



BRITISH ARAB COMMERCIAL BANK plc
YOUR PARTNER IN ARAB FINANCE WORLDWIDE

ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

Financial Highlights

12 months ended/as at 31 December Thousands of Pounds Sterling (unless otherwise stated)	2012	2011	2010	2009	2008
Profit before provisions	16,914	18,732	23,577	34,311	32,757
Impairment losses on loans and advances	(3,359)	(18,523)	(4,583)	(29,456)	(825)
Profit before tax	13,555	209	18,994	4,855	31,932
Income tax	(3,332)	29	(5,222)	(1,763)	(9,474)
Profit after tax	10,223	238	13,772	3,092	22,458
Dividends declared	† 7,200	0	0	0	7,000
Earnings per share (p)	9.5	0.2	12.8	2.9	20.9
Dividends per share (p)	6.7	0.0	0.0	0.0	6.5
Shareholders' Funds	189,770	178,887	178,954	169,273	175,413
Total Assets	2,181,285	2,936,355	3,350,126	3,302,692	3,093,327
Capital / Risk Weighted Assets	# 26%	26%	21%	18%	16%
Dollar / sterling exchange rate					
Year end	\$1.62	\$1.55	\$1.55	\$1.61	\$1.46
Average	\$1.60	\$1.60	\$1.54	\$1.56	\$1.83
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.

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

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

British Arab Commercial Bank plc

CONTENTS

CONTENTS.....	1
BOARD OF DIRECTORS	2
EXECUTIVE MANAGEMENT	3
CHAIRMAN'S STATEMENT	4
OPERATING AND FINANCIAL REVIEW	5
STATEMENT OF DIRECTORS' RESPONSIBILITIES.....	19
DIRECTORS' REPORT.....	20
INDEPENDENT AUDITOR'S REPORT.....	22
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME	24
STATEMENTS OF FINANCIAL POSITION.....	25
STATEMENTS OF CHANGES IN EQUITY	26
STATEMENTS OF CASH FLOW	27
NOTES TO THE FINANCIAL STATEMENTS	28
1. General information	28
2. Basis of preparation	28
3. Significant accounting policies	29
4. Risk management.....	40
5. Fair values of financial assets and liabilities	53
6. Critical accounting estimates and judgements in applying accounting policies.....	55
7. Net interest income	58
8. Net fee and commission income	59
9. Net trading income.....	59
10. Administrative expenses	60
11. Impairment losses on loans and advances.....	61
12. Income tax expense.....	63
13. Profit dealt with in the accounts of British Arab Commercial Bank plc	64
14. Debt securities.....	64
15. Loans and advances to banks	64
16. Loans and advances to customers	66
17. Equity shares and investments	66
18. Shares in Group undertakings	66
19. Property, plant and equipment and intangible assets.....	67
20. Deferred taxation.....	68
21. Derivatives	69
22. Prepayments, accrued income and other debtors	70
23. Deposits.....	71
24. Other liabilities, accruals and deferred income	71
25. Pension fund.....	71
26. Subordinated liabilities	75
27. Called up share capital	76
28. Capital and reserves attributable to the Group's equity holders.....	76
29. Contingent liabilities	77
30. Other commitments.....	77
31. Analysis of financial assets and liabilities by measurement basis.....	78
32. Foreign currency assets / liabilities	82
33. Legal proceedings	83
34. Consolidated segmental report.....	83
35. Related parties.....	85

British Arab Commercial Bank plc

BOARD OF DIRECTORS

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

Mr Mohamed Shokri Vice Chairman (non-executive director)
Appointed 26 June 2012.

Dr Ezzadin Ashur (non-executive director)
Appointed 17 October 2012

Mr Crispian Denby (executive director)
Appointed 1 March 2013

Mr Sameh Krekshi (non-executive director)
Appointed 17 July 2012

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 Officer (executive director)
Appointed 27 September 2002.

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

Mr Mohamed Zine (non-executive director)
Appointed 30 October 2012

Dr Khaled Zentuti ceased to be a director on 6 March 2012. Dr Mohamed Bait-Elmal ceased to be a director on 17 July 2012 and Mr Mohamed Benchaaboun ceased to be a director on 30 October 2012.

British Arab Commercial Bank plc

EXECUTIVE MANAGEMENT

Michael Parr	CHIEF EXECUTIVE OFFICER
Layth Al Falaki	HEAD OF RISK MANAGEMENT & COMPLIANCE
Gary Bishop	HEAD OF OPERATIONS
David Crew	HEAD OF HUMAN RESOURCES
Crispian Denby	FINANCE DIRECTOR & COMPANY SECRETARY
Eric Foreythe-Reid	HEAD OF INFORMATION TECHNOLOGY
Malcolm Himsworth	HEAD OF INTERNAL AUDIT
George Kimber	HEAD OF INSTITUTIONAL & CORPORATE BANKING
John Penn	HEAD OF DEVELOPING MARKETS

Mr Al Falaki left the Group on 20 February 2013 and will be replaced in due course.

CHAIRMAN'S STATEMENT

Global economic conditions remain very challenging and the banking sector in MENA continues to be faced by both that, and a difficult regional political and business environment. It is against this background, that I am delighted BACB has been able to deliver a much improved performance in 2012 and can return to declaring a dividend for its shareholders following recent difficult trading years. With total operating income for 2012 broadly in line with 2011, reported profit before tax of £13.6m combined with lower bad debt impairment charges is encouraging.

Margins on new lending increased, confirmed credit turnover was a record £1,707m and payment volumes from Libyan customers recovered somewhat. However, interest rates internationally continued to be low, delaying the recovery in BACB's interest earnings on customer balances and denying treasury operations gapping opportunities.

The Board recognises that the continent of Africa represents a good opportunity to leverage BACB's trade finance, treasury and other skills, and further efforts will be made throughout 2013 and beyond to identify attractive new business in countries outside its traditional niche markets. Over a three-year horizon, these initiatives are expected to contribute to a significant increase in shareholder return.

As part of BACB's strategic plan the Board is taking action to improve its financial performance, through additional investment in people, products and technology. Costs continue to be controlled but on the back of weaker revenues BACB's cost to income ratio has risen to 55%, and may show a further increases the company invests in future growth. New revenue streams are expected to bring ratios closer to 2010 levels over time.

The Board was delighted in 2012 to welcome a number of new directors appointed by BACB's largest shareholder Libyan Foreign Bank ("**LFB**"), which resumed full participation in the Group's affairs. I wish to place on record appreciation of LFB's wise counsel and continued support.

During the year BACB completed a number of regulatory steps in order to meet requirements, including the filing with the FSA of capital ("**ICAAP**") and liquidity ("**ILAA**") documents prepared in earlier years, and to meet new regulatory requirements, a Recovery and Resolution Plan ("**RRP**") document prepared for the first time in 2012. BACB takes all regulatory demands made of it seriously and dedicates whatever resources are necessary to comply.

Our Chief Executive, Mr Michael Parr, who has served the company for over 10 years, will retire in 2013, handing over to his successor, Mr Andrew Martin. I would like to take this opportunity to thank him for his exceptional contribution, and in particular for steering the company through a very challenging period. I would also like to thank my fellow directors and all staff for their valuable contributions to BACB.

R D Dowie
Chairman
1 March 2013

OPERATING AND FINANCIAL REVIEW

RESULTS (AUDITED)

Following the disruptions of last year, 2012 saw a gradual return to normal operations, but the need to replace the lost pipeline of transactions in progress resulted in slightly lower earnings booked. Operating income in 2012 was 5% below that achieved in the previous year.

	2012	2011
	£'000	£'000
Trade finance	16,167	16,953
Banking services	2,411	4,055
Commercial term lending	7,520	5,769
Treasury	12,892	13,046
Other	(1,455)	(567)
Total operating income	37,535	39,256
General and administrative expenses	(20,621)	(20,524)
Net operating income	16,914	18,732
Impairments	(3,359)	(18,523)
Profit before tax	13,555	209
Cost / Income ratio	55%	52%

Operating income

Efforts in 2012 focused on rebuilding relationships put on hold in 2011 as a result of Middle East and North Africa (“MENA”) region instability. In Libya, the resumption of trade and other business after the conflict of 2011 was quite slow, gathering pace as the year progressed. The impact of the Arab Spring was however not limited to Libya, with political uncertainty in Egypt persisting, Syria closed for new business and political change in Yemen, all of which provided a challenging background for new business development.

The Group was successful in engaging with its Libyan customers quickly as matters stabilised in the country, and business volumes were ahead of the Group’s forecast for 2012.

Interest revenues in 2012 continued to be impacted by very low benchmark interest rates across the major currencies, including the emergence of negative interest rates for short date Euro. The Group’s ability to generate margins was strained by low rates, impacting revenues from banking activities. The high cost of maintaining liquidity levels (shown under “Other” above) also undermined net interest.

The Group enjoyed success in growing lending activities in accordance with its strategy of seeking new sources of revenues in new markets. Reasonable volumes of relatively short dated loans were sourced by the newly formed Business Development team with acceptable margin and risk profiles.

British Arab Commercial Bank plc

Administrative expenses

Overall, at £20.6m (2011: £20.5m) the level of administrative expenses was similar to the prior year. Total staff employment costs made up some 60.6% (2011: 54.3%) of the total administrative expenses. Performance awards granted to staff were higher in 2012 in light of the higher overall profit for the year.

Impairments

At the end of 2012 10 facilities with a gross exposure amounting to £40,299,000 were judged to be impaired. 7 of these totalling £37,841,000 related to amounts which had been impaired at 31 December 2011, with 3 newly impaired facilities amounting to £2,458,000.

Prospect for recoveries from the newly impaired items were regarded as being remote, and 100% provisions have been raised against these. The balance of the impairment charge for the year, £1,075,000, arose as a result of adjustments to the previously established provisions.

Balance sheet

Balance sheet totals were as follows:-

	2012	2011
	£'000s	£'000s
Professional market placements, debt securities and derivatives	1,544,623	2,411,790
Commercial term lending	532,782	437,551
Other	103,880	87,014
Balance sheet footings	<u>2,181,285</u>	<u>2,936,355</u>
Contingent liabilities	94,742	118,143
Other commitments	655,082	611,958

The decline in the balance sheet during the year mainly reflected a deliberate reduction in short date deposits where the Group felt unable to pass on costs associated with negative interest rates to its customers. Overall, deposit balances held by the group declined from £2,681,546,000 to £1,911,518,000, a drop of £770,028,000.

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 else invested in liquid and high quality debt securities. Their overall impact is to make the Group a placer of funds into professional markets. The total balances of 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.

British Arab Commercial Bank plc

Within the total balance sheet, the commercial term lending book grew as the Group sought to diversify its sources of revenues. The main part of this new lending was concentrated in maturities up to 1 year.

Capital adequacy¹

At 31 December 2012 and throughout the year, the Group exceeded the capital requirements as set out by the Financial Services Authority (the “FSA”).

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

	2012	2011
	£'000s	£'000s
Tier 1 Capital	179,534	179,330
Tier 2 Capital	60,661	63,276
Total eligible capital at 31 December	<u>240,195</u>	<u>242,606</u>

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 2012 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

	2012	2011
	£'000	£'000
Credit risk	73,236	74,206
Market risk	169	554
Counterparty risk capital component	1,634	2,507
Operational risk	6,815	6,616
Total Pillar 1 capital requirement	<u>81,854</u>	<u>83,883</u>
Capital in place	240,195	242,606
Excess of capital in place over minimum requirement under Pillar 1	<u>158,341</u>	<u>158,723</u>

¹ Unaudited

British Arab Commercial Bank plc

The Group has agreed with the FSA an Individual Capital Guidance ('ICG') requirement. This requirement mandates an uplift to the Pillar 1 requirement set out above to accommodate a range of other risks (Pillar 2 risks) not captured by the standardised methodology used to determine the minimum requirement. In addition the FSA expects that the Group will normally maintain a buffer above the sum of the Pillar 1 and Pillar 2 requirements described as the Capital Planning Buffer ("CPB"). At 31 December 2012, and throughout the year, the Group's capital in place exceeded its minimum ICG requirement. The Group does not forecast exceeding these requirements during 2013.

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.

Risk Weighted Assets ("RWAs") were similar at 31 December 2012 to the level at the end of 2011 despite the lower balance sheet totals. The reduction in assets was concentrated in low risk weighted items, including zero weighted government securities.

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.

Liquidity

2012 marked a year of some normalisation for the Group in its liquidity operations after the regional disruptions of 2011.

However, conditions during 2012 were by no means benign, either systemically, or for the particular idiosyncratic circumstances of the Group.

Systemically, financial markets were under severe stress through most of 2012. The credit crisis continued to evolve with central banks around the world obliged to provide very large amounts of liquidity to markets to prevent a seizure of the system, and cascading defaults. As the year progressed confidence began to return to some extent, but interest rates have fallen to historic low levels, including negative rates in some currencies including in particular the Euro.

The Group noted in its 2011 annual report that it had lost significant access to funded credit markets from outside its customer base. Matters stabilised in 2012, and some access to third party credit was restored, but not yet to the levels enjoyed in 2010 and before. Instead the Group's deposits derive predominantly from its customer base, and liquidity management in the Group is undertaken by reference to the characteristics of those relationships.

The Group regards itself as a "stand alone" entity, not relying on any related party for future liquidity support in the event of stress. Liquidity is managed by the Group's Treasury operation, overseen and guided by Management's ALCO committee, and reporting to the Board.

The Group manages its liquidity in accordance with regulatory best practice, focusing on cash flows to 14 days and to 90 days, as well as restricting its longer term (over 1 year) assets by

British Arab Commercial Bank plc

reference to permanent and longer term resources. The Group also maintains stocks of liquid debt security assets, including highly liquid OECD government securities. During the year the holdings of government securities were reduced somewhat reflecting the normalisation of the Group's liquidity position referred to above. Details of the maturity profile of the Group's assets and liabilities are shown in note 4 to these financial statements.

As noted above, balance sheet totals fell in the year. The reduction was concentrated in short date deposit balances, and related placements, and the Group was successful in maintaining its longer dated resources thus ensuring that liquidity risk was maintained within the Group's overall liquidity risk appetite notwithstanding the decline in total deposits. Liabilities up to one month declined by £703,644,000 (see note 4) accounting for the main part of the overall reduction in deposit balances.

The Group also continued to reduce its longer dated assets. Loans and advances with over 5 years residual maturity fell by 29% from £142,726,000 to £101,378,000.

At 31 December 2012 £7,200,000 had been placed with two other institutions by way of collateral securing derivative and other transactions. The amount of the collateral pledged by the Group is fixed, though may be varied with the Group's agreement.

Exposures to the European Union

As disclosed in Note 4, at 31 December 2012, the Group had exposures to selected 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, at 31 December 2012, the Group had no exposures to either the governments of, or 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 bear a lower rating than their country of residence.

The Group's exposures to counterparties resident in the European Union at 31 December 2012 were as follows:-

British Arab Commercial Bank plc

Credit quality step	S&P rating	Moody's rating	Contingent liabilities and other commitments £'000	Cash, loans and advances, debt securities and derivatives £'000	Gross exposure 2012 £'000	Gross exposure 2011 £'000
Central Governments or Central Banks						
1	AAA to AA-	Aaa to Aa3	0	35,390	35,390	109,944
2	A+ to A-	A1 to A3	0	1,360	1,360	0
3	BBB+ to BBB-	Baa1 to Baa3	0	3,251	3,251	0
			<u>0</u>	<u>40,001</u>	<u>40,001</u>	<u>109,944</u>
Institutions						
1	AAA to AA-	Aaa to Aa3	70,413	377,554	447,967	742,946
2	A+ to A-	A1 to A3	8,169	236,306	244,475	233,398
3	BBB+ to BBB-	Baa1 to Baa3	545	3,083	3,628	4,044
4	BB+ to BB-	Ba1 to Ba3	49	0	49	363
5	B+ to B-	B1 to B3	0	5,708	5,708	0
Unrated			579	0	579	464
			<u>79,755</u>	<u>622,651</u>	<u>702,406</u>	<u>981,215</u>
Corporates						
1	AAA to AA-	Aaa to Aa3	0	1,389	1,389	0
2	A+ to A-	A1 to A3	0	18,965	18,965	0
3	BBB+ to BBB-	Baa1 to Baa3	0	0	0	6,349
4	BB+ to BB-	Ba1 to Ba3	23,103	0	23,103	22,830
5	B+ to B-	B1 to B3	0	0	0	0
Unrated			15,126	1,739	16,865	20,274
			<u>38,229</u>	<u>22,093</u>	<u>60,322</u>	<u>49,453</u>
			<u>117,984</u>	<u>684,745</u>	<u>802,729</u>	<u>1,140,612</u>
Being:						
Debt securities					221,794	185,391
Loans and advances to banks					451,405	834,481
Loans and advances to customers					10,091	13,536
Derivatives					1,455	65
Contingent Liabilities and other commitments					117,984	107,139
					<u>802,729</u>	<u>1,140,612</u>

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 the European Union region.

British Arab Commercial Bank plc

MANAGEMENT REVIEW (UNAUDITED)

This review describes the Group's activities during 2012. The Group's activities have been affected by events in the MENA region.

Trade Finance

A substantial increase in volumes was recorded in the Group's core trade finance activities in 2012, as business returned following the Arab Spring events of 2011. Total turnover of confirmed letter of credit business in 2012 was £1,707m against £1,328m in 2011: an increase of nearly 30%.

Whilst confirmed letters of credit from Algeria grew by 10% and contributed the largest share of Trade Services turnover, most of the growth achieved in 2012 was attributable to the recovery in Libyan business. After a modest contribution in 2011, Libyan turnover contributed 20% of total turnover in 2012. This was a welcome return of an important market, reflecting the end of conflict in the country and the easing of sanctions. The Group's relationship managers had been careful to maintain contact with customers through the period of conflict and accordingly were able to re-establish trading relations immediately that restrictions were eased. Turnover in Libya in 2012 was driven by the import of essential commodities and equipment. Large infrastructure projects (which historically had underpinned Libyan business) have yet to materialise, but are expected to contribute significantly once political transition in the country is complete.

Although some historically important markets continue to be affected by political unrest of varying severity, the Group recorded positive growth in many of its traditional Middle East and North African markets. Confirmed letter of credit volumes from Egypt for example were more than double 2010 volumes, reflecting the easing of competition for this business.

Outside of these markets, excellent volumes were received from Turkey (mainly relating to oil imports), and Mauritania, which was the leading sub-Saharan market for the Group, and an important source of soft commodity transactions.

The Group expects to continue to develop its business in its traditional MENA markets in 2013. The Group is also developing new sources of trade finance business in wider African markets, especially where there is a link to the core MENA region.

Banking Services

The low, and in some currencies negative, interest rate environment during 2012 significantly affected interest income earned from on-demand current accounts as the ability to attach a margin to deposit balances between the rate paid to the customer, and the rate at which the Group was able to deploy the funds, was eroded.

The loss of ability to attach spreads to balances was exacerbated by a fall in the overall total of balances held (down 33% on average), although this reduction was managed with the agreement of the depositors precisely because of the difficulties of deploying funds in a negative rate environment.

British Arab Commercial Bank plc

Customer overdraft balances were also lower as the Group adopted a more cautious approach to the granting of such facilities in the light of regional uncertainties.

Some compensation for these factors was obtained by a healthy level of discounting of Letter of Credit receivables for the benefit of exporters.

Payment volumes recovered slowly, growing 16% on 2011, but below 2010 levels mainly as Libyan customers resumed business. Some sanctions remained in place on selected Libyan entities at end 2012 and sanctions and other regulations in connection with the international payments business mean that the Group continues to invest significant resources in due diligence and other control procedures associated with this activity.

A new Trade Services module to the Group's electronic banking portal, BACBe, was rolled out in 2013, designed to improve its ability to provide services to its clients. Work also continued through 2012 on a new payments and sanctions monitoring system together with electronic delivery mechanisms designed to support repetitive payments such as expatriate payrolls. Completion of this project in 2013 is expected to ensure that the Group is able to offer improved payments services on a competitive and efficient basis in core markets.

Commercial Term Lending

Lending balances grew during 2012 by 22%. This expansion was in line with the Group's decision to broaden its geographic focus to include opportunities in countries in Sub-Saharan Africa. Executives were recruited during 2012 with experience in lending into these markets and success was achieved in sourcing new transactions for the Group at margins which reflected the utilisation of capital and liquidity, and at acceptable risk. Borrowers were either sovereign, quasi-sovereign, trading companies or banks and financed both imports and exports in the region. A number of transactions also had structures designed to mitigate the underlying risk. In general the transactions are of relatively short duration (1-2 years), as the Group has only limited appetite for new longer dated transactions.

In addition, the Group continued to make available short-term trade-related discounting and refinancing facilities to both exporters and importers in support of the Group's trade finance business, and for the benefit of those dealing in and with the MENA region.

Aside from the activities described above, the historic loan book comprised longer dated facilities to MENA borrowers including oil, gas and power-related project financings, loans to sovereign-related institutions together with holdings of regional sovereign paper. These loans continued to amortise, and the Group is currently standing aside from longer dated transactions of this nature.

British Arab Commercial Bank plc

	2012	2011
	£'000	£'000
Short term commercial advances	101,075	27,496
Project finance	134,113	154,729
Agency guaranteed loans	12,688	17,267
Asset and Islamic finance	52,321	50,834
Other trade and term loans	213,927	162,946
Unimpaired loans	<u>514,124</u>	<u>413,272</u>
Impaired loans		
Loans subject to restructuring on terms which give rise to impairment	14,409	27,224
Other impaired loans	13,847	5,464
	28,256	32,688
Impairments	(9,598)	(8,409)
Total term lending	<u>532,782</u>	<u>437,551</u>
Comprising:		
Loans and advances to banks	199,957	84,017
Loans and advances to customers	342,423	361,943
Impairments	(9,598)	(8,409)
	<u>532,782</u>	<u>437,551</u>

The Group's plan envisages that new lending, focussing on shorter tenor trade related transactions, including further transactions in wider African markets, will take place during 2013.

Treasury

The Treasury department continued to undertake a dual role on behalf of the Group. The Treasury team provides access for the Group's customers to the London markets servicing their requirements in interest rate, foreign exchange, derivative and debt markets. This responsibility is combined with the task of managing the Group's own financial resources, including its balance sheet structure, cashflow and liquidity management, and hedging. The Treasury also undertakes own-account (proprietary) trades, taking positions in these markets with a view to earning income for the Group.

Credit risk was a major concern during 2012, especially with regard to sovereign debt stresses across Europe. The Group is obliged to invest its surplus funds in credit and bond markets, but the priority during 2012 had been to reduce credit risk by limiting investments to the better sectors rather than to seek out yield. Exposures to some European sectors in particular were scaled back during 2012 as market news became more troubling, but with the result that deployments became more concentrated in a narrow range of names. As the year progressed, and as conditions stabilised, some resumption of dealings took place on a conservative basis to re-establish diversification.

The Group maintains a primary portfolio of OECD Sovereign bonds issued by the governments and related entities of the UK, America, Germany, Holland, France, and Belgium. At 31 December 2012 this portfolio totalled £290,187,000 (31 December 2011: £571,143,000). These bonds tend to yield below the rate which the Group seeks to reward its own depositors, and compensation for this cost is obtained by way of a secondary portfolio of bank and corporate debt securities (including bank Certificates of Deposit) issued by well rated institutions.

British Arab Commercial Bank plc

BACB's external rating was reduced in 2011 in light of events in North Africa which limits the Group's access to wholesale funded credit markets though some third party credit lines were restored as 2012 progressed. While the Group's access to funded credit remains limited, its access to derivative and other trading lines is acceptable, and it is able to price transactions on behalf of its customers across the full range of markets on a fully competitive basis. The Group's service proposition for its customers is the ability to combine professional execution across the full range of Treasury and capital markets with efficient settlement and competitive pricing.

The Group's deposit base is undiversified, but the Treasury team maintain close relationships with its customers seeking to balance both the Group's needs, and their aspirations.

In 2013 the Treasury will continue to grow its core business with its institutional clients from the MENA region. Relationships in Sub Saharan, and wider African markets will also be explored, especially those with some link to the Arab world. The regulatory challenges in the areas of liquidity, capital management and due diligence are not expected to abate.

Risk Management and Compliance

Credit risk continues to be an area of major focus in the light of political and social events in the Group's niche markets, combined with the continuing sovereign debt crisis in the Eurozone and elsewhere. The Group reacted by restricting exposure and tenors to higher risk counterparties whilst continuing to manage challenging credit situations. From a compliance perspective, the sanctions regimes in the bank's niche markets continued to evolve with restrictions eased on Libya but tightened on Syria.

The processes utilised to manage credit risk are subject to continual development in the light of best practice and experience. Additional functionality within the new credit rating, analysis and management tool implemented by the Group in 2011 began to be utilised in 2012 bolstering credit analysis and helping better identify incipient credit problems.

The Group's anti-money laundering ("AML") and financial crime prevention processes continued to be strengthened with the commencement of the rollout of a new AML grading system. The improved sanction filtering and behavioural monitoring systems due to be implemented during 2012 will now be implemented in 2013. Staff training is a key defence in this risk area and the Group continued to ensure that training levels met regulatory requirements.

Regulatory compliance remained a focus during 2012. The FSA visited the Group to undertake a risk assessment in 2012. The outcome of the visit was largely positive confirming capital and liquidity guidance, and highlighting a small number of issues to address.

The UK regulatory move towards "twin peaks" regulation has been a primary focus in 2012, as dual regulation will result in a larger compliance burden for the Group. The detail and potential impacts were continually reviewed as the regulators issued guidance on the new regulations. Other important compliance tasks included the submission of the Group's first Recovery and Resolution Plan, progress towards MiFID 2, work on implementing the Basel 3 accords and new large exposure rules, analysis of the new regulatory reporting (FINREP/COREP) rules and assessment of the impact of the US tax, FATCA. Appropriate

British Arab Commercial Bank plc

controls and oversight continued to be exercised in this area and no significant regulatory or compliance breaches occurred during the year.

Information Management

During 2011 the Group embarked on a multi-year programme to update its core banking systems.

The major project during 2012 has been the implementation of a new payments and due diligence system. Payments lie at the heart of a bank's operations. The Group specialises in international payments which in recent years have become an operation requiring much more intense management and oversight than before. At the end of 2011 the Group selected the MIDAS Message Manager and related Funds Transfer systems supplied by MISYS which integrate well with the Group's core banking system, MIDAS. The group also selected the Omni sanctions monitoring and due diligence system, supplied by InfracoreTech. The development of these applications has proved challenging, and the project which had initially been scheduled for completion in 2012 will now not be completed until 2013. Nevertheless the Group is satisfied that, once completed, it will have in place a system fit to meet the challenges of making high volumes of international payments in a highly sensitive and regulated environment.

During 2012 the Group undertook a review of its core banking package, not least in light of the impending expiry of the license for that package, but also in the context of the ageing of that application. As a result of the review the Group elected to remain with MISYS, upgrading from the old version of the MIDAS system to their latest release, MIDAS Bank Fusion. Agreements in this regard were entered into at the end of 2012, and a major project to implement this upgrade will begin later in 2013.

The Group intends undertaking a number of other technical projects which are expected to result in a higher level of investment over the next few years.

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 2012, the Internal Audit programme for the year was completed successfully. Internal audit resources were further strengthened by the appointment of a professional audit firm to provide internal audit support services.

British Arab Commercial Bank plc

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 2013, 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 2012.

Human Resources

The total staffing headcount rose during 2012 from 136 at the start of the year to 142 at the end of the year. The increase in staff numbers was due mainly to increases in overall business volumes; a trend that we expect to continue during 2013.

The Group has continued to benefit from a pattern of low turnover levels with the result that a high proportion of experienced employees have been retained, ensuring consistent delivery of high levels of service to its customers. An emphasis on internal training and development, together with a reliance on 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 2012, with revisions to the FSA Remuneration Code (“the Code”) taking effect from November 2012. Certain qualitative and quantitative disclosures are required by the Code and the Group has included these disclosures in its Pillar 3 disclosures document, available on the Group’s website at www.bacb.co.uk.

An Employee Engagement Survey was conducted during the year, which produced some encouraging results, with 79% of our employees feeling satisfied or very satisfied with working for BACB. The overall level of Employee Engagement received an “Excellent” score, demonstrating a high level of employee commitment to the Group. The survey also helped to identify some aspects that could be improved still further and measures are being adopted to address these areas.

One of these areas was that of Management Development Training, where a new training programme was required. During the year a new programme was designed and the first workshops delivered, with further workshops being planned for 2013.

A number of the Group’s long serving senior executives will be retiring or leaving the Group in 2013. The Chief Executive Officer, Mr Michael Parr who has served since 2002 is retiring in 2013, and will be replaced by Mr Andrew Martin who joins the Group from another UK based bank. Mr George Kimber, the Head of Institutional and Corporate Banking and Mr David Crew, the Head of Human Resources are also retiring in 2013, and their experience and long service will also be missed. Mr Layth Al-Falaki, Head of Risk and Compliance left the Group in February to pursue his career elsewhere. Succession plans for these positions are in place, both by way of internal reorganisation and promotion, and external recruitment.

British Arab Commercial Bank plc

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 the Articles of Association of 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

During 2011 the Group operated under revised governance arrangements in light of sanctions against Libya. These restrictions were lifted in December 2011, and during 2012 the Group's Board has been reformed, resuming its full governance functions. The Board comprises the individuals listed on page 2. It 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") and the Finance Director are full time employees of the Bank and are regarded as being an Executive Directors. All of the other directors are regarded as being Non-Executive Directors. The Board met six times during 2012.

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

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.

The committee met separately from the Board four times during 2012.

Compensation Committee

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

British Arab Commercial Bank plc

Nominations Committee

An ad-hoc committee which is formed when the need to make appointments involving the Board arises. During 2012 the committee acted in the matter of the selection of a new CEO for 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 the 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.

British Arab Commercial Bank plc

and its subsidiary companies

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.

British Arab Commercial Bank plc

and its subsidiary companies

DIRECTORS' REPORT

for the year ended 31 December 2012

The directors present their annual report and the audited financial statements for the year ended 31 December 2012. 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 £10,223,000. The Directors recommend a dividend in respect of this profit of 6.705p per ordinary share amounting to £7,200,000 (2011: *No dividend was paid*). The amount of this dividend will be recognised during 2013. The balance of profit amounting to £3,023,000 will be retained in the Profit and Loss account.

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.

British Arab Commercial Bank plc

and its subsidiary companies

DIRECTORS' REPORT

for the year ended 31 December 2012 (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 £8,000.

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 2012.

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

1 March 2013

British Arab Commercial Bank plc

and its subsidiary companies

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 2012 set out on pages 24 to 87. 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 Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

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 2012 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.

British Arab Commercial Bank plc

and its subsidiary companies

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

1 March 2013

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2012

	Note	2012	2011
Interest and similar income	7	30,827	33,300
Less: Interest expense and similar charges	7	(16,913)	(18,693)
Net interest income		13,914	14,607
Fee and commission income	8	17,213	18,228
Less: Fee and commission expense	8	(822)	(1,141)
Net fee and commission income		16,391	17,087
Net trading income	9	6,598	7,188
Other operating income		632	374
Total operating income		37,535	39,256
General administrative expenses	10	(20,621)	(20,524)
Net charge for impairment losses on loans and advances	11	(3,359)	(18,523)
		(23,980)	(39,047)
Profit before income tax		13,555	209
Income tax (expense)/credit	12	(3,332)	29
Profit for the year		10,223	238
Other comprehensive income/(expense)			
Actuarial (loss)/gain on pension fund	25	(3,823)	429
Change in fair value of available for sale financial assets	12	4,741	(818)
Effective portion of changes in fair value of cash flow hedges	12	0	17
Fair value gains attributable to available for sale financial assets transferred to income	12	(17)	0
Income tax on other comprehensive income	12	(241)	67
Other comprehensive gain/(loss) for the period, net of tax		660	(305)
Total comprehensive gain/(loss) for the period		10,883	(67)

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

The Notes on pages 28 to 87 form part of these financial statements.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

STATEMENTS OF FINANCIAL POSITION

As at 31 December 2012

	Note	Group 2012	Bank 2012	Group 2011	Bank 2011
Assets					
Cash, notes and coin		509	509	448	448
Debt securities	14	583,233	583,233	840,223	840,223
Loans and advances to banks	15	1,205,647	1,205,647	1,676,078	1,676,078
Loans and advances to customers	16	352,551	352,551	381,302	381,302
Equity shares and investments	17	11,853	11,853	10,050	10,050
Shares in group undertakings	18	0	1	0	1
Property, plant and equipment	19	8,921	8,921	9,232	9,232
Intangible assets	19	1,887	1,887	1,209	1,209
Deferred taxation	20	15	15	406	406
Derivatives	21	2,244	2,244	1,581	1,581
Corporation tax receivable		234	234	2,334	2,334
Prepayments, accrued income and other debtors	22	14,191	14,191	13,492	13,492
Total assets		2,181,285	2,181,286	2,936,355	2,936,356
Liabilities					
Deposits from banks	23	1,258,217	1,258,217	1,864,028	1,864,028
Other deposits	23	653,301	653,302	817,518	817,519
Other liabilities, accruals and deferred income	24	16,797	16,797	9,487	9,487
Derivatives	21	2,452	2,452	3,225	3,225
Net pension liability	25	2,484	2,484	2,073	2,073
Subordinated liabilities	26	58,264	58,264	61,137	61,137
Total liabilities		1,991,515	1,991,516	2,757,468	2,757,469
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	106,213	106,213	95,330	95,330
Capital and reserves attributable to the Group's equity holders	28	189,770	189,770	178,887	178,887
Total liabilities and equity		2,181,285	2,181,286	2,936,355	2,936,356

The Notes on pages 28 to 87 form part of these financial statements.

Signed:

Mr RD Dowie
Chairman

Mr M Shokri
Vice Chairman

M J Parr
Director and Chief Executive

1 March 2013

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

STATEMENTS OF CHANGES IN EQUITY

For the year ended 31 December 2012

Group and 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 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
Profit for 2012	0	0	0	0	10,223	10,223	10,223
Other comprehensive income / (expense) for 2012	0	3,608	0	0	(2,948)	660	660
Balance at 31 December 2012	79,453	3,163	0	4,104	103,050	110,317	189,770

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

STATEMENTS OF CASH FLOW

For the year ended 31 December 2012

	Group and Bank	
	2012	2011
Net cash flow from operating activities		
Profit before taxation	13,555	209
Adjustments for:		
Loan impairment losses	3,359	18,523
Provisions utilised	0	(40,169)
Depreciation and amortisation	1,010	1,081
(Profit)/loss on sale of fixed assets	(5)	7
Non-cash items included in net profit	4,364	(20,558)
Loans, advances and other debt securities other than cash and cash equivalents	(173,971)	51,539
Other debtors and prepayments	(1,552)	9,725
Change in operating assets	(175,523)	61,264
Customer accounts and deposits by banks	(686,651)	(375,289)
Other liabilities	3,463	(11,285)
Change in operating liabilities	(683,188)	(386,574)
Tax paid	(1,132)	(3,429)
Net cash used in operating activities	(841,924)	(349,088)
Cash flow from investing activities:		
Purchases of equity shares and investments	(1,889)	(2,143)
Proceeds of redemptions of equity shares and investments	119	0
Proceeds on sale of fixed assets	18	27
Purchase of tangible assets	(195)	(250)
Purchase of intangible assets	(1,195)	(612)
Net cash used in investing activities	(3,142)	(2,978)
Net reduction in cash and cash equivalents	(845,066)	(352,066)
Cash equivalents at the beginning of the year	1,916,869	2,286,866
Effect of exchange rate change on cash and cash equivalents	(56,945)	(17,931)
Cash and cash equivalents at the end of the year	1,014,858	1,916,869
Cash and cash equivalents comprise		
Cash, notes and coin	509	448
Loans and advances to banks of original maturity three months or less	993,932	1,563,550
Certificates of deposit and other debt securities of three months original maturity or less	20,417	352,871
	1,014,858	1,916,869

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2012

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 2012 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 1 March 2013.

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 2012. 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

A number of changes in IFRS are now being proposed by the IASB which are expected to effect the Group's reporting in future years. The changes of relevance to the Group are as follows:-

IFRS 9 Financial Instruments

This standard forms part of the International Accounting Standard Board's project to replace the existing standard on the recognition and measurement of financial instruments. This standard requires all financial assets to be classified and measured on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. The standard also differs from existing requirements for accounting for financial assets in various other areas, such as embedded derivatives and the recognition of fair value adjustments in the Statement of Other Comprehensive Income ("OCI"). The standard will be applied retrospectively (subject to the standard's transitional provisions). The impact on the annual financial statements has not yet been fully determined. The standard is expected to be effective for annual periods beginning on or after 1 January 2015.

IFRS 13 Fair Value Measurement

This standard replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. It does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. The standard also sets out certain specific disclosure requirements which are required to meet the disclosure objective within the standard. The standard is expected to be effective for annual periods beginning on or after 1 January 2015.

IAS 19 Employee Benefits

The amended standard requires that the expected return on plan assets recognised in profit or loss is calculated based on the rate used to discount the defined benefit obligation rather than on expected returns on those assets. The standard is effective for annual periods beginning on or after 1 January 2013. Note 25 to these financial statements provides details of the impact of this standard for the Group.

IAS 32 Offsetting Financial Assets and Financial Liabilities

The amendments to the standard address inconsistencies in current practice when applying the offsetting criteria. The amendments clarify the meaning of 'currently has a legally enforceable right of set-off'; and confirms that some gross settlement systems may be considered equivalent to net settlement. The standard is effective for annual periods beginning on or after 1 January 2014.

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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-

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.

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 2012, the lease had 134 years and 2 months remaining.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 shares

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 2012

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 2012 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 £255,919,000 (2011: £220,171,000). 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:

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

Group and Bank 31 December 2012	Contingent liabilities and other commitments	Cash, loans and advances, debt securities and derivatives	Maximum exposure to credit risk	Cash collateral	Net credit exposure
Low	144,692	1,250,770	1,395,462	(22,022)	1,373,440
Satisfactory	383,059	624,295	1,007,354	(156,013)	851,341
Fair	205,337	186,372	391,709	(77,224)	314,485
Less: impairments	0	(469)	(469)	0	(469)
Watchlist	10,092	18,337	28,429	(617)	27,812
Substandard	0	9,259	9,259	0	9,259
Less: impairments	0	0	0	0	0
Doubtful	6,645	24,868	31,513	(43)	31,470
Less: impairments	0	(21,172)	(21,172)	0	(21,172)
Loss	0	0	0	0	0
Total credit exposures	749,825	2,092,260	2,842,085	(255,919)	2,586,166

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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 332 counterparties encompassing exposure to 61 countries and territories (2011: 394 counterparties in 63 countries). Regional concentrations of credit risk arising from operations were as follows:

Group and Bank	Contingent liabilities and other commitments	Cash, loans and advances, debt securities and derivatives	Total
31 December 2012			
United Kingdom	26,917	603,144	630,061
Other European Union	117,984	684,745	802,729
Middle East and Africa	570,853	551,916	1,122,769
Other Countries	34,071	274,096	308,167
Impairments	0	(21,641)	(21,641)
Maximum exposure to credit risk	749,825	2,092,260	2,842,085
Group and Bank			
31 December 2011			
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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

By industry, concentrations of credit risk were as follows:

	Group and Bank	
	2012	2011
Financial institutions		
(including central banks)		
Banks	2,162,091	2,910,739
UK building societies	92,000	97,377
Multilateral financial institutions	2,928	3,937
Other financial intermediaries	33,294	30,478
	2,290,313	3,042,531
Corporates		
Commodities	15,821	13,016
Construction and engineering	36,778	39,608
Energy	162,572	197,980
Non-bank credit grantors	28,827	41,266
Transport and storage	37,940	47,761
Other	187,200	168,603
	469,138	508,234
Public administration		
Impairments	104,275	69,499
	(21,641)	(19,041)
Maximum exposure to credit risk	2,842,085	3,601,223

Maximum exposure to credit risk comprises:

	Group and Bank	
	2012	2011
Cash, notes and coin	509	448
Debt securities	583,233	840,223
Loans and advances to banks	1,205,647	1,676,078
Less bills discounted (Note 15) *	(51,923)	(28,510)
Loans and advances to customers	352,551	381,302
Derivatives (Note 21)	2,244	1,581
	2,092,261	2,871,122
Contingent liabilities (Note 29)	94,742	118,143
Other commitments (Note 30)	655,082	611,958
	749,824	730,101
	2,842,085	3,601,223

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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 2012 (being the sterling equivalent value of all the currencies where the currency obligations were higher than currency receivables) was £503,000 (2011: £366,000). Were these currencies to strengthen by 5% against the remaining currencies, then the Group would lose £25,000 (2011: £18,000). Positions as determined daily were as follows:

	2012	2011
	£'000	£'000
Maximum	2,927	6,895
Minimum	241	294
Average	962	1,259

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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 2012, PVBP amounted to £7,616 (2011: £10,967). PVBP (calculated on a daily basis) was as follows:

	2012	2011
	£	£
Maximum	13,565	14,698
Minimum	1,131	2,265
Average	5,846	7,871

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 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Debt securities	85,143	122,803	302,069	67,336	0	5,882	583,233
Loans and advances to banks	1,054,520	125,392	25,579	0	0	156	1,205,647
Loans and advances to customers	85,411	152,049	118,619	13,936	4,505	(21,969)	352,551
Other assets						39,854	39,854
Total assets	1,225,074	400,244	446,267	81,272	4,505	23,923	2,181,285
Deposits from banks	860,150	255,611	142,456	0	0	0	1,258,217
Other deposits	500,935	46,480	72,909	32,593	0	384	653,301
Subordinated liabilities	0	58,264	0	0	0	0	58,264
Other liabilities and shareholders' funds	0	0	0	0	0	211,503	211,503
Total equity and liabilities	1,361,085	360,355	215,365	32,593	0	211,887	2,181,285
Derivatives (at contract value)							
Receivable	72,506	32,074	5,606	0	0	0	
Payable	67,220	12,334	0	26,229	4,403	0	
Overall gap	(130,725)	59,629	236,508	22,450	102	(187,964)	
Reverse Cumulative gap	187,964	318,689	259,060	22,552	102	(187,964)	

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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)	

Bank 31 December 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Debt securities	85,143	122,803	302,069	67,336	0	5,882	583,233
Loans and advances to banks	1,054,520	125,392	25,579	0	0	156	1,205,647
Loans and advances to customers	85,411	152,049	118,619	13,936	4,505	(21,969)	352,551
Other assets	0	0	0	0	0	39,855	39,855
Total assets	1,225,074	400,244	446,267	81,272	4,505	23,924	2,181,286
Deposits from banks	860,150	255,611	142,456	0	0	0	1,258,217
Other deposits	500,935	46,480	72,909	32,593	0	385	653,302
Subordinated liabilities	0	58,264	0	0	0	0	58,264
Other liabilities and shareholders' funds	0	0	0	0	0	211,503	211,503
Total equity and liabilities	1,361,085	360,355	215,365	32,593	0	211,888	2,181,286
Derivatives (at contract value)							
Receivable	72,506	32,074	5,606	0	0	0	
Payable	67,220	12,334	0	26,229	4,403	0	
Overall gap	(130,725)	59,629	236,508	22,450	102	(187,964)	
Reverse Cumulative gap	187,964	318,689	259,060	22,552	102	(187,964)	

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

<i>Bank</i>							
<i>31 December 2011</i>	<i>Up to 1 month</i>	<i>1-3 months</i>	<i>3-12 months</i>	<i>1-5 years</i>	<i>Over 5 years</i>	<i>Non-interest bearing</i>	<i>Total</i>
<i>Debt securities</i>	318,414	265,055	241,555	15,998	0	(794)	840,223
<i>Loans and advances to banks</i>	1,511,362	111,583	52,765	0	0	368	1,676,078
<i>Loans and advances to customers</i>	71,048	153,906	145,434	14,853	4,686	(8,625)	381,302
<i>Other assets</i>	0	0	0	0	0	38,753	38,753
<i>Total assets</i>	1,900,824	530,544	439,754	30,846	4,686	29,702	2,936,356
<i>Deposits from banks</i>	1,413,812	262,398	187,810	0	0	8	1,864,028
<i>Other deposits</i>	717,311	65,990	33,821	0	0	396	817,518
<i>Subordinated liabilities</i>	0	61,137	0	0	0	0	61,137
<i>Other liabilities and shareholders' funds</i>	0	0	0	0	0	193,673	193,673
<i>Total equity and liabilities</i>	2,131,123	389,525	221,631	0	0	194,077	2,936,356
<i>Derivatives (at contract value)</i>							
<i>Receivable</i>	5,824	65,290	31,410	6,471	0	0	
<i>Payable</i>	3,236	44,826	21,613	34,700	4,620	0	
<i>Overall gap</i>	(227,711)	161,483	227,920	2,617	66	(164,375)	
<i>Reverse Cumulative gap</i>	164,375	392,086	230,608	2,683	66	(164,375)	

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 2013 would reduce the present value of the gaps in the banking book by £394,000. However, earnings from the financial assets associated with the non-interest bearing liabilities would increase during 2013 by £480,000 (2011: a 0.5% increase in interest rates would have reduced the present value of the gaps by £568,000, but earnings in 2012 would have been increased by £1,002,000).

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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 measures that risk by quantifying the mismatches between the maturity of assets and liabilities, and controls the risk by placing limits on those mismatches, 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 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Undated	Total
Debt securities	26,647	29,982	344,538	176,183	0	5,883	583,233
Loans and advances to banks	1,021,688	96,568	62,454	18,501	0	6,436	1,205,647
Loans and advances to customers	28,544	35,846	48,428	160,324	101,378	(21,969)	352,551
Other assets	0	0	0	0	0	39,854	39,854
Total assets	1,076,879	162,396	455,420	355,008	101,378	30,204	2,181,285
Deposits from banks	829,315	255,611	142,456	30,835	0	0	1,258,217
Other deposits	500,935	46,480	72,909	32,593	0	385	653,302
Subordinated liabilities	0	0	0	0	58,264	0	58,264
Other liabilities and shareholders' funds	0	0	0	0	0	211,502	211,502
Total equity and liabilities	1,330,250	302,091	215,365	63,428	58,264	211,887	2,181,285
Net liquidity gap	(253,371)	(139,695)	240,055	291,580	43,114	(181,683)	

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

<i>At 31 December 2011</i>	<i>Up to 1 month</i>	<i>1-3 months</i>	<i>3-12 months</i>	<i>1-5 years</i>	<i>Over 5 years</i>	<i>Undated</i>	<i>Total</i>
<i>Debt securities</i>	270,251	201,932	309,558	59,276	0	(794)	840,223
<i>Loans and advances to banks</i>	1,496,570	90,200	88,940	0	0	368	1,676,078
<i>Loans and advances to customers</i>	19,925	38,331	46,761	142,184	142,726	(8,625)	381,302
<i>Other assets</i>	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
<i>Deposits from banks</i>	1,316,747	262,398	187,810	97,065	0	8	1,864,028
<i>Other deposits</i>	717,310	65,990	33,822	0	0	396	817,518
<i>Subordinated liabilities</i>	0	0	0	0	61,137	0	61,137
<i>Other liabilities and shareholders' funds</i>	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)	
Bank	Up to 1		3-12		Over 5		
At 31 December 2012	month	1-3 months	months	1-5 years	years	Undated	Total
<i>Debt securities</i>	26,647	29,982	344,538	176,183	0	5,883	583,233
<i>Loans and advances to banks</i>	1,021,688	96,568	62,454	18,501	0	6,436	1,205,647
<i>Loans and advances to customers</i>	28,544	35,846	48,428	160,324	101,378	(21,969)	352,551
<i>Other assets</i>	0	0	0	0	0	39,855	39,855
Total assets	1,076,879	162,396	455,420	355,008	101,378	30,205	2,181,286
<i>Deposits from banks</i>	829,315	255,611	142,456	30,835	0	0	1,258,217
<i>Other deposits</i>	500,935	46,480	72,909	32,593	0	386	653,303
<i>Subordinated liabilities</i>	0	0	0	0	58,264	0	58,264
<i>Other liabilities and shareholders' funds</i>	0	0	0	0	0	211,502	211,502
Total equity and liabilities	1,330,250	302,091	215,365	63,428	58,264	211,888	2,181,286
Net liquidity gap	(253,371)	(139,695)	240,055	291,580	43,114	(181,683)	

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

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. The principal limits in place relate to the relationship between net cash outflows up to 14 days and up to 3 months, and the balance of holdings of liquid assets. Structural liquidity risk is also controlled by limiting the extent to which assets maturing beyond one year may exceed funding resources of that tenor.

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:

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

Group and Bank At 31 December 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Undated	Total
Deposits from banks	830,328	256,131	143,220	31,460	0	0	1,261,139
Other deposits	501,423	46,524	73,735	32,104	0	544	654,330
Derivatives	96	12	539	968	17	0	1,632
Subordinated liabilities	478	0	1,419	7,597	68,393	0	77,887
Total cash outflows	1,332,325	302,667	218,913	72,129	68,410	544	1,994,988

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

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 ALCO.

Operational losses in 2012 amounted to £10,000 (2011: £108,000).

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 (except otherwise stated)	31 December 2012		31 December 2011	
	Carrying value	Fair value	Carrying value	Fair value
Financial Assets				
Cash, notes and coins	509	509	448	448
Loans and advances to banks	1,200,505	1,192,402	1,654,465	1,653,887
Loans and advances to customers	329,196	305,330	362,400	330,450
Prepayments, accrued income and other debtors	16,668	16,668	17,406	17,406
Financial Liabilities				
Deposits from banks	1,196,548	1,195,386	1,828,437	1,825,430
Other deposits: Group	653,300	652,728	817,518	816,484
Other deposits: Bank	653,301	652,729	817,519	816,485
Subordinated liabilities	58,264	46,028	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 2012 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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 2012			31 December 2011		
	Sterling	US Dollars	Euro	Sterling	US Dollars	Euro
Interest rates						
3 month	0.48%	0.33%	0.10%	1.10%	0.63%	1.36%
6 month	0.61%	0.52%	0.16%	1.30%	1.09%	1.69%
1 year	0.91%	0.76%	0.41%	1.70%	1.22%	2.07%
5 year	1.37%	1.23%	0.86%	1.85%	1.60%	2.00%
Exchange rates	1.0000	1.6216	1.2264	1.0000	1.5454	1.1937

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 31 December 2012	Level 1	Level 2	Level 3	Total
Debt Securities	540,024	43,209	0	583,233
Loans and Advances to Banks	5,142	0	0	5,142
Loans and Advances to Customers	11,717	14,409	0	26,126
Derivative Assets	0	2,244	0	2,244
Equity Shares and Investments	0	0	11,853	11,853
	<u>556,883</u>	<u>59,862</u>	<u>11,853</u>	<u>628,598</u>
Deposits from banks	0	61,669	0	61,669
Derivative Liabilities	0	2,452	0	2,452
	<u>0</u>	<u>64,121</u>	<u>0</u>	<u>64,121</u>
Group and Bank 31 December 2011	Level 1	Level 2	Level 3	Total
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
	<u>716,126</u>	<u>166,193</u>	<u>10,050</u>	<u>892,369</u>
Deposits from banks	0	35,591	0	35,591
Derivative Liabilities	0	3,225	0	3,225
	<u>0</u>	<u>38,816</u>	<u>0</u>	<u>38,816</u>

There were no significant transfers of assets between levels during 2012, 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

At 31 December 2012 loans to ten customers were impaired (*2011: seven loans*). The Group is not confident that any future cash flows will arise in respect of six of those loans (*2011: two 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.

Two impaired loans were subject to broadly common rescheduling terms during 2011 and 2012, crystallising a loss as the interest rate payable was at below market levels. One other impaired loan was the subject of a buyback offer from the borrower at the year end at a discount to its par value. The Group accepted this offer in January 2013 (for completion later in the year), and the amount of the impairment has been determined based on this offer. One further related loan is expected to be rescheduled in 2013, but on terms which are not expected to give rise to an impairment.

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

If recoveries on the remaining impaired loan are 10% lower than has been estimated, then the amount of the impairment which would have been charged in 2012 in respect of that loan would have been increased by £359,000 (*2011: £1,400,000 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 £4,960,000 if the discount rate were to be 3.8% rather than 4.3% (leaving all other assumptions the same) (*2011: scheme liabilities would increase by £4,400,000 if the discount rate were to be 4.3% rather than 4.8%*), and that the value of the scheme liabilities would increase by £365,000 if the rate of increase in salaries were to be 3.85%pa rather than 3.6%pa (leaving all other assumptions the same) (*2011: scheme liabilities would increase by £400,000 if the rate of increase in salaries were to be 4.15% rather than 3.9%*).

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 29.5/30.9 years for males/females who are 60 this year, rising to 30.6/32.0 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 27.2/28.6 years for males/females aged 60 and to 27.8/29.2 years for males/females aged 50. These would result in a decrease in uninsured Scheme liabilities of approximately £3,000,000. 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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

7. Net interest income

	Group and Bank	
	2012	2011
Interest income		
Professional market placements	17,439	21,575
Loans and advances	13,381	11,595
Other	7	130
	<u>30,827</u>	<u>33,300</u>
Interest income comprises		
Interest arising on financial assets at fair value through the income statement	2,053	4,078
Interest recognised on impaired assets (Note 11)	507	969
Gains / (losses) arising from the change in fair value of fair value hedges		
- on hedging instruments	(56)	10
- on hedged items attributable to the hedged risk	8	111
Other interest	28,315	28,132
	<u>30,827</u>	<u>33,300</u>

The amount reported in the income statement in respect of the ineffectiveness of fair value hedges was £nil in the year ended 31 December 2012 (*Year ended 31 December 2011:£nil*).

Interest expense

Banks and customers	14,891	16,541
Subordinated loans	2,022	2,152
	<u>16,913</u>	<u>18,693</u>

Interest expense comprises

Interest arising on financial liabilities at fair value through the income statement	944	817
Other interest	15,969	17,876
	<u>16,913</u>	<u>18,693</u>

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

8. Net fee and commission income

	Group and Bank	
	2012	2011
Fee and commission income		
Safe custody	246	150
Trade services		
Guarantees	1,125	1,484
Other trade services income	14,510	15,225
Term lending (other than amounts which form part of the effective interest rate)	0	2
Banking payments and services	1,332	1,367
	<u>17,213</u>	<u>18,228</u>
Fee and commission expense		
Brokerage and other fees	822	1,141

9. Net trading income

	Group and Bank	
	2012	2011
Foreign exchange dealing	5,312	5,670
Other	1,286	1,518
	<u>6,598</u>	<u>7,188</u>

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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

10. Administrative expenses

	Group and Bank	
	2012	2011
Staff costs:		
Salaries and other emoluments	7,985	7,588
Social security costs	1,133	932
Other pension costs:		
- Defined benefit scheme	531	851
- Expenses associated with defined benefit scheme	180	180
- Defined contribution scheme	553	563
Total fixed staff employment costs	10,382	10,114
Variable staff costs: performance awards	2,115	1,029
Total staff employment costs	12,497	11,143
Reorganisation costs (excluding pension augmentations)	1,117	954
Other employment related costs	507	309
Total staff costs	14,121	12,406
Fees payable to the Bank's auditors for the audit of the Bank's annual financial statements	140	152
Fees payable to the Bank's auditors for other services :		
- Other services pursuant to legislation	8	6
- Taxation advice	21	23
- All other services	77	0
Depreciation (including amortisation of intangibles)	1,010	1,081
Amortisation of prepaid rental on land	63	63
Loss on sale of tangible and intangible assets	5	7
Regulatory supervision fees	45	49
Other administrative expenses	5,131	6,737
	20,621	20,524

The average number of employees in place during the year was 139 (2011: 138).

Directors' remuneration included above totalled £824,000 (2011: £629,000). The emoluments of the highest paid director were £490,000 (2011: £323,000) and the amount of his accrued pension as at balance sheet date was £nil (2011: £nil). There were no pension contributions for any directors during the year (2011: £nil).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

11. Impairment losses on loans and advances

The movements in impairment provisions were as follows:

	Group and Bank	
	2012	2011
Balance at 1 January	19,041	41,319
Exchange translation and other movements	(252)	337
Effect of discounting (Note 7)	(507)	(969)
Provisions written off	0	(40,169)
Profit and loss account		
New allowances	6,112	19,007
Reversal of allowances no longer required	(2,527)	(389)
Recoveries of amounts written off in previous periods	(226)	(95)
	3,359	18,523
Balance at 31 December	21,641	19,041
Being impairments against		
Loans and advances to banks	0	0
Loans and advances to customers	21,641	19,041
	21,641	19,041

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 2012, ten facilities comprising amounts due to the Group of £40,299,000 were determined to be impaired (2011: seven facilities comprising £39,174,000 due to the Group). No collateral was held by the Group in respect of these facilities.

£Nil was past due at the reporting date in respect of unimpaired financial assets (31 December 2011: £976,000).

Of the 10 (2011: seven) facilities which were impaired at 31 December 2012, 2 facilities amounting to £14,409,000 had been formally rescheduled (2011: 1 facility amounting to £6,606,000) 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.

3 facilities totalling £9,961,000 at 31 December 2012 (2011: 7 facilities totalling £32,902,000) had been formally rescheduled on terms which may be less favourable to the Group, but which did not give rise to impairment. A further 4 facilities totalling £24,928,000 are expected to be formally rescheduled at some

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

point, also on terms which may be less favourable to the Group, but which are not expected to give rise to impairment.

As part of its banking and trade services business the Group may from time to time be required, or otherwise agree to provide overdraft or other temporary facilities to its customers beyond the precise terms upon which such facilities have been intended to operate. At 31 December 2012 facilities for 2 customers to whom the Group's maximum exposure to credit risk was £8,328,000 were subject to such temporary forbearance (2011: 4 customers to whom the Group's exposure to credit risk was £26,542,000).

5 facilities totalling £22,658,000 have been categorised as being "watchlist", as disclosed in note 4 (2011: 12 facilities totalling £62,049,000). "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.

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 2012 the Group had waived material covenants and had agreed such relaxations in respect of a number of the facilities described above, but had not agreed relaxations in respect of other facilities (2011: 1 additional facility amounting to £497,000).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

12. Income tax expense

	Group and Bank	
	2012	2011
Current tax:		
Total UK corporation tax charge/(credit)	3,234	(470)
Of which: amount dealt with through reserves	(1,102)	237
Current tax on items taken through the income statement	2,132	(233)
Current tax adjustment in respect of previous periods	(1)	(156)
Deferred tax (Note 20)		
Origination and reversal of timing differences	310	(508)
Effect of tax rate change	67	26
Amounts associated with movements in the pension fund	824	842
	<u>3,332</u>	<u>(29)</u>

The charge for tax on the profit for the year is based on the average UK corporation tax rate of 24.5% (2011: 26.5%). The UK corporation tax rate will reduce to 23% from 6 April 2013. Thereafter it is forecast to reduce to 21%, though this further reduction in rate has yet to be enacted into law.

The tax charge for the period is higher (2011: lower) than the standard rate of corporation tax in the UK as explained below:

	Group and Bank	
	2012	2011
Profit on ordinary activities before tax	13,555	209
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK	3,321	55
Effect of loss carried back to prior period	0	4
Adjustment in respect of previous periods	(1)	(156)
Effect of change in tax rate	67	26
Permanently disallowed items	(89)	(46)
Other items	34	88
UK Corporation tax charge/(credit)	<u>3,332</u>	<u>(29)</u>

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

Group and Bank	2012			2011		
	Before tax	Tax	Net of tax	Before tax	Tax	Net of tax
Actuarial (loss)/gain on pension fund	(3,823)	937	(2,886)	429	(113)	316
Change in fair value of available for sale financial assets	4,741	(1,158)	3,583	(818)	230	(588)
Effective portion of changes in fair value of cash flow hedges	0	0	0	17	(5)	12
Fair value gains attributable to available for sale financial assets transferred to income	(17)	4	(13)	0	0	0
Effect of change in tax rates	0	(24)	(24)	0	(45)	(45)
	<u>901</u>	<u>(241)</u>	<u>660</u>	<u>(372)</u>	<u>67</u>	<u>(305)</u>
Dealt with as follows:						
Current tax		(1,102)			237	
Deferred tax (Note 20)		(14)			17	
Adjusted through pension fund liability		<u>875</u>			<u>(187)</u>	
		<u>(241)</u>			<u>67</u>	

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

All of the consolidated profit for the financial year (2011: All) 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	
	2012	2011
Unlisted certificates of deposit (CDs)	43,209	158,006
OECD government securities	290,187	571,143
Other listed debt securities guaranteed by OECD Governments	0	6,024
Other listed debt securities issued by banks	224,344	105,050
Other listed debt securities issued by non-banks	<u>25,493</u>	<u>0</u>
	<u>583,233</u>	<u>840,223</u>

Debt securities with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £81,066,000 (2011: £110,892,000).

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 £nil (2011: £21,613,000).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

	Group and Bank	
	2012	2011
Funds held at correspondent banks	52,217	112,235
Professional market placements	892,188	1,434,485
Commercial term lending	199,957	84,017
Bills discounted	51,923	28,510
Overdrafts and other advances	9,362	16,831
Less: Provisions for impairments (Note 11)	0	0
	<u>1,205,647</u>	<u>1,676,078</u>

Professional market placements includes £nil (2011: £119,999,000) 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 £5,142,000 (2011: £21,613,000) loans and advances to banks constituted as debt securities, and designated by the Group at inception as being available for sale.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 £23,355,000 (2011: £13,673,000).

	Group and Bank	
	2012	2011
Professional market placements to non banks	14,741	23,266
Commercial term lending	342,423	361,943
Overdrafts and other advances	17,028	15,134
Less: Provisions for impairments (Note 11)	(21,641)	(19,041)
	<u>352,551</u>	<u>381,302</u>

Included in commercial term lending is £11,717,000 (2011: £12,295,000) 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:

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	
	2012	2011
Balance at 1 January	10,050	7,308
Exchange translation	(330)	(1)
Changes in fair value during the year	363	600
Net additions	1,770	2,143
Balance at 31 December	<u>11,853</u>	<u>10,050</u>
Comprising:		
Equity shares	2,782	2,657
Equity investment funds	9,071	7,393
	<u>11,853</u>	<u>10,050</u>

18. Shares in Group undertakings

At 31 December 2012 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	31 December
UBAF Limited	Corporate trustee Dormant	30 September

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 2012	14,757	2,110	16,867	3,838	20,705
Additions during the year	37	158	195	1,195	1,390
Disposals during the year	0	(133)	(133)	(43)	(176)
At 31 December 2012	<u>14,794</u>	<u>2,135</u>	<u>16,929</u>	<u>4,990</u>	<u>21,919</u>
Less: accumulated depreciation					
Balance at 1 January 2012	6,041	1,594	7,635	2,629	10,264
Charge for the year	302	204	506	504	1,010
Disposals during the year	0	(133)	(133)	(30)	(163)
At 31 December 2012	<u>6,343</u>	<u>1,665</u>	<u>8,008</u>	<u>3,103</u>	<u>11,111</u>
Net book value at 31 December 2012	<u>8,451</u>	<u>470</u>	<u>8,921</u>	<u>1,887</u>	<u>10,808</u>
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	<u>14,757</u>	<u>2,110</u>	<u>16,867</u>	<u>3,838</u>	<u>20,705</u>
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	<u>6,041</u>	<u>1,594</u>	<u>7,635</u>	<u>2,629</u>	<u>10,264</u>
Net book value at 31 December 2011	<u>8,716</u>	<u>516</u>	<u>9,232</u>	<u>1,209</u>	<u>10,441</u>

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

There were commitments for capital expenditure of £421,000 (2011: £59,000).

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 2012 was £16,899,000 (2011: £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 £6,536,000 (2011: £6,158,000).

Additions to computer software include £175,000 (2011: £129,000) in respect of internal costs directly associated with the testing and implementation of purchased software applications.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

20. Deferred taxation

	Group and Bank	
	2012	2011
Capital allowances in advance of depreciation	(498)	(534)
Unamortised balance of opening IFRS adjustments	238	388
Other short term temporary differences	275	552
	<u>15</u>	<u>406</u>
Balance at 1 January	406	(93)
Adjustments taken through reserves	(14)	17
(Charge)/credit to income statement	(310)	508
Effect of tax rate changes	(67)	(26)
Balance at 31 December	<u>15</u>	<u>406</u>

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

21. Derivatives

The following were outstanding for the Group and Bank:

	31 December 2012		
	Contract amount	Positive fair values	Negative fair values
Spot and forward foreign exchange contracts held for trading purposes	288,449	525	(248)
Interest rate swaps qualifying as fair value hedges	36,182	0	(1,621)
Interest rate swaps at fair value through the profit and loss account	12,334	98	(98)
Interest rate cap, collar and floor contracts at fair value through the profit and loss account	61,669	1,136	0
Foreign exchange options at fair value through the profit and loss account			
Purchased	87,661	485	0
Sold	87,661	0	(485)
		<u>2,244</u>	<u>(2,452)</u>
	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)
		<u>1,581</u>	<u>(3,225)</u>

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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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	
	2012	2011
Prepaid rental for land	8,447	8,510
Prepayments and accrued income	5,086	4,310
Other debtors	658	672
	<u>14,191</u>	<u>13,492</u>

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. (2011: £160,000 p.a.).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

23. Deposits

Deposits from banks with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £Nil (2011: £3,235,000).

Other deposits with fixed interest rates (other than those with a single interest period less than 1 year) amounted to £31,306,000 (2011: £Nil).

The Group has not had any defaults of principal, interest or other breaches with respect to its liabilities during 2012 (2011: Nil).

24. Other liabilities, accruals and deferred income

	Group and Bank	
	2012	2011
Other liabilities	11,988	4,828
Accruals and deferred income	4,809	4,659
	<u>16,797</u>	<u>9,487</u>

25. Pension fund

Defined benefit scheme

30 (2011: 30) 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 30 June 2011.

The ordinary contributions to the scheme have been made at a rate of 36.6% of pensionable salaries (2011: 36.6%). Contributions paid by the employer in the year ended 31 December 2011 amounted to £3,892,000 being £622,000 by way of ordinary contributions and £3,270,000 by way of deficit reduction contributions (2011: £634,000 by way of ordinary contributions and £3,270,000 by way of deficit reduction contributions and £123,000 by way of augmentations). A further £47,000 (2011: £30,000) was paid by the employees. The Group expects to contribute £593,000 by way of ordinary contributions (together with a further £65,000 from employees) in the year commencing 1 January 2013.

Scheme expenses are met from the assets of the scheme. The contribution rate 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 amount of the estimated expenses has been dealt with separately through the Group's administrative expenses (Note 10).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 2012 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 2012	At 31 December 2011
Rate of increase in salaries	3.60%	3.90%
Rate of increase in pensions in payment	3.10%	3.20%
Discount rate	4.30%	4.80%
Inflation assumption (RPI)	3.10%	3.20%
Mortality assumptions		
- Pre retirement (male/female)	<i>None</i>	<i>None</i>
- Post retirement (male/fe male)	<i>SIPM/FA "Light" Birth Year LC 1%pa minimum improvement</i>	<i>SIPM/FA "Light" Birth Year LC 1%pa minimum improvement</i>
Life expectancy from age 60 for non pensioner members		
now aged 50 (male/female)	30.6/32.0 years	30.5/31.9 years
Life expectancy for pensioner members		
now aged 60 (male/female)	29.5/30.9 years	29.4/30.8 years

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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

	Long-term rate of return expected at 31 December 2012	Value at 31 December 2012	Long-term rate of return expected at 31 December 2011	Value at 31 December 2011
Growth assets	7.00%	18,568	7.70%	15,490
Index linked LDI	3.10%	9,041	3.10%	14,917
Corporate bonds	4.30%	9,958	4.80%	2,018
Purchased annuities	4.30%	22,884	4.80%	21,246
Cash and other assets	3.10%	205	3.10%	351
Weighted average return	4.94%		5.15%	
Total market value of assets		<u>60,656</u>		<u>54,022</u>
Actual return on plan assets		<u>4,393</u>		<u>5,617</u>

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.

The IASB published revisions to IAS19 which will become effective for the Group from 1 January 2013. The Group has not early adopted those revisions. The principal effect for the Group is that the expected return on pension scheme assets should be determined by reference to the discount rate rather than to the long term expected return on those assets. Had these accounts been prepared on this basis, then the expected return on pension scheme assets in 2012 would have been £2,650,000 instead of £2,840,000, and the overall amount included in employee benefit expenses (excluding administration costs charged separately) would have been £721,000 instead of £531,000. The projected expense for 2013 on this revised basis (excluding administration expenses) is expected to be £887,000.

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, with the matching payments to pensioners included in 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).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

	2012	2011
Analysis of defined benefit obligations		
Present value of funded obligations	63,881	56,785
Present value of unfunded obligations	<u>0</u>	<u>0</u>
Present value of defined benefit obligations	63,881	56,785
Fair value of plan assets	<u>(60,656)</u>	<u>(54,022)</u>
	3,225	2,763
Related deferred tax asset	<u>(741)</u>	<u>(690)</u>
Net liability in balance sheet	<u>2,484</u>	<u>2,073</u>
Income statement impact		
Employer's current service cost	669	687
Augmentations of employee benefits	0	123
Expected return on pension scheme assets	(2,840)	(2,755)
Interest on pension scheme liabilities	<u>2,702</u>	<u>2,796</u>
Total included in employee benefits expense	<u>531</u>	<u>851</u>
Change in present value of defined benefit obligations		
Opening defined benefit obligation	56,785	52,833
Employer's current service cost (including augmentations)	669	810
Contributions by employees	47	30
Interest on pension scheme liabilities	2,702	2,796
Actuarial losses on obligations	5,376	2,433
Benefits paid	<u>(1,698)</u>	<u>(2,117)</u>
Present value of scheme liabilities at end of year	<u>63,881</u>	<u>56,785</u>
Change in fair value of plan assets		
Opening fair value of plan assets	54,022	46,464
Expected return on pension scheme assets	2,840	2,755
Actuarial gains on plan assets	1,553	2,862
Contributions by plan employer	3,892	4,028
Contributions by plan employees	47	30
Benefits paid	<u>(1,698)</u>	<u>(2,117)</u>
Fair value of plan assets at end of year	<u>60,656</u>	<u>54,022</u>
Analysis of the amounts to be included in the consolidated statement of comprehensive income		
Net actuarial (loss)/gain recognised in the year	(3,823)	429
Net cumulative actuarial losses	<u>(14,633)</u>	<u>(10,810)</u>

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

History of experience gains and losses:

	2012	2011	2010	2009	2008
Difference between the expected and the actual return on scheme assets	1,553	2,862	726	(1,946)	(5,440)
Percentage of scheme assets	3%	5%	2%	-5%	-13%
Experience (losses)/ gains on scheme liabilities	(820)	782	503	(55)	14
Percentage of the present value of the scheme liabilities	-1%	1%	1%	0%	0%
Total amount recognised in comprehensive income	(3,823)	429	(3,555)	(8,737)	356
Percentage of the present value of the scheme liabilities	-6%	1%	-7%	-19%	1%

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 2012, 105 employees were members of that scheme (2011: 94 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 2012, the Group paid £553,000 (2011: £563,000) by way of contributions into that scheme. There were no outstanding or pre-paid contributions to this scheme at 31 December 2012 (2011: £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	
	2012	2011
Due 29th October 2020	19,422	20,379
Due 29th April 2023	19,421	20,379
Due 29th October 2025	19,421	20,379
	<u>58,264</u>	<u>61,137</u>

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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	
	2012	2011	2012	2011
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
	<u>112,377</u>	<u>112,377</u>	<u>79,453</u>	<u>79,453</u>

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

	Group and Bank	
	2012	2011
Called up share capital	79,453	79,453
Capital redemption reserve	4,104	4,104
Other reserves		
Retained earnings	103,050	95,775
AFS Reserve	3,163	(445)
Cash flow hedging reserve	0	0
	<u>106,213</u>	<u>95,330</u>
	<u>189,770</u>	<u>178,887</u>

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 declared a dividend in respect of the profits for the year ended 31 December 2012 of £7,200,000 (2011: £nil).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 £94,742,000 at 31 December 2012 (2011: £118,143,000).

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 2012 (2011: Nil).

30. Other commitments

	Group and Bank	
	2012	2011
Other commitments comprise:		
Credit lines and other commitments to lend:		
under one year	4,994	5,677
over one year	15,599	5,240
Documentary credits and short-term trade-related transactions	605,843	588,852
Own acceptances	28,646	12,189
	<u>655,082</u>	<u>611,958</u>

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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 policies 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 2012	Loans and receivables	Available for sale	At fair value through profit and loss	Derivatives designated as fair value hedging instruments	Financial assets and liabilities at amortised cost	Total
Assets						
Cash, notes and coin	0	0	0	0	509	509
Debt securities	0	583,233	0	0	0	583,233
Loans and advances to banks	1,200,505	5,142	0	0	0	1,205,647
Loans and advances to customers	326,424	11,717	14,409	0	0	352,550
Equity shares and investments	0	11,853	0	0	0	11,853
Prepayments, accrued income and other debtors	0	0	0	0	14,424	14,424
Derivatives	0	0	2,244	0	0	2,244
Total financial assets	1,526,929	611,945	16,653	0	14,933	2,170,460
Total non-financial assets						10,825
Total assets						2,181,285
Liabilities						
Deposits from banks	0	0	61,669	0	1,196,548	1,258,217
Other deposits	0	0	0	0	653,301	653,301
Other liabilities, accruals and deferred income	0	0	0	0	16,797	16,797
Derivatives	0	0	831	1,621	0	2,452
Subordinated liabilities	0	0	0	0	58,264	58,264
Total financial liabilities	0	0	62,500	1,621	1,924,910	1,989,031
Total non-financial liabilities						192,254
Total equity and liabilities						2,181,285

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

Bank						
31 December 2012	Loans and	Available for	At fair value	Derivatives	Financial	Total
	receivables	sale	through profit	designated as	assets and	
			and loss	fair value	liabilities at	
				hedging	amortised cost	
				instruments		
Assets	0	0	0	0	509	509
Cash, notes and coin	0	583,233	0	0	0	583,233
Debt securities	1,200,505	5,142	0	0	0	1,205,647
Loans and advances to banks	326,424	11,717	14,409	0	0	352,550
Loans and advances to customers	0	11,853	0	0	0	11,853
Equity shares and investments	0	0	0	0	14,424	14,424
Prepayments, accrued income and other debtors	0	0	2,244	0	0	2,244
Derivatives	1,526,929	611,945	16,653	0	14,933	2,170,460
Total financial assets						10,826
Total non-financial assets						2,181,286
Total assets						
Liabilities						
Deposits from banks	0	0	61,669	0	1,196,548	1,258,217
Other deposits	0	0	0	0	653,302	653,302
Other liabilities, accruals and deferred income	0	0	0	0	16,797	16,797
Derivatives	0	0	831	1,621	0	2,452
Subordinated liabilities	0	0	0	0	58,264	58,264
Total financial liabilities	0	0	62,500	1,621	1,924,911	1,989,032
Total non-financial liabilities						192,254
Total equity and liabilities						2,181,286

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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

Of the total £16,653,000 (2011: £8,156,000) assets at fair value through the profit and loss account, £1,108,000 (2011: £926,000) represents financial assets and derivatives held for trading purposes, and £15,545,000 (2011: £7,230,000) financial assets designated as such at inception. Of the total £62,500,000 (2011: £37,046,000) liabilities at fair value through the profit and loss account, £831,000 (2011: £1,455,000) represents financial liabilities and derivatives held for trading purposes, and £61,669,000 (2011: £35,591,000) financial liabilities designated as such at inception.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

32. Foreign currency assets / liabilities

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

Group 31 December 2012	Sterling	Dollars	Euro	Other currencies	Total
Total assets	416,126	1,197,608	527,967	39,584	2,181,285
Total equity and liabilities	(409,972)	(1,316,195)	(401,235)	(53,883)	(2,181,285)
Derivatives (at contract value)	(6,193)	118,319	(126,785)	14,659	0
Net exposures	(39)	(268)	(53)	360	
Contingent liabilities and other commitments	34,286	332,344	341,607	41,586	749,823
Group 31 December 2011	Sterling	Dollars	Euro	Other currencies	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
Bank 31 December 2012	Sterling	Dollars	Euro	Other currencies	Total
Total assets	416,127	1,197,608	527,967	39,584	2,181,286
Total equity and liabilities	(409,973)	(1,316,195)	(401,235)	(53,883)	(2,181,286)
Derivatives (at contract value)	(6,193)	118,319	(126,785)	14,659	0
Net exposures	(39)	(268)	(53)	360	
Contingent liabilities and other commitments	34,286	332,344	341,607	41,586	749,823
Bank 31 December 2011	Sterling	Dollars	Euro	Other currencies	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

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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.
- **Commercial term 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.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

Group 2012	Trade Finance	Banking Services	Commercial term lending	Treasury	Other	Total
Net interest income	525	1,252	7,528	6,499	(1,890)	13,914
Net fee and commission income	15,642	1,159	(8)	(205)	(197)	16,391
Net trading income	0	0	0	6,598	0	6,598
Other operating income	0	0	0	0	632	632
Total Operating income	16,167	2,411	7,520	12,892	(1,455)	37,535
Directly attributable segment expenses	(4,195)	(1,616)	(1,279)	(1,537)	0	(8,627)
Net charge for impairment losses	245	0	(3,604)	0	0	(3,359)
Net segment profit / (loss)	12,217	795	2,637	11,355	(1,455)	25,549
Common costs not attributable to segments						(11,994)
Profit before income tax						13,555
BALANCE SHEET						
Segment assets	51,923	14,856	532,782	1,544,623	37,101	2,181,285
Segment liabilities	0	602,397	0	1,311,573	267,315	2,181,285
Contingent liabilities and other commitments	729,231	0	20,593	0	0	749,824

Group 2011	Trade Finance	Banking Services	Commercial term 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

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

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	2012	2011
United Kingdom	6,286	7,758
Other European Union	1,344	1,168
Libya	8,862	7,760
Other Middle East and Africa	19,533	20,949
Other	1,510	1,621
	<u>37,535</u>	<u>39,256</u>

35. Related parties

- a) The Group regards the following as being related parties in accordance with IAS24:
- The Group regards Libyan Foreign Bank as its parent company. 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, are considered to be related parties. The Group considers these parties to be in a position to exert significant influence over the Group. The Group enters into commercial transactions in the ordinary course of business with these parties on an arm's-length basis.
 - Key management personnel, including the Group's directors, and identified Executive Managers.

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

b) Transactions with related parties were as follows:

	Significant influence	Nature of related party	
		Subsidiary company	Key management personnel
Balances at 31 December 2012			
Loans and advances	0	0	8 *
Deposits	1,030,118	0	0
Subordinated liabilities	58,581	0	0
Contingent liabilities and other commitments	132,134	0	0
Volumes executed during 2012			
Loans and advances	116,043	0	10
Deposits	93,707,550	0	0
Derivatives (contract amount)	6,407,065	0	0
Contingent liabilities and other commitments	246,388	0	0
Included in income statement			
Interest receivable	62	0	0
Interest payable	14,198	0	0
Fees and commissions receivable	3,975	0	0
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

* At 31 December 2012 £8,000 was outstanding by way of interest free loans due from three Executive Managers of the Group, and no amount was outstanding from any director. (At 31 December 2011 £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).

British Arab Commercial Bank plc

and its subsidiary companies

All amounts in £'000s unless otherwise stated

NOTES TO THE FINANCIAL STATEMENTS (continued)

For the year ended 31 December 2012

- c) In addition, the Group has entered into the following further related party transactions:
- i. The Group meets the employment costs of executives seconded to it by related parties. The costs of these secondments were £381,000 (2011:£ 714,000).
 - ii. Key management personnel compensation:

	2012	<i>2011</i>
Directors attendance and standing fees	333	305
Executive Managers		
Salaries and other short term benefits	1,548	1,867
Post-employment benefits	146	279
	<u>2,027</u>	<u>2,451</u>

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British Arab Commercial Bank plc
Incorporated in England with limited liability
Registered in England Number 1047302

