**	**2,936,356**
Net liquidity gap	**(247,311)**	**2,075**	**231,004**	**97,018**	**81,589**	**(164,375)**	

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Bank ***At 31 December 2010***	***Up to 1 month***	***1-3 months***	***3-12 months***	***1-5 years***	***Over 5 years***	***Undated***	***Total***
Debt securities	*407,503*	*215,055*	*146,620*	*66,779*	*0*	*(1,414)*	*834,543*
Loans and advances to banks	*1,820,120*	*77,334*	*33,468*	*26,097*	*0*	*2,089*	*1,959,108*
Loans and advances to customers	*101,492*	*27,421*	*54,918*	*138,548*	*190,705*	*246*	*513,330*
Other assets	*0*	*0*	*0*	*0*	*0*	*43,146*	*43,146*
Total assets	***2,329,115***	***319,810***	***235,006***	***231,424***	***190,705***	***44,067***	***3,350,127***
Deposits from banks	*1,791,121*	*173,163*	*124,871*	*35,474*	*0*	*0*	*2,124,629*
Other deposits	*775,055*	*145,303*	*37,987*	*0*	*0*	*0*	*958,345*
Subordinated liabilities	*0*	*0*	*0*	*0*	*60,936*	*0*	*60,936*
Other liabilities and shareholders' funds	*0*	*0*	*0*	*0*	*0*	*206,217*	*206,217*
Total equity and liabilities	***2,566,176***	***318,466***	***162,858***	***35,474***	***60,936***	***206,217***	***3,350,127***
Net liquidity gap	***(237,061)***	***1,344***	***72,148***	***195,950***	***129,769***	***(162,150)***	

The methodology for analysing cash flows into time bands as set out above is similar to that used by the Group's Management for the monitoring and control of its daily liquidity requirements except that the Group regards the main part of its holdings of debt securities as being immediately available funds on the grounds that they can be sold into deep and liquid markets at short notice. The Group's liquidity risk management processes also involve the undertaking of regular stress tests underpinned by robust assumptions in relation to market conditions and probabilities of retention of deposits with a view to providing reasonable assurance that the Group's liquid assets are sufficient to meet stressed net cash outflows over a designated time horizon.

In the tables above, the inclusion of interest cash flows in respect of liabilities would result in a restatement of the cash outflows as shown below. In these latter tables, interest is included at all payment dates to final maturity. In the case of floating rate liabilities, it is assumed that interest payable in future periods will be at the same rate as is applying in the current period:

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Group and Bank At 31 December 2011	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Undated**	**Total**
Deposits from banks	1,317,858	262,790	189,877	97,509	0	8	1,868,042
Other deposits	717,432	66,328	34,086	0	0	396	818,242
Derivatives	832	630	965	825	(7)	0	3,245
Subordinated liabilities	520	0	1,549	8,257	74,198	0	84,524
Total cash outflows	**2,036,642**	**329,748**	**226,477**	**106,591**	**74,191**	**404**	**2,774,053**

Group and Bank At 31 December 2010	***Up to 1 month***	***1-3 months***	***3-12 months***	***1-5 years***	***Over 5 years***	***Undated***	***Total***
Deposits from banks	*1,791,706*	*173,483*	*125,615*	*35,760*	*0*	*0*	*2,126,564*
Other deposits	*775,318*	*146,628*	*38,851*	*0*	*0*	*0*	*960,797*
Derivatives	*3,104*	*2,455*	*2,799*	*992*	*0*	*0*	*9,350*
Subordinated liabilities	*0*	*0*	*2,275*	*8,926*	*76,557*	*0*	*87,758*
Total cash outflows	***2,570,128***	***322,566***	***169,540***	***45,678***	***76,557***	***0***	***3,184,469***

Operational risk

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

The operational risks facing the Group have been carefully analysed and risk management policies, procedures and controls are in place to minimise their impact. These procedures and controls are documented in formal procedure manuals, accessible by all staff and are regularly updated. Overall management of operational risk falls within the responsibility of the Group's Risk Management department.

Key elements of the control environment are the strict segregation of duties, clearly defined authority levels and expenditure controls and strict safeguards over the integrity of and access to all types of confidential data. Secure offsite storage arrangements for key magnetic data and paper records are in place.

Underpinning the Group's operational controls is the existence of an independent Internal Audit function together with contingency planning and disaster recovery arrangements that include the availability of a "warm" site where replicated systems and office facilities are available. These arrangements are the subject of regular testing in accordance with documented procedures.

Operational losses are closely monitored and reported to the Group's Asset and Liability Committee ('ALCO').

Operational losses in 2011 amounted to £108,000 *(2010: £23,000).*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Reputational risk

Reputational risk is recognised as a key risk area and policies are in place to minimise the potential impact. These include comprehensive Know Your Customer (KYC) requirements, environmental, defence and sectoral lending policies and a risk based due diligence programme. Electronic transaction screening and a behavioural monitoring system are also in place to prevent inadvertent involvement in money laundering, terrorist financing or fraud.

Other risks

The Group is exposed to a range of other operational risks. In each case various risk mitigation techniques are adopted to control the risk. These risks include the following:

- Sanctions risks. From time to time financial and other sanctions can be imposed by the authorities within whose remit the Group operates against parties with whom the Group may have dealings. The Group has in place staff and systems dedicated to monitoring all transactions with a view to ensuring that any involving sanctioned parties comply with the requirements of the relevant sanctions regulations.
- Legal risks. The Group enters into contracts both in the course of its ordinary business, but also as part of its banking activities. Specialist staff are employed to review and negotiate contract documents, and external legal counsel is also sought where appropriate.
- Settlement and confirmation risk. The Group seeks to employ, retain and train its staff to ensure that they are competent to carry out such procedures. Suitable computer systems to support such operations are maintained, and operational procedures are documented, and subject to regular audit.
- Litigation risks. Disputes arise from time to time in the course of the Group's business. Such disputes are subject to early identification, and escalation to senior executives qualified to manage their resolution. External counsel's opinions and assistance is sought as required.
- Pension Fund risk. The Group offers defined benefit pension arrangements to some of its staff. There are risks that the liabilities associated with these arrangements may be higher than expected, or that the assets may not grow as expected. The Group recognises that these are long term obligations, and seeks to manage the risks through the use of assumptions and investment strategies designed to reduce the various risks.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

5. Fair values of financial assets and liabilities

The majority of the Group's financial instruments measured at fair value are valued using quoted market prices or market standard valuation techniques based on observable market data.

Observable market prices are not, however, available for many of the Group's financial assets and liabilities not measured at fair value. IFRS 7 requires that the fair values of such assets be estimated and disclosed, and the following table summarises the carrying amounts and estimated fair values of those financial assets and liabilities. Bid prices are used to determine fair values of assets, whereas offer prices are applied for liabilities.

The fair values set out below are based on indices for proxy assets and liabilities not already carried at fair value which are considered to be similar, but not identical, to those held by the Group. Further, these fair values have been determined using internal models, the results of which might not be equivalent to those which would be arrived at between willing buyer and willing seller.

Group and Bank	**31 December 2011**		***31 December 2010***	
(except as otherwise stated)	**Carrying value**	**Fair value**	***Carrying value***	***Fair value***
Financial assets				
Cash, notes and coin	448	448	*380*	*380*
Loans and advances to banks	1,654,465	1,653,887	*1,930,447*	*1,930,622*
Loans and advances to customers	362,400	330,450	*490,756*	*460,154*
Prepayments, accrued income and other debtors	17,406	17,406	*19,641*	*19,641*
Financial liabilities				
Deposits from banks	1,828,437	1,825,430	*2,089,155*	*2,087,927*
Other deposits: Group	817,518	816,484	*938,995*	*938,349*
Other deposits: Bank	817,519	816,485	*938,996*	*938,350*
Subordinated liabilities	61,137	41,777	*60,936*	*54,842*

Loans and advances to banks and customers

Loans and advances to banks includes professional market placements and other loans and advances, net of accumulated impairments.

The estimated fair value of professional market placements (which are for terms up to one year) is based on discounted cash flows using prevailing market interest rates for the relevant periods.

The estimated fair value of commercial term lending is derived by comparing the actual yields being received on loans advanced by the Group with observed yields from corporate and financial bond indices considered to be of similar credit quality and duration. At 31 December 2011 observed market yields for those indices were higher than those being achieved, and as a result the estimated fair market value of the loans at that date represents an overall discount to their carrying value as shown above. The Group has no current intention of disposing of any of these loans, and accordingly, in the opinion of the directors, the amount of the discount is not indicative of an impairment which should be recognised through the Group's accounts. Loans and advances which are impaired are stated at their book value without further adjustment.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Deposits
The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without a quoted market price is based on discounted cash flows using market interest rates for debts with similar remaining maturity.

The market interest and exchange rates as at year-end for the principal currencies in which the Group has assets and liabilities, and by reference to which assets and liabilities have been valued, were as follows:

	31 December 2011			*31 December 2010*		
	Sterling	US Dollars	Euro	*Sterling*	*US Dollars*	*Euro*
Interest rates						
3 month	1.10%	0.63%	1.36%	*0.75%*	*0.25%*	*0.97%*
6 month	1.30%	1.09%	1.69%	*0.95%*	*0.60%*	*1.18%*
1 year	1.70%	1.22%	2.07%	*1.51%*	*0.86%*	*1.46%*
5 year	1.85%	1.60%	2.00%	*2.31%*	*1.99%*	*1.89%*
Exchange rates	1.0000	1.5454	1.1937	1.0000	1.5505	1.1597

Debt securities in issue
The aggregate fair values of listed debt securities are calculated based on quoted market prices. Unlisted debt securities are valued by reference to discounted cash flows using market interest rates for debts with similar remaining maturity.

Subordinated liabilities
Subordinated liabilities represent term obligations. The obligations are not quoted, and a valuation has been estimated using discounted cash flow techniques based on yields observed in the market for perpetual instruments issued by other similar organisations with similar credit rating.

As other financial institutions use different valuation methodologies and assumptions in determining fair values, comparisons of fair values between financial institutions may not be meaningful and users are advised to exercise caution when using this data. In addition, the following table lists those financial instruments where the carrying amount is a reasonable approximation of fair value, for example, because they are either short term in nature or reprice to current market rates frequently.

Assets
Cash, notes and coin
Amounts included in Prepayments, accrued income and other debtors

Liabilities
Amounts included in Other liabilities, accruals and deferred income

6. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Valuation of Financial Instruments
The Group's accounting policy on fair value measurements is discussed in Note 3h.

The Group measures fair values using the following fair value hierarchy that reflects the significance of inputs used in making the measurements.

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.

Level 2: Valuation techniques based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category comprises instruments valued using reference to quoted market data such as yield curves.

Level 3: Valuation techniques using significant unobservable inputs. This category comprises unlisted equity investments valued by reference to published accounts or third party valuations.

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 valuation techniques.

Valuation techniques include net present value and discounted cashflow 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 interest 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 of the financial instrument at the reporting date that would have been determined by market participants acting at arms length.

The Group uses widely recognised valuation models in determining the fair value of common and more simple financial instruments such as interest rate and currency 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, exchange traded derivatives and simple over the counter derivatives such as interest 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which measurement is categorised.

Group and Bank	**Level 1**	**Level 2**	**Level 3**	**Total**
31 December 2011				
Debt Securities	682,218	158,005	0	840,223
Loans and Advances to Banks	21,613	0	0	21,613
Loans and Advances to Customers	12,295	6,607	0	18,902
Derivative Assets	0	1,581	0	1,581
Equity Shares and Investments	0	0	10,050	10,050
	716,126	166,193	10,050	892,369
Deposits from banks	0	35,591	0	35,591
Other deposits	0	0	0	0
Derivative Liabilities	0	3,225	0	3,225
	0	38,816	0	38,816

Group and Bank	***Level 1***	***Level 2***	***Level 3***	***Total***
31 December 2010				
Debt Securities	*382,556*	*451,987*	*0*	*834,543*
Loans and Advances to Banks	*28,661*	*0*	*0*	*28,661*
Loans and Advances to Customers	*19,349*	*3,225*	*0*	*22,574*
Derivative Assets	*0*	*5,122*	*0*	*5,122*
Equity Shares and Investments	*0*	*0*	*7,308*	*7,308*
	430,566	*460,334*	*7,308*	*898,208*
Deposits from banks	*0*	*35,474*	*0*	*35,474*
Other deposits	*0*	*19,349*	*0*	*19,349*
Derivative Liabilities	*0*	*9,301*	*0*	*9,301*
	0	*64,124*	*0*	*64,124*

There were no significant transfers of assets between levels during 2011, and no significant changes in valuation techniques.

Assets categorised as Level 3 comprise the Group's investments in equity shares and investments. These assets are valued by reference to reports from fund managers, and from the audited annual reports of the companies in which the Group is invested. Details of these assets, together with movements in the year are set out in Note 17.

Impairment losses on loans and advances
The Group reviews its loan portfolios to assess impairment at least on an annual basis. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from individual loans and advances. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a portfolio, or national or local economic conditions that correlate with defaults on assets in the portfolio. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

At 31 December 2011 loans to seven customers were impaired *(2010: eleven loans)*. The Group is not confident that any future cash flows will arise in respect of two of those loans *(2010: five loans)*, and they are therefore considered to be fully impaired. Any cashflows which do arise in the future will be recognised in income on receipt. Three loans are subject to broadly common rescheduling terms, one of which was completed during 2011, and the remaining two of which are expected to be completed during 2012. An impairment was crystallised on the loan rescheduled during 2011 as the interest rate payable was at below market levels. The impairment on the other two loans has been estimated based on the expected outcome of the rescheduling negotiations. Impairments on these loans will cease to be regarded as being impaired once a track record of compliance with the rescheduled terms is established.

Some recoveries are anticipated in respect of the two remaining loans, but these recoveries are subject to a degree of uncertainty.

If recoveries on impaired loans (excluding the loan which has now been renegotiated) are 10% lower than has been estimated, then the amount of the impairment which would have been charged in 2011 in respect of the remaining four loans would have been increased by £1,400,000 *(2010: £227,000 in respect of three loans)*.

Pension fund

The Group assesses the value of its defined benefit pension fund assets and obligations in accordance with IAS19. The standard requires that certain assumptions be made which are set out in Note 25. The scheme actuary has estimated that the value of the scheme net liabilities would increase by £4,400,000 if the discount rate were to be 4.3% rather than 4.8% (leaving all other assumptions the same) *(2010: scheme liabilities would increase by £3,700,000 if the discount rate were to be 4.9% rather than 5.4%)*, and that the value of the scheme liabilities would increase by £400,000 if the rate of increase in salaries were to be 3.9%pa rather than 4.15%pa (leaving all other assumptions the same) *(2010: scheme liabilities would increase by £300,000 if the rate of increase in salaries were to be 4.25% rather than 4.00%).*

The mortality assumptions have been set in consultation with the actuary to the Scheme. The Scheme's membership is not sufficiently large to permit statistical analysis in the choice of table and therefore reflects the experience of other schemes in the finance sector in the UK, but with an additional allowance for further mortality improvement in the future. The assumption used is believed to be at the upper end of the range used by similar companies. The life expectancy at age 60 assumed for members of the Scheme is dependant on their year of birth. For example, the life expectancy is 29.4/30.8 years for males/females who are 60 this year, rising to 30.5/31.9 years for males/females who are currently aged 50. This is based on the standard mortality table SIPMA "Light" with projections made on an individuals' year of birth and with allowance made for the Long Cohort effect with a minimum improvement rate of 1%pa. As an illustration, changing to the medium cohort with no minimum rate of mortality improvement decreases the life expectancies above to 27.1/28.5 years for males/females aged 60 and to 27.7/29.1 years for males/females aged 50. These would result in a decrease in Scheme liabilities of approximately £2,500,000. It is anticipated that the Scheme will continue to purchase annuities to match its pensioner liabilities at regular intervals so that the risk from further improvement in mortality is minimised.

The Group's Management is not aware of any other judgement areas that would materially affect the income statement.

7. Net interest income

	Group and Bank 2011	*Group 2010*	*Bank 2010*
Interest income			
Professional market placements	21,575	*20,791*	*20,887*
Loans and advances	11,595	*12,657*	*12,657*
Other	130	*29*	*29*
	33,300	*33,477*	*33,573*
Interest income comprises			
Interest arising on financial assets at fair value through the income statement	4,078	*4,416*	*4,512*
Interest recognised on impaired assets (Note 11)	969	*64*	*64*
Gains / (losses) arising from the change in fair value of fair value hedges			
- on hedging instruments	10	*28*	*28*
- on hedged items attributable to the hedged risk	111	*(61)*	*(61)*
Cash flow hedge losses removed from equity and recognised in income	0	*(261)*	*(261)*
Other interest	28,132	*29,291*	*29,291*
	33,300	*33,477*	*33,573*

The amount reported in the income statement in respect of the ineffectiveness of fair value hedges was £nil in the year ended 31 December 2011 *(Year ended 31 December 2010: £Nil).*

	Group and Bank 2011	*Group 2010*	*Bank 2010*
Interest expense			
Banks and customers	16,541	*14,881*	*14,881*
Debt securities in issue	0	*194*	*203*
Subordinated loans	2,152	*3,264*	*3,264*
	18,693	*18,339*	*18,348*
Interest expense comprises			
Interest arising on financial liabilities at fair value through the income statement	355	*504*	*504*
Other interest	18,338	*17,835*	*17,844*
	18,693	*18,339*	*18,348*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

8. Net fee and commission income

	Group and Bank	
	2011	***2010***
Fee and commission income		
Safe custody	150	*125*
Trade services		
Guarantees	1,484	*1,921*
Other trade services income	15,225	*18,202*
Term lending (other than amounts which form part of the effective interest rate)	2	*12*
Banking payments and services	1,367	*2,188*
	18,228	*22,448*
Fee and commission expense		
Brokerage and other fees	1,141	*1,376*

9. Net trading income

	Group and Bank	
	2011	***2010***
Foreign exchange dealing	5,670	*8,001*
Other	1,518	*727*
	7,188	*8,728*

Foreign exchange dealing income includes gains and losses from spot and forward contracts, options and translated foreign currency assets and liabilities.

10. Administrative expenses

	Group and Bank	
	2011	***2010***
Staff costs:		
Salaries and other emoluments	7,588	*7,796*
Social security costs	932	*1,202*
Other pension costs:		
- Defined benefit scheme	851	*789*
- Expenses associated with defined benefit scheme	180	*0*
- Defined contribution scheme	563	*414*
Total fixed staff employment costs	**10,114**	***10,201***
Variable staff costs: performance awards	1,029	*3,331*
Total staff employment costs	**11,143**	***13,532***
Reorganisation costs (excluding pension augmentations)	954	*17*
Other employment related costs	309	*510*
Total staff costs	**12,406**	***14,059***
Fees payable to the Bank's auditors for the audit of the Bank's annual financial statements	152	*177*
Fees payable to the Bank's auditors for other services :		
- Other services pursuant to legislation	6	*5*
- Taxation advice	23	*18*
- Advice in connection with change of control	0	*29*
- All other services	0	*72*
Other fees in connection with change in control	208	*487*
Depreciation (including amortisation of intangibles)	1,081	*877*
Amortisation of prepaid rental on land	63	*63*
Loss/(profit) on sale of tangible and intangible assets	7	*(4)*
Regulatory supervision fees	49	*60*
Other administrative expenses	*6,529*	*5,871*
	20,524	***21,714***

The average number of employees in place during the year was 138 (*2010: 144*).

Directors' remuneration included above totalled £629,000 *(2010: £841,000).* The emoluments of the highest paid director were £323,000 *(2010: £362,000)* and the amount of his accrued pension as at balance sheet date was £nil *(2010: £nil).* There were no pension contributions for any directors during the year *(2010: £nil).*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

11. Impairment losses on loans and advances

The movements in impairment provisions were as follows:

	Group and Bank	
	2011	***2010***
Balance at 1 January	41,319	*35,101*
Exchange translation and other movements	337	*1,699*
Effect of discounting (Note 7)	(969)	*(64)*
Provisions written off	(40,169)	*0*
Profit and loss account		
New allowances	19,007	*4,617*
Reversal of allowances no longer required	(389)	*(34)*
Recoveries of amounts written off in previous periods	(95)	*0*
	18,523	*4,583*
Balance at 31 December	19,041	*41,319*
Being impairments against		
Loans and advances to banks	0	*15,229*
Loans and advances to customers	19,041	*26,090*
	19,041	*41,319*

The Group is active in wholesale markets. Accordingly, its portfolio of financial assets comprises a relatively small number of individually significant claims, rather than a large number of individually insignificant claims as would be the case for similar companies acting in retail markets. This means that each claim due to the Group is subject to individual impairment review at the reporting date taking account of the factors described in Note 3k.

Collective impairments arise in respect of groups of exposures with similar risk characteristics for which previous experience indicates that impairment has taken place at the balance sheet date, but whose existence has yet to emerge. In light of the extensive individual reviews, and based on previous experience, no evidence was detected that impairments existed at the balance sheet date requiring a collective impairment allowance. Accordingly, all of the impairments set out above are individual impairments.

At 31 December 2011, 7 facilities comprising amounts due to the Group of £39,174,000 were determined to be impaired *(2010: eleven facilities comprising £68,828,000 due to the Group)*. No collateral was held by the Group in respect of these facilities.

£976,000 was past due at the reporting date in respect of unimpaired financial assets *(31 December 2010: £4,818,000).*

Of the 7 facilities which were impaired at 31 December 2011, 1 facility amounting to £6,606,000 had been formally rescheduled, and a further two facilities amounting to £14,745,000 are expected to be formally rescheduled during 2012 on terms which are less favourable to the Group than the original facility terms. The other impaired facilities are subject to such recoveries as the Group will be able to negotiate in due course.

A further 7 facilities totalling £32,902,000 at 31 December 2011 had been (or are expected to be) formally rescheduled at some point on terms which may be less favourable to the Group, but which did not give rise to impairment.

In the normal course of its lending business, the Group may from time to time be prepared to waive material financial covenants, or agree to temporary relaxations of repayment terms which are subsequently cured. At 31 December 2011 the Group can identify 1 facility amounting to £497,000 where waivers or relaxations have been granted, but have not been cured. No impairment has arisen in respect of this facility.

As part of its banking and trade services business the Group may from time to time be required, or otherwise agree to provide overdraft of other temporary facilities to its customers beyond the precise terms upon which such facilities have been intended to operate. At 31 December 2011 facilities for 4 customers to whom the Group's maximum exposure to credit risk was £26,542,000 were subject to such temporary forbearance.

12 facilities totalling £62,048,000 have been categorised as being "watchlist", as disclosed in note 4 (2010: 10 facilities totalling £47,779,000). "Watchlist" items are so designated where there may have been some deterioration in the financial strength of the counterparty. The group may have granted forbearance in such cases, or may simply be monitoring the position more closely with no element of forbearance granted.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

12. Income tax expense

	Group and Bank 2011	*Group 2010*	*Bank 2010*
Current tax:			
Total UK corporation tax charge	(470)	*4,984*	*4,984*
Plus:Amounts dealt with through reserves	237	*594*	*594*
Current tax on items taken through the income statement	(233)	*5,578*	*5,578*
Current tax adjustment in respect of previous periods	(156)	*(93)*	*(94)*
Deferred tax (Note 20)			
Origination and reversal of timing differences	(508)	*(252)*	*(228)*
Effect of tax rate change	26	*6*	*6*
Amounts associated with movements in the pension fund	842	*(17)*	*(17)*
	(29)	*5,222*	*5,245*

The charge for tax on the profit for the year is based on the average UK corporation tax rate of 26.5% *(2010: 28.0%).* The UK corporation tax rate will reduce to 26.0% from 6 April 2012. Thereafter it is forecast to reduce to 24% in annual steps of 1%, though these further reductions in rate have yet to be enacted into law.

The tax charge for the period is lower *(2010: lower)* than the standard rate of corporation tax in the UK as explained below:

	Group and Bank 2011	*Group 2010*	*Bank 2010*
Profit on ordinary activities before tax	209	*18,994*	*19,080*
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK	55	*5,318*	*5,343*
Effect of loss carried back to prior period	4	*0*	*0*
Adjustment in respect of previous periods	(156)	*(93)*	*(94)*
Effect of change in tax rate	26	*6*	*6*
Permanently disallowed items	(46)	*102*	*102*
Other items	88	*(111)*	*(112)*
UK Corporation tax (credit) / charge	(29)	*5,222*	*5,245*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Income tax recognised in other comprehensive income is made up as follows:

Group		**2011**			*2010*	
	Before tax	**Tax**	**Net of tax**	***Before tax***	***Tax***	***Net of tax***
Actuarial gains/(losses) on pension fund	429	(113)	316	*(3,555)*	*995*	*(2,560)*
Change in fair value of available for sale financial assets	(818)	230	(588)	*(1,784)*	*502*	*(1,282)*
Effective portion of changes in fair value of cash flow hedges	17	(5)	12	*(17)*	*5*	*(12)*
Change in fair value of cash flow hedges transferred to income statement	0	0	0	*(261)*	*73*	*(188)*
Effect of change in tax rates	0	(45)	(45)	*0*	*(49)*	*(49)*
	(372)	67	(305)	*(5,617)*	*1,526*	*(4,091)*
Dealt with as follows:						
Current tax		237			*594*	
Deferred tax (Note 20)		17			*1*	
Adjusted through pension fund liability		(187)			*931*	
		67			*1,526*	

Bank		**2011**			*2010*	
	Before tax	**Tax**	**Net of tax**	***Before tax***	***Tax***	***Net of tax***
Actuarial gains/(losses) on pension fund	429	(113)	316	*(3,555)*	*995*	*(2,560)*
Change in fair value of available for sale financial assets	(818)	230	(588)	*(1,865)*	*525*	*(1,340)*
Effective portion of changes in fair value of cash flow hedges	17	(5)	12	*(17)*	*5*	*(12)*
Change in fair value of cash flow hedges transferred to income statement	0	0	0	*(261)*	*73*	*(188)*
Effect of change in tax rates	0	(45)	(45)	*0*	*(49)*	*(49)*
	(372)	67	(305)	*(5,698)*	*1,549*	*(4,149)*
Dealt with as follows:						
Current tax		237			594	
Deferred tax (Note 20)		17			24	
Adjusted through pension fund liability		(187)			931	
		67			1,549	

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

13. Profit dealt with in the accounts of British Arab Commercial Bank plc

All of the consolidated profit for the financial year *(2010: £13,835,000)* has been dealt with in the accounts of British Arab Commercial Bank plc.

14. Debt securities

Debt securities comprised marketable securities held for investment purposes.

	Group and Bank	
	2011	***2010***
Unlisted certificates of deposit (CDs)	158,006	*451,989*
OECD government securities	571,143	*220,852*
Other listed debt securities guaranteed by OECD Governments	6,024	*58,824*
Other listed debt securities	105,050	*102,878*
	840,223	*834,543*

Debt securities with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £110,892,000 *(2010: £88,401,000)*.

15. Loans and advances to banks

Loans and advances to banks with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £21,613,227 *(2010: £28,661,000)*.

	Group and Bank	
	2011	***2010***
Funds held at correspondent banks	112,235	*8,573*
Professional market placements	1,434,485	*1,867,986*
Commercial term lending	84,017	*57,324*
Bills discounted	28,510	*26,456*
Overdrafts and other advances	16,831	*13,998*
Less: Provisions for impairments (Note 11)	0	*(15,229)*
	1,676,078	*1,959,108*

Professional market placements includes £119,999,000 *(2010: £38,466,000)* lent to other institutions against the security of OECD government debt securities by way of sale and repurchase transactions executed in accordance with market standard terms (reverse repo transactions).

Included in commercial term lending is £21,613,000 *(2010: £28,661,000)* loans and advances to banks constituted as debt securities, and designated by the Group at inception as being available for sale.

16. Loans and advances to customers

Loans and advances to customers with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £13,673,000 *(2010: £12,899,000)*.

	Group and Bank	
	2011	***2010***
Professional market placements to non banks	23,266	*78,113*
Commercial term lending	361,943	*450,403*
Overdrafts and other advances	15,134	*10,904*
Less: Provisions for impairments (Note 11)	(19,041)	*(26,090)*
	381,302	*513,330*

Included in commercial term lending is £12,295,000 *(2010: £19,349,000)* loans and advances to customers constituted as debt securities, and designated by the Group at inception as being available for sale.

17. Equity shares and investments

Equity shares comprise unlisted long-term participations of not more than 10% of the share capital of the following companies:

Banque d'Affaires de Tunisie: 2,474 ordinary shares of Tunisian Dinars 100
International Company for Leasing SAE: 1,727,999 ordinary shares of Egyptian Pounds 10

Investments comprise long-term participations in equity investment funds managed by third parties, whose purpose is to identify growing companies in the Arab Mediterranean region.

The movements on equity shares and investments were as follows:

	Group and Bank	
	2011	*2010*
Balance at 1 January	7,308	*7,022*
Exchange translation	(1)	*156*
Changes in fair value during the year	600	*499*
Additions / (Repayments)	2,143	*(369)*
Balance at 31 December	10,050	*7,308*
Comprising:		
Equity shares	2,657	*2,625*
Equity investment funds	7,393	*4,683*
	10,050	*7,308*

18. Shares in Group undertakings

At 31 December 2011 the Bank owned 100% of the ordinary share capital of the following unlisted companies registered in England and Wales:

Company	**Nature of Business**	**Accounting Date**
BACB Pension Trust Limited	Dormant Corporate trustee	31 December
UBAF Limited	Dormant	30 September

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

19. Property, plant and equipment and intangible assets

Group and Bank	Property, plant and equipment			Intangible assets	
	Long leasehold premises and improvements	Other assets	Total	Computer software	Total
Cost					
Balance at 1 January 2011	14,682	2,810	17,492	4,139	21,631
Additions during the year	75	175	250	612	862
Disposals during the year	0	(875)	(875)	(913)	(1,788)
At 31 December 2011	14,757	2,110	16,867	3,838	20,705
Less: accumulated depreciation					
Balance at 1 January 2011	5,742	2,230	7,972	2,965	10,937
Charge for the year	299	210	509	572	1,081
Disposals during the year	0	(846)	(846)	(908)	(1,754)
At 31 December 2011	6,041	1,594	7,635	2,629	10,264
Net book value at 31 December 2011	**8,716**	**516**	**9,232**	**1,209**	**10,441**
Cost					
Balance at 1 January 2010	*14,639*	*2,651*	*17,290*	*3,587*	*20,877*
Additions during the year	*43*	*348*	*391*	*552*	*943*
Disposals during the year	*0*	*(189)*	*(189)*	*0*	*(189)*
At 31 December 2010	*14,682*	*2,810*	*17,492*	*4,139*	*21,631*
Less: accumulated depreciation					
Balance at 1 January 2010	*5,423*	*2,229*	*7,652*	*2,596*	*10,248*
Charge for the year	*319*	*189*	*508*	*369*	*877*
Disposals during the year	*0*	*(188)*	*(188)*	*0*	*(188)*
At 31 December 2010	*5,742*	*2,230*	*7,972*	*2,965*	*10,937*
Net book value at 31 December 2010	***8,940***	***580***	***9,520***	***1,174***	***10,694***

Other assets comprise furniture, fixtures and fittings, office equipment and motor vehicles.

The depreciation charge for 2011 includes an amount of £112,000 by way of additional depreciation following the write down of certain intangible assets whose continuing value to the Group is uncertain *(2010: £nil).*

There were commitments for capital expenditure of £59,000 *(2010: £15,000).*

All the land and buildings are owned by the Group for the purposes of occupation in connection with its business. The carrying book value of the land and buildings at 31 December 2011 was £17,226,000. On 10 May 2011 the Group received a valuation report in connection with this asset prepared by qualified chartered surveyors familiar with the market for such assets estimating that the market value of the Group's interest at that time amounted to £17,850,000.

The original cost of fully depreciated tangible and intangible assets still in use by the Group at year-end was £6,158,000 *(2010: £6,996,000).*

Additions to computer software include £129,000 *(2010: £26,000)* in respect of internal costs directly associated with the testing and implementation of purchased software applications.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

20. Deferred taxation

	Group and Bank 2011	***Group 2010***	***Bank 2010***
Capital allowances in advance of depreciation	(534)	*(621)*	*(621)*
Unamortised balance of opening IFRS adjustments	388	*558*	*558*
Other short term temporary differences	552	*(30)*	*(30)*
	406	*(93)*	*(93)*
Balance at 1 January	(93)	*(340)*	*(339)*
Adjustments taken through reserves	17	*1*	*24*
Charge to income statement	508	*252*	*228*
Effect of tax rate changes	(26)	*(6)*	*(6)*
Balance at 31 December	406	*(93)*	*(93)*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

21. Derivatives

The following were outstanding for the Group and Bank:

	31 December 2011		
	Contract amount	**Positive fair values**	**Negative fair values**
Spot and forward foreign exchange contracts held for trading purposes	99,035	76	(610)
Interest rate swaps qualifying as fair value hedges	96,054	32	(1,770)
Interest rate swaps at fair value through the profit and loss account	12,942	327	(322)
Interest rate cap, collar and floor contracts at fair value through the profit and loss account	32,355	623	0
Foreign exchange options at fair value through the profit and loss account			
Purchased	334,129	523	0
Sold	334,129	0	(523)
		1,581	(3,225)

	31 December 2010		
	Contract amount	*Positive fair values*	*Negative fair values*
Spot and forward foreign exchange contracts held for trading purposes	*608,945*	*2,646*	*(4,893)*
Interest rate swaps qualifying as fair value hedges	*106,536*	*332*	*(2,497)*
Interest rate swaps at fair value through the profit and loss account	*76,082*	*485*	*(1,406)*
Interest rate cap, collar and floor contracts at fair value through the profit and loss account	*97,713*	*949*	*0*
Foreign exchange options at fair value through the profit and loss account			
Purchased	*105,075*	*535*	*0*
Sold	*99,902*	*0*	*(505)*
Foreign exchange options purchased as cash flow hedges	*15,521*	*175*	*0*
		5,122	*(9,301)*

Foreign exchange contracts are agreements by which an amount of one currency is exchanged for a different amount of a different currency at a specified future date. The contract amount in the table above is the amount receivable.

Interest rate swaps are agreements by which interest on an agreed amount is paid at various dates in the future on a specified basis, and in exchange interest is received on the same amount, but on a different basis.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Interest rate cap contracts are option contracts under which the buyer of the contract will pay the difference between a periodic floating market rate and a fixed rate of interest (the cap rate), but only where that periodic market rate exceeds the cap rate.

Interest rate floor contracts are option contracts under which the buyer of the contract will receive the difference between a fixed rate of interest (the floor rate) and the periodic floating market rate, but only where that periodic market rate is below the floor rate.

Interest rate collar contracts are combinations of interest rate caps and interest rate floors.

Foreign exchange options are agreements to enter into a foreign exchange contract at a rate which has been fixed at the outset, at a specified date in the future if the market rate ruling at a future date is more (or less) than the fixed rate.

Interest rate swaps qualifying as fair value hedges comprise synthetic alterations whereby interest bearing assets or liabilities with fixed or extended re-pricing periods have been converted into shorter re-pricing periods which can be more easily accommodated within the Group's risk management policies.

Interest rate swaps at fair value through the profit and loss account represent either speculative market positions or are hedges of economic exposure, but not qualifying for hedge accounting in accordance with IAS39. Interest rate cap, collar and floor contracts at fair value through the profit and loss account are regarded as being hedges of economic exposures, but do not qualify for hedge accounting in accordance with IAS39.

Foreign exchange options at fair value through the profit and loss account represent either contracts executed for customers against similar contracts with market counterparties, or else represent speculative market positions.

Derivatives entered into by the Group are in accordance with standard market terms.

22. Prepayments, accrued income and other debtors

	Group and Bank	
	2011	*2010*
Prepaid rental for land	8,510	*8,573*
Prepayments and accrued income	4,310	*5,434*
Other debtors	672	*5,634*
	13,492	*19,641*

The Group is obliged to pay ground rent in respect of its leasehold land interest over the remaining life of the lease; currently £160,000 p.a. *(2010: £160,000 p.a.)*.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

23. Deposits

Deposits from banks with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £3,235,000 *(2010: £3,225,000)* and other deposits with fixed interest rates (other than those with a single interest period less than 1 year) amounted to Nil *(2010: £21,075,000).*

The Group has not had any defaults of principal, interest or other breaches with respect to its liabilities during 2011 *(2010: Nil).*

24. Other liabilities, accruals and deferred income

	Group and Bank	
	2011	*2010*
Other liabilities	4,828	*4,729*
Accruals and deferred income	4,659	*6,769*
	9,487	*11,498*

25. Pension fund

Defined benefit scheme

30 *(2010: 33)* of the Group's employees are members of the BACB Pension Scheme, which is a defined benefits scheme. The contributions are determined by a qualified actuary, based on triennial valuations using the Attained Age method. The scheme is closed to new entrants with the result that the overall age profile of the active membership is rising. This valuation method is designed to smooth contributions over the remaining working lives of the members. A full actuarial valuation was carried out at 1 January 2011. This valuation showed that the market value of the assets at that date was sufficient to cover 88.4% of the actuarial value of the future benefits that had accrued to members: a deficit of £6,058,000.

In light of the deficit revealed by the 1 January 2011 valuation an agreement was entered into between the Group and the Trustees of the BACB Pension Scheme under which the Group would discharge the amount of the deficit in four equal semi-annual instalments commencing 30th June 2011.

The ordinary contributions to the scheme, which are met entirely by the Group, have been made at a rate of 38.0% of pensionable salaries *(2010: 38.0%).* Contributions paid by the employer in the year ended 31 December 2011 amounted to £4,028,000 being £634,000 by way of ordinary contributions, £3,270,000 by way of deficit reduction contributions and £123,000 by way of benefit augmentations *(2010: £726,000 ordinary contributions).* A further £30,000 *(2010:£14,000)* was paid by the employees. The Group expects to contribute £594,000 by way of ordinary contributions and £3,270,000 by way of deficit reduction contributions (together with a further £47,000 from employees) in the year commencing 1 January 2012.

Scheme expenses are met from the assets of the scheme. The contribution rate of 38.0% applied in 2010 included an allowance intended to cover the estimated level of expenses in the longer term. The contribution rate applied in 2011 excluded any allowance for expenses, and the employer instead paid a separate amount (not included in the amount of contributions described above) of £180,000 by way of reimbursement of the estimated expenses of running the scheme during that year. The estimated expenses of the scheme were dealt with through the Group's profit and loss account in 2010 by way of adjustment to the long term rates of return expected from scheme assets. During 2011 the amount of the

estimated expenses has been dealt with separately through the Group's administrative expenses (Note 10).

The Scheme does not hold any securities issued by the Group, nor does it own any property occupied by the Group.

The assumptions in the 2011 valuation which had the most significant effect on the results of that valuation were those relating to the annual rate of return on investments and the annual rates of increase in salaries and pensions and were as follows:

Rate of increase in salaries		4.00%
Rate of increase in pensions in payment		3.50%
Discount rate:	Pre-retirement liabilities	6.50%
	Post-retirement liabilities	5.00%
Inflation assumption		3.50%
Mortality assumptions		
- Pre retirement		None
- Post retirement		SIPMA Light Long cohort 1% pa improvement underpin

The full valuation of the scheme as at 1 January 2011 has been updated to 31 December 2011 by a qualified independent actuary, using approximate actuarial techniques and available information, and using the Projected Unit method as required by IAS19. The current service cost determined under this method is expected to rise in future years. The following major actuarial assumptions, which are aligned as far as is permitted under the requirements of IAS19 with those which will be used in the scheme were made:

	At 31 December 2011	***At 31 December 2010***
Rate of increase in salaries	3.90%	*4.00%*
Rate of increase in pensions in payment	3.20%	*3.30%*
Discount rate	4.80%	*5.40%*
Inflation assumption (RPI)	3.20%	*3.30%*
Mortality assumptions		
- Pre retirement (male/female)	*None*	*None*
- Post retirement (male/female)	*SIPM/FA "Light" Birth Year LC 1%pa minimum improvement*	*SIPM/FA "Light" Birth Year LC 1%pa minimum improvement*
Life expectancy from age 60 for non pensioner members now aged 50 (male/female)	30.5/31.9 years	*30.3/31.8 years*
Life expectancy for pensioner members now aged 60 (male/female)	29.4/30.8 years	*29.3/30.8 years*

Based on these assumptions, the assets in the scheme and the expected rate of return were:

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

	Long-term rate of return expected at 31 December 2011	**Value at 31 December 2011**	***Long-term rate of return expected at 31 December 2010***	***Value at 31 December 2010***
Growth assets	7.70%	15,490	*7.70%*	*13,647*
Index linked LDI	3.10%	14,917	*4.30%*	*10,634*
Corporate bonds	4.80%	2,018	*n/a*	*0*
Global property	n/a	0	*7.70%*	*27*
Purchased annuities	4.80%	21,246	*5.40%*	*21,859*
Cash and other assets	3.10%	351	*4.30%*	*297*
Weighted average return	5.15%		*5.82%*	
Total market value of assets		54,022		*46,464*
Actual return on plan assets		5,617		*4,454*

The overall expected rate of return is determined by reference to market expectations for each class of asset. It is based upon a combination of historical analysis, current observed market yields and the forecasts of market professionals.

Annuities have been purchased from prime insurance providers in respect of pensioners' liabilities with a view to reducing mortality risk in the fund. The terms of those annuities substantially mirrors the terms of the fund's obligations to the pensioner members, and the value of the annuities has been estimated using the same discount rates as has been used to calculate the associated liability. Payments received from these annuities have been included in the actual return on plan assets during 2011, with the matching payments to pensioners included in benefits paid. During 2010 annuity receipts were netted against the benefits paid.

Index linked Liability Driven Investment (LDI) assets comprise short term cash investments linked to long term index linked swaps which are intended to deliver cash flows in the future which will match the expected future obligations for pension payments. These assets are similar to index linked annuities, but do not take account of mortality risk. The long term expected return is the yield on long term UK government securities (Gilts).

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

The pension cost for the defined benefit scheme was as follows:

	2011	***2010***
Analysis of defined benefit obligations		
Present value of funded obligations	56,785	*52,833*
Present value of unfunded obligations	0	*0*
Present value of defined benefit obligations	56,785	*52,833*
Fair value of plan assets	(54,022)	*(46,464)*
	2,763	*6,369*
Related deferred tax asset	(690)	*(1,720)*
Net liability in balance sheet	**2,073**	***4,649***
Income statement impact		
Employer's current service cost	687	*800*
Augmentations of employee benefits	123	*0*
Expected return on pension scheme assets	(2,755)	*(2,629)*
Interest on pension scheme liabilities	2,796	*2,618*
Total included in employee benefits expense	851	*789*
Change in present value of defined benefit obligations		
Opening defined benefit obligation	52,833	*45,912*
Employer's current service cost (including augmentations)	810	*800*
Contributions by employees	30	*14*
Interest on pension scheme liabilities	2,796	*2,618*
Actuarial losses on obligations	2,433	*5,380*
Benefits paid	(2,117)	*(1,891)*
Present value of scheme liabilities at end of year	56,785	*52,833*
Change in fair value of plan assets		
Opening fair value of plan assets	46,464	*43,161*
Expected return on pension scheme assets	2,755	*2,629*
Actuarial gains/(losses) on plan assets	2,862	*1,825*
Contributions by plan employer	4,028	*726*
Contributions by plan employees	30	*14*
Benefits paid	(2,117)	*(1,891)*
Fair value of plan assets at end of year	54,022	*46,464*
Analysis of the amounts to be included in the consolidated statement of comprehensive income		
Net actuarial gains / (losses) recognised in the year	429	*(3,555)*
Net cumulative actuarial losses	(10,810)	*(11,239)*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

History of experience gains and losses:

	2011	*2010*	*2009*	*2008*	*2007*
Difference between the expected and the actual return on scheme assets	2,862	*726*	*(1,946)*	*(5,440)*	*1,190*
Percentage of scheme assets	5%	*2%*	*-5%*	*-13%*	*3%*
Experience gains on scheme liabilities	782	*503*	*(55)*	*14*	*426*
Percentage of the present value of the scheme liabilities	1%	*1%*	*0%*	*0%*	*1%*
Total amount recognised in comprehensive income	429	*(3,555)*	*(8,737)*	*356*	*4,369*
Percentage of the present value of the scheme liabilities	*1%*	*-7%*	*-19%*	*1%*	*10%*

Defined contribution scheme

On 31 January 1998, the BACB Pension Scheme was closed to new entrants and employees recruited after that date are members of the BACB Retirement and Death Benefit Plan. At 31 December 2011, 94 employees were members of that scheme *(2010: 97 employees).* Contributions to the BACB Defined Contribution Retirement Benefit Scheme are made by both employer and employee in accordance with a fixed formula. In the year ended 31 December 2011, the Group paid £563,000 *(2010: £414,000)* by way of contributions into that scheme. There were no outstanding or pre-paid contributions to this scheme at 31 December 2011 *(2010: £nil).*

26. Subordinated liabilities

Subordinated loans in issue are denominated in US Dollars and are subordinated in all respects to the claims of other creditors. The loans can only be repaid before their due dates either on liquidation of the borrower after all other claims have been satisfied, or with express permission granted by the Financial Services Authority. The loans, which have been subscribed in full by the Group's principal shareholder, Libyan Foreign Bank, qualify for inclusion in full in the Group's capital base as Lower Tier 2 capital and bear interest based on inter-bank offered rates for dollar deposits.

	Group and Bank	
	2011	*2010*
Due 29th October 2020	20,379	*20,312*
Due 29th April 2023	20,379	*20,312*
Due 29th October 2025	20,379	*20,312*
	61,137	*60,936*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

27. Called up share capital

Authorised share capital comprises 115,000,000 Ordinary Shares of £1 each, 140,000,000 Ordinary Shares of US$1 each and 5,000,000 Deferred Non-Voting Shares of £1 each. Each paid up Ordinary £1 share carries the same rights as each paid up Ordinary $1 share. No rights attach to the Deferred Non-Voting shares until such time as they become paid up.

Issued share capital comprises:

	Group and Bank			
	Number of shares ('000)		Paid up amount	
	2011	*2010*	**2011**	*2010*
Ordinary Shares of £1 each fully paid	30,403	*30,403*	30,403	*30,403*
Ordinary Shares of US$1 each fully paid	76,974	*76,974*	49,050	*49,050*
Deferred Non-Voting Shares of £1 each nil paid	5,000	*5,000*	0	*0*
	112,377	*112,377*	79,453	*79,453*

28. Capital and reserves attributable to the Group's equity holders

	Group and Bank	
	2011	*2010*
Called up share capital	79,453	*79,453*
Capital redemption reserve	4,104	*4,104*
Other reserves		
Retained earnings	95,775	*95,295*
AFS Reserve	(445)	*114*
Cash flow hedging reserve	0	*(12)*
	95,330	*95,397*
	178,887	*178,954*

The Capital Redemption reserve arose on the purchase and cancellation of issued share capital in 2008.

The Available-for-sale ('AFS') reserve arises in respect of changes in the market value of assets categorised as being available for sale (Note 3h). The Cash Flow Hedging reserve arises from changes in the market value of derivatives which qualify as cash flow hedges (Note 3g).

Retained earnings, the AFS reserve and the cash flow hedging reserve are available for distribution subject to the maintenance of adequate capital resources.

The directors have not declared a dividend in respect of the profits for the year ended 31 December 2011 *(2010: £nil).*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

29. Contingent liabilities

The Group and the Bank extend guarantee facilities to customers including performance guarantees, bid and bail bonds, and other guarantees related to non-financial events. Such transactions amounted to £118,143,000 at 31 December 2011 *(2010: £194,288,000).*

The Group and the Bank's practice is to extend such facilities against a counter-indemnity. Accordingly, the Group and the Bank's risk in such transactions is a failure of the party providing the counter-indemnity, rather than that a loss arises as a result of a claim under the guarantee being called. No losses arose from such contracts in the year ended 31 December 2011 *(2010: Nil).*

30. Other commitments

	Group and Bank	
	2011	*2010*
Other commitments comprise:		
Credit lines and other commitments to lend:		
under one year	5,677	*12,517*
over one year	5,240	*1,191*
Documentary credits and short-term trade-related transactions	588,852	*730,820*
Own acceptances	12,189	*8,945*
	611,958	*753,473*

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

31. Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting polices in Note 3 describes how the classes of financial instruments are measured, and how income and expense, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the statements of financial position by the class of financial instrument to which they are assigned and therefore by the measurement basis.

Group 31 December 2011	Loans and receivables	Available for sale	At fair value through profit and loss	Derivatives designated as fair value hedging instruments	Derivatives designated as cash flow hedging instruments	Financial assets and liabilities at amortised cost	Total
Assets							
Cash, notes and coin	0	0	0	0	0	448	448
Debt securities	0	840,223	0	0	0	0	840,223
Loans and advances to banks	1,654,465	21,613	0	0	0	0	1,676,078
Loans and advances to customers	362,400	12,295	6,607	0	0	0	381,302
Equity shares and investments	0	10,050	0	0	0	0	10,050
Prepayments, accrued income and other debtors	0	0	0	0	0	15,826	15,826
Derivatives	0	0	1,549	32	0	0	1,581
Total financial assets	**2,016,865**	**884,181**	**8,156**	**32**	**0**	**16,274**	**2,925,508**
Total non-financial assets							10,847
Total assets							**2,936,355**
Liabilities							
Deposits from banks	0	0	35,591	0	0	1,828,437	1,864,028
Other deposits	0	0	0	0	0	817,518	817,518
Other liabilities, accruals and deferred income	0	0	0	0	0	9,487	9,487
Derivatives	0	0	1,455	1,770	0	0	3,225
Subordinated liabilities	0	0	0	0	0	61,137	61,137
Total financial liabilities	**0**	**0**	**37,046**	**1,770**	**0**	**2,716,579**	**2,755,395**
Total non-financial liabilities							180,960
Total equity and liabilities							**2,936,355**

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Group 31 December 2010	Loans and receivables	Available for sale	At fair value through profit and loss	Derivatives designated as fair value hedging instruments	Derivatives designated as cash flow hedging instruments	Financial assets and liabilities at amortised cost	Total
Assets							
Cash, notes and coin	0	0	0	0	0	380	380
Debt securities	0	834,543	0	0	0	0	834,543
Loans and advances to banks	1,930,447	28,661	0	0	0	0	1,959,108
Loans and advances to customers	490,756	19,349	3,225	0	0	0	513,330
Equity shares and investments	0	7,308	0	0	0	0	7,308
Prepayments, accrued income and other debtors	0	0	0	0	0	19,641	19,641
Derivatives	0	0	4,615	332	175	0	5,122
Total financial assets	**2,421,203**	**889,861**	**7,840**	**332**	**175**	**20,021**	**3,339,432**
Total non-financial assets							10,694
Total assets							**3,350,126**
Liabilities							
Deposits from banks	0	0	35,474	0	0	2,089,155	2,124,629
Other deposits	0	0	19,349	0	0	938,995	958,344
Other liabilities, accruals and deferred income	0	0	0	0	0	11,498	11,498
Derivatives	0	0	6,804	2,497	0		9,301
Subordinated liabilities	0	0	0	0	0	60,936	60,936
Total financial liabilities	**0**	**0**	**61,627**	**2,497**	**0**	**3,100,584**	**3,164,708**
Total non-financial liabilities							185,418
Total equity and liabilities							**3,350,126**

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Bank **31 December 2011**	Loans and receivables	Available for sale	At fair value through profit and loss	Derivatives designated as fair value hedging instruments	Derivatives designated as cash flow hedging instruments	Financial assets and liabilities at amortised cost	Total
Assets							
Cash, notes and coin	0	0	0	0	0	448	448
Debt securities	0	840,223	0	0	0	0	840,223
Loans and advances to banks	1,654,465	21,613	0	0	0	0	1,676,078
Loans and advances to customers	362,400	12,295	6,607	0	0	0	381,302
Equity shares and investments	0	10,050	0	0	0	0	10,050
Prepayments, accrued income and other debtors	0	0	0	0	0	15,826	15,826
Derivatives	0	0	1,549	32	0	0	1,581
Total financial assets	**2,016,865**	**884,181**	**8,156**	**32**	**0**	**16,274**	**2,925,508**
Total non-financial assets							10,848
Total assets							**2,936,356**
Liabilities							
Deposits from banks	0	0	35,591	0	0	1,828,437	1,864,028
Other deposits	0	0	0	0	0	817,519	817,519
Other liabilities, accruals and deferred income	0	0	0	0	0	9,487	9,487
Derivatives	0	0	1,455	1,770	0	0	3,225
Subordinated liabilities	0	0	0	0	0	61,137	61,137
Total financial liabilities	**0**	**0**	**37,046**	**1,770**	**0**	**2,716,580**	**2,755,396**
Total non-financial liabilities							180,960
Total equity and liabilities							**2,936,356**

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Bank 31 December 2010	Loans and receivables	Available for sale	At fair value through profit and loss	Derivatives designated as fair value hedging instruments	Derivatives designated as cash flow hedging instruments	Financial assets and liabilities at amortised cost	Total
Assets							
Cash, notes and coin	0	0	0	0	0	380	380
Debt securities	0	834,543	0	0	0	0	834,543
Loans and advances to banks	1,930,447	28,661	0	0	0	0	1,959,108
Loans and advances to customers	490,756	19,349	3,225	0	0	0	513,330
Equity shares and investments	0	7,308	0	0	0	0	7,308
Prepayments, accrued income and other debtors	0	0	0	0	0	19,641	19,641
Derivatives	0	0	4,615	332	175	0	5,122
Total financial assets	**2,421,203**	**889,861**	**7,840**	**332**	**175**	**20,021**	**3,339,432**
Total non-financial assets							10,695
Total assets							**3,350,127**
Liabilities							
Deposits from banks	0	0	34,474	0	0	2,090,155	2,124,629
Other deposits	0	0	19,349	0	0	938,996	958,345
Other liabilities, accruals and deferred income	0	0	0	0	0	11,498	11,498
Derivatives	0	0	6,804	2,497	0		9,301
Subordinated liabilities	0	0	0	0	0	60,936	60,936
Total financial liabilities	**0**	**0**	**60,627**	**2,497**	**0**	**3,101,585**	**3,164,709**
Total non-financial liabilities							185,418
Total equity and liabilities							**3,350,127**

Of the total £8,156,000 *(2010: £7,840,000)* assets at fair value through the profit and loss account, £926,000 *(2010: £3,666,000)* represents financial assets and derivatives held for trading purposes, and £7,230,000 *(2010: £4,174,000)* financial assets designated as such at inception. Of the total £37,046,000 *(2010: £61,627,000)* liabilities at fair value through the profit and loss account, £1,455,000 *(2010: £6,804,000)* represents financial liabilities and derivatives held for trading purposes, and £35,591,000 *(2010: £53,823,000)* financial liabilities designated as such at inception.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

32. Foreign currency assets / liabilities

Foreign currency assets and liabilities for the Group and the Bank were as follows:

Group 31 December 2011	**Sterling**	**Dollars**	**Euro**	**Other curencies**	**Total**
Total assets	569,149	1,243,523	1,054,386	69,297	2,936,355
Total equity and liabilities	(557,331)	(1,259,232)	(1,072,449)	(47,343)	(2,936,355)
Derivatives (at contract value)	(12,205)	15,728	18,057	(21,580)	0
Net exposures	**(387)**	**19**	**(6)**	**374**	
Contingent liabilities and other commitments	31,101	270,439	383,497	45,064	730,101

Group 31 December 2010	***Sterling***	***Dollars***	***Euro***	***Other curencies***	***Total***
Total assets	*448,262*	*1,707,012*	*1,078,178*	*116,674*	*3,350,126*
Total equity and liabilities	*(562,609)*	*(1,722,985)*	*(983,885)*	*(80,647)*	*(3,350,126)*
Derivatives (at contract value)	*114,520*	*15,451*	*(94,191)*	*(35,780)*	*0*
Net exposures	***173***	***(522)***	***102***	***247***	
Contingent liabilities and other commitments	*26,642*	*288,476*	*584,593*	*48,050*	*947,761*

Bank 31 December 2011	**Sterling**	**Dollars**	**Euro**	**Other curencies**	**Total**
Total assets	569,150	1,243,523	1,054,386	69,297	2,936,356
Total equity and liabilities	(557,332)	(1,259,232)	(1,072,449)	(47,343)	(2,936,356)
Derivatives (at contract value)	(12,205)	15,728	18,057	(21,580)	0
Net exposures	**(387)**	**19**	**(6)**	**374**	
Contingent liabilities and other commitments	31,101	270,439	383,497	45,064	730,101

Bank 31 December 2010	***Sterling***	***Dollars***	***Euro***	***Other curencies***	***Total***
Total assets	*448,263*	*1,707,012*	*1,078,178*	*116,674*	*3,350,127*
Total equity and liabilities	*(562,610)*	*(1,722,985)*	*(983,885)*	*(80,647)*	*(3,350,127)*
Derivatives (at contract value)	*114,520*	*15,451*	*(94,191)*	*(35,780)*	*0*
Net exposures	***173***	***(522)***	***102***	***247***	
Contingent liabilities and other commitments	*26,642*	*288,476*	*584,593*	*48,050*	*947,761*

The Group's policies for managing the risk of exchange revaluations on foreign currency assets and liabilities are explained in Note 4.

33. Legal proceedings

The Group does not consider that the outcomes of any proceedings against it, either individually or in aggregate, are likely to have a material effect on its financial position.

34. Consolidated segmental report

The Group has five reportable segments as described below, which are the Group's principal operating departments. While sharing customers in common, the departments offer different products and services with different risk and operational characteristics. Internal management information is constructed to measure separately the operational and risk characteristics of these departments, together with the resources they consume, and the financial results that they produce. The following summary describes the operations of each of the Group's reportable segments:-

- Trade Finance. The provision of secured payment and other guarantee type facilities in support of the international trade ambitions of its customers represents the Group's principal franchise. The majority of these customers are located in the countries of North Africa and the Eastern Mediterranean which form the Group's geographic niche.
- Banking Services. The Group acts as an important banking correspondent for its customers providing tailored account and international payment services.
- Lending. The Group undertakes lending both in support of its customers ambitions, but also in support of projects or investments in the wider Arab world.
- Treasury. In addition to servicing the Group's own funding and market risk management requirements, the Treasury also provides access to the international financial markets for the Group's customers. The Treasury also assumes market risk by way of trading activities within agreed limitations.
- Other. This includes items not specifically allocated to segments. The principal item is the interest earned on assets which have been funded from non interest bearing sources such as equity capital (described as earnings on free capital), less the difference between the cost of deposits and other sources of longer term funding (such as issued subordinated debt), and the income earned from the assets funded by those sources (described as net infrastructure costs).

Information regarding the results of each reportable segment is included below. Performance is measured based on net segment profit as included in the internally generated management information utilised by the board of directors, and by executive management. Segment profit is stated after charging (or crediting) interest 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.

Segment information regarding the Bank is not presented, as such information is not distinguished in reporting to either the Board of Directors or to Executive Management.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Group 2011	Trade Finance	Banking Services	Lending	Treasury	Other	Total
Net interest income	243	2,853	5,771	6,110	(370)	14,607
Net fee and commission income	16,710	1,202	(2)	(252)	(571)	17,087
Net trading income	0	0	0	7,188	0	7,188
Other operating income	0	0	0	0	374	374
Total Operating income	16,953	4,055	5,769	13,046	(567)	39,256
Directly attributable segment expenses	(3,588)	(1,733)	(830)	(1,596)	0	(7,747)
Net charge for impairment losses	(10,845)	116	(7,794)	0	0	(18,523)
Net segment profit / (loss)	2,520	2,438	(2,855)	11,450	(567)	12,986
Common costs not attributable to segments						(12,777)
Profit before income tax						**209**
BALANCE SHEET						
Segment assets	29,242	21,049	437,551	2,411,790	36,723	2,936,355
Segment liabilities	0	914,098	0	1,770,673	251,584	2,936,355
Contingent liabilities and other commitments	719,184	0	10,917	0	0	730,101

Group 2010	*Trade Finance*	*Banking Services*	*Lending*	*Treasury*	*Other*	*Total*
Net interest income	*360*	*2,079*	*7,087*	*7,650*	*(2,038)*	*15,138*
Net fee and commission income	*20,123*	*1,944*	*7*	*(635)*	*(367)*	*21,072*
Net trading income	*0*	*0*	*0*	*8,728*	*0*	*8,728*
Other operating income	*0*	*0*	*0*	*0*	*353*	*353*
Total Operating income	*20,483*	*4,023*	*7,094*	*15,743*	*(2,052)*	*45,291*
Directly attributable segment expenses	*(3,990)*	*(2,261)*	*(1,087)*	*(2,647)*	*0*	*(9,985)*
Net charge for impairment losses	*(704)*	*0*	*(3,879)*	*0*	*0*	*(4,583)*
Net segment profit / (loss)	*15,789*	*1,762*	*2,128*	*13,096*	*(2,052)*	*30,723*
Common costs not attributable to segments						*(11,729)*
Profit before income tax						***18,994***
BALANCE SHEET						
Segment assets	*26,456*	*21,498*	*470,237*	*2,794,301*	*37,634*	*3,350,126*
Segment liabilities	*0*	*844,231*	*0*	*2,248,043*	*257,852*	*3,350,126*
Contingent liabilities and other commitments	*934,053*	*0*	*13,708*	*0*	*0*	*947,761*

Substantially all of the assets of the Group are held in the United Kingdom. However, many of the Group's customers are domiciled overseas. Directors and Executive Management monitor the Group's sources of revenue by reference to the geographic location of the customer. The analysis of total operating income below is based on the location of the customer giving rise to the revenue. As for the segmental information shown above, customer income is stated after charging (or crediting) interest in respect of assets that either require or generate income. Geographic information for the Bank is not presented as such information is not distinguished in reporting to either the board of directors or to Executive Management.

Group	**2011**	*2010*
United Kingdom	7,758	*7,698*
Other European Union	1,168	*2,005*
Libya	7,760	*12,003*
Other Middle East and Africa	20,949	*21,813*
Other	1,621	*1,772*
	39,256	*45,291*

35. Related parties

The Group regards the following as being related parties in accordance with IAS24:

a) On 29 October 2010, the Group became a subsidiary company of Libyan Foreign Bank. From that date the Group has regarded Libyan Foreign Bank and all of its subsidiaries, together with Libyan Foreign Bank's owner, the Central Bank of Libya and all of its subsidiaries, as being related parties. Prior to that date, the Group regarded Libyan Foreign Bank and all of its subsidiaries and the HSBC Group as being connected to the Group. The Group considers these parties to be in a position to exert significant influence over the Group for the relevant periods. The Group entered into commercial transactions in the ordinary course of business with these parties on an arm's-length basis during the relevant periods.

b) Key management personnel, including the Group's directors, and identified Executive Managers.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2011

Transactions with related parties were as follows:

	Nature of related party			
	Significant influence	Subsidiary company	Key management personnel	
Balances at 31 December 2011				
Loans and advances	363	0	5	*
Deposits	1,582,094	0	0	
Subordinated liabilities	61,481	0	0	
Contingent liabilities and other commitments	91,728	0	0	
Volumes executed during 2011				
Loans and advances	76,157	0	0	
Deposits	31,608,578	0	0	
Derivatives (contract amount)	3,980,319	0	0	
Contingent liabilities and other commitments	46,937	0	0	
Included in income statement				
Interest receivable	84	0	0	
Interest payable	13,445	0	0	
Fees and commissions receivable	3,224	0	0	
Balances at 31 December 2010				
Loans and advances	*84*	*0*	*5*	*
Deposits	*1,493,137*	*0*	*0*	
Subordinated liabilities	*61,326*	*0*	*0*	
Contingent liabilities and other commitments	*196,681*	*0*	*0*	
Volumes executed during 2010				
Loans and advances	*3,417,850*	*0*	*0*	
Deposits	*122,835,107*	*0*	*0*	
Derivatives (contract amount)	*2,774,018*	*0*	*0*	
Contingent liabilities and other commitments	*84,186*	*0*	*0*	
Included in income statement				
Interest receivable	*325*	*231*	*0*	
Interest payable	*4,759*	*231*	*0*	
Fees and commissions receivable	*1,830*	*0*	*0*	
Fees and commissions payable	*329*	*0*	*0*	

* At 31 December 2011 £5,000 was outstanding by way of interest free loans due from 2 Executive Managers of the Group, and no amount was outstanding from any director. *(At 31 December 2010 £5,000 was outstanding by way of interest free loans due from two Executive Managers of the Group, and no amount was outstanding from any director).*

In addition, the Group has entered into the following further related party transactions:

a) The Group meets the employment costs of executives seconded to it by related parties. The costs of these secondments were £714,000 *(2010:£ 1,205,000).*

b) Key management personnel compensation:

	2011	*2010*
Directors attendance and standing fees	305	*432*
Executive Managers		
Salaries and other short term benefits	1,867	*2,049*
Post-employment benefits	279	*375*
	2,451	*2,856*

36. Impact of regional instability

Political events in the various countries within the Middle East & North African (MENA) region in which the Group specialises, including in Libya, the country of the Bank's principal shareholder, had a significant impact on operations during 2011.

Political change in Tunisia and in Egypt during 2011 did not directly affect the Group's operations.

The emergence of conflict in Libya, and the imposition of international financial and other sanctions over the weekend of 26 and 27 February 2011 had a significant impact on the Group's operations. Events elsewhere as the year progressed, including in Syria (where financial sanctions were extended by the EU by Council Regulation (EU) 1011/2011 on 13 October 2011), Yemen and Bahrain also had an effect.

While the Group itself was licensed as being outside the scope of the Libyan sanctions (and hence in the same position as regards the sanctions as other non-Libyan owned entities), some of its customers and counterparties were within the scope of sanctions. Deposits placed with the Group by those counterparties totalling £1,496,779,000 became frozen in its balance sheet at the date that sanctions were imposed, and the Group was not permitted to extend new facilities to those customers and counterparties other than in accordance with explicit permissions granted by the designated UK authorities.

Further, in view of its ownership, the Group was required by the Financial Services Authority (the FSA) to place certain restrictions on its governance arrangements, and to introduce enhanced "due diligence" controls over its operations.

These sanctions, and the related restrictions on the Group's operations, remained in place for a substantial part of the year. Sanctions against the Libyan banks (including the Central Bank of Libya and Libyan Foreign Bank) were released by the UN on 16 December 2011(enacted in the EU by Council Regulation (EU) No 1360/2011 on 22 December 2011), and the FSA agreed to the lifting of the final restrictions relating to the Group's operations on 21 December 2011.

Sanctions remain in place in relation to certain other Libyan institutions, and at 31 December 2011 deposits held by the Group in the name of both residual Libyan, and designated Syrian institutions amounting to £264,118,000 remained frozen.

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