Company Registration No. 2643004

Turkish Bank (UK) Limited

Report and financial statements 2008

Contents

Page

Turkish Bank (UK) Limited

Report and Financial Statements

31 December 2008

Turkish Bank (UK) Limited

Report and financial statements 2008

Chairman's statement

I am pleased to be able to report that the Bank has had a reasonably good year given the turmoil seen in the financial markets and the consequent downturn in the World Economy. Much of this relative success can be put down to the conservative approach to lending and business development which has long been the hallmark of the members of the Turkish Bank Group. We are not complacent however and have adjusted our lending criteria to take into account the decline in the commercial and residential property markets in the United Kingdom in particular. This is not to say that the Bank has ceased to lend money, far from it, but we are doing so within the very prudent guidelines set by the Board. We continue to be vigilant in monitoring the market conditions in the United Kingdom as well as further afield and in Turkey especially.

The Bank continues to seek ways of improving its ability to serve its chosen clientele and as an indication of this I can confirm that the Bank will this year open in Lewisham, South London, its sixth branch in the UK.

Turkey's economic outlook continues to mirror the global decline in economic activity. The Turkish banking industry has avoided most if not all of the pitfalls which have entrapped many US, UK and other European banks. Nevertheless pressures are being seen in the financial markets with the cost of lending, particularly in foreign currencies, having a depressing effect on growth. Inflation stands at or near 10% but is expected to decline rapidly to 7.5% per annum before the end of 2009. In order to try to stimulate growth the Central Bank of Turkey has reduced its policy interest rate to a historic low of 11.5% recently and further reductions are anticipated. The domestic and trade deficits, the latter eased somewhat by the reduction in the price of oil, remain concerns however as, indeed, does the failure of the Government to tackle effectively the cost of Social Security in the country. At the same time the Government continues to sustain the positive view of Turkey by the international community and capital flows remain positive. The status of Northern Cyprus (TRNC) remains an outstanding issue but recent contacts between the two leaders of the communities provide some encouragement to the hope that a solution will be found.

The banking sector in the UK continues to experience traumatic times with the whole or part nationalisation of a number of banks. All of this has been well documented as indeed has the number of efforts made by the UK Government to free up the sector and stimulate lending. These efforts are further augmented by other UK Government led initiatives which seek to reduce the effects of a significant downturn in the UK economy. It appears that the current recession, led by the decline in the housing and commercial property markets and accentuated by the loss of consumer confidence in part generated by the crisis in the banking sector, is likely to last well into 2010 despite all the measures taken by the Authorities.

One such measure is the unprecedented reduction in UK interest rates during the final quarter of 2008 and into 2009. This in itself has proved a challenge to the Bank as there is a real necessity to balance equitably the need to reduce lending rates against the essential requirement to maintain customer deposits. I believe the Bank has achieved this difficult balancing act successfully, not least because it has grown both its customer deposits and lending through the year. However management remain aware of the need to monitor the interest rate climate constantly and carefully.

The Bank recorded a net profit after tax for the year of £387,000 showing an increase year-on-year of some 16%. Despite the adverse impact on net interest income caused by the reduction in Base Rate during 2008 which reduced the interest earning capacity of the Bank's free capital, the year-end figure showed a modest increase to £2.4m reflecting the over 34% increase in lending to customers which has been achieved while maintaining conservative lending criteria. Indeed the Bank has benefited by the lack of lending capability of many of its competitors, a situation we recognise will not last forever. Fee income showed a fall of 4.3% which is accounted for largely by the continuing decline in "workers remittances". This has not only occurred through fierce competition for the business but equally the economic downturn appears to have reduced to some extent the availability of funds for remittance. Nevertheless the Bank has responded to the competition by introducing and promoting a number of products not least of which is the Turkish Lira transfer and this has helped reduce the impact on the Bank's fee income levels. The Bank introduced during the year its Internet Banking product and looks to further enhance its functionality during the present year.

Two particular events took place during the year which I must address as they have affected the balance sheet. Firstly the placement by Group members of deposits with the Bank had to be reduced significantly due to the introduction of new regulations in Turkey and the TRNC, which restrict the amount of deposits banks can place with other financial institutions including subsidiaries. Largely as a consequence of this the Bank's footings have been reduced from £138m to £116m. Nevertheless the Bank retains the full support of Group members.

Chairman's statement (continued)

The second event relates to the significant decline in the market value of bonds held in the Bank's own investment portfolio. The Bank is to continue to classify these investments as Available-for-Sale where all such investments are fair valued and fair value gains and losses are taken to the Available-for-Sale reserve in equity. This has resulted in a write-down of some £2.2m and a consequent 5% reduction in the level of "Own Funds" year on year.

The Board, aware of the general decline in property values in London, sought a professional valuation towards the end of 2008 of the properties we own, and although this showed some reduction in the value of individual properties, the portfolio as a whole maintained most of its value following the purchase earlier in the year of the flat above our Palmers Green branch. The Board therefore considers it unnecessary to make any adjustment at this time to the values shown in the balance sheet.

Looking forward the Bank is well placed to continue its steady growth both in its branch network, product offerings and balance sheet. The Bank will benefit this year from the fact that the significant investment of over £1m in the Temenos banking system made in 2004 has been fully depreciated over the five years to 2008. However other investments are now required such as the further upgrading of our banking system and the need to introduce other products important to our clients such as a debit card the cost of which will offset much of this advantage. We continue to invest wisely for the future.

The Directors have again decided not to declare a dividend thus adding the net profit of £387,000 to reserves. Capital and Reserves stood at £19m at the year-end.

Finally a very warm thank you to the staff who have worked hard during 2008, sometimes in difficult circumstances, to take the Bank forward to meet successfully the challenges of what might prove to be one of the most difficult years economically for the UK in particular and the world in general since the Second World War.

M T Ozyol

Chairman

Turkish Bank (UK) Limited

Report and financial statements 2008

Officers and professional advisers

Directors

M T Ozyol (Chairman)
I H Bortecene
M D Bendon
R W Long
M E Erenman
J Clouting

Secretaries

K. Bissell

Registered office

84-86 Borough High Street
London SE1 1LN

Bankers

HSBC Bank plc
27-32 Poultry
London EC2P 2BX

Auditors

Deloitte LLP
Chartered Accountants
London

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2008.

Activity Report

The principal activities of Turkish Bank (UK) Limited ("TBUK") are twofold namely:

- to provide a superior community banking service to the Turkish speaking peoples of North London particularly and the UK in general; and
- meet the UK banking needs of Corporate clients and high net worth individuals who are customers of our parent or sister organisations within the Turkish Bank Group.

TBUK is a wholly owned subsidiary of Turkish Bank Limited and a member of the Turkish Bank Group headquartered in Istanbul. The Chairman of the Group also performs the role of Chairman of TBUK and the Group's Chief Executive sits on the Board of TBUK. TBUK operates within and is guided by the overall strategic objectives of the Group. These focus on the aim to provide a quality customer service at a competitive price to our clients and to provide a reasonable return on capital to our shareholder. More information regarding Group activities can be obtained by accessing the Group's web site at www.turkishbankgroup.com.

Review of the Year

The development of the Bank into a retail operation meeting the needs of the Turkish speaking community of the UK has continued successfully during the year despite the turmoil in the financial services industry. The conservative policies recommended by the Board to the management have been observed and hence many of the difficulties experienced by other institutions have been avoided.

As a result profit after tax has increased from £334,000 to £387,000 a near 16% increase year-on-year. Over the same period the balance sheet has reduced by 16% from £138m to £116m reflecting in large part a change in regulatory requirements in Turkey and North Cyprus which have restricted the amount of deposits which other Group members can place with us. As a consequence Group deposits fell by 38% to £11.2m at the end of the year.

Lending by the Retail bank to our chosen prime market sector, small and medium sized local enterprises, rose 21.7% from £23.5m to £28.5m. Overall deposits also rose through the achievements of the Wholesale and Markets Division although domestic deposits fell slightly as a result of a management decision to be less aggressive in setting interest rates above the market average. In this respect the significant reductions in the Bank of England Base Rate during the final quarter of the year and ongoing have themselves presented a challenge in that management must weigh up equitably the counter claims of reducing lending rates against the need to give depositors a fair return. With the kind co-operation of our customers we believe we have to date achieved this balance.

We continue to seek to improve the product offerings and service quality to our customers. This year we launched our Internet Banking product which is proving to be well received by our customers and we will increase the range of services covered by this product during the current year. In addition we are upgrading our banking system to help improve service quality by installing the latest version of Temenos Globus T24 to which we converted originally in 2005. We will also work towards providing our customers with a debit card. In addition, we will further our capability to reach our chosen market sectors by expanding our branch network through opening a branch in Lewisham, South London and continue to consider locations for future branch locations.

Principal risks and uncertainties

The Bank's activities expose it to a number of financial risks including credit risk, cash flow risk and liquidity and funding risk. The use of financial derivatives is governed by the Bank's policies approved by the board of directors, which are based on written principles on the use of financial derivatives to manage these risks. The Bank does not use derivative financial instruments for trading purposes.

Cash flow risk: The Bank's activity exposes it primarily to the financial risk of changes to the interest rate environment and to a lesser extent to foreign currency exchange rate movement. With regard to interest rate risk the Bank has a consolidated net interest margin sufficient to protect its position in this respect. The Bank also enters into some currency swap contracts to hedge its foreign currency exposures.

Credit risk: The Bank has no significant concentration of credit risk. Regular stress testing of the Bank's collateral security is carried out and the Directors are satisfied with the levels of equity where lending is against freehold and long dated leasehold property which is itself restricted to the UK market.

Directors' report (continued)

Liquidity and funding risk: In order to maintain liquidity and funding to ensure that sufficient funds are available for ongoing operations and future developments, the Bank uses a mixture of medium term and short-term money market as well as fixed and notice customer deposits. The directors believe that the Bank has a strong liquidity and funding position that meets with their Policy guidelines.

The Bank operates a risk management policy and uses financial instruments based on the operations it undertakes and this risk management policy, which includes a description of how financial instruments are used, is disclosed in note 27 to the accounts.

Results and dividends
The profit for the year after taxation amounted to £387,000 (2007 - £334,000).

The directors do not recommend the payment of a dividend (2007 - £nil).

Future developments
The directors aim to maintain the management policies that have resulted in the Bank’s growth.

Political and charitable contributions

During the year, the Bank made various charitable contributions totalling £200 (2007 - £250).

Directors and their interests

The directors who served during the year were as follows:

M T Ozyol (Chairman)
I H Bortecene
M D Bendon *
R W Long
M E Erenman
J Clouting *
* members of audit committee

The interests of the directors at 31 December 2008 in the share capital of the Bank were as follows:

	Ordinary shares of £1 each	
	2008	**2007**
M T Ozyol	1	1

M T Ozyol owns this share as a nominee.

Audit committee

The Bank has an audit committee comprising two independent non-executive directors who are experienced bankers. The committee met on four occasions in 2008 (2007: three times).

Disclosure of information to auditors

Each of the directors of the company holding office at the date of approval of this report confirm that:

(1) so far as each of the directors are aware, there is no relevant audit information of which the Bank's auditors are unaware; and

(2) so far as each of the directors are aware they have taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Bank's auditor's are aware of that information.

This confirmation is given and shall be interpreted in accordance with the provisions of S.234ZA of the Companies Act 1985.

Directors' report (continued)

Auditors

In accordance with Section 386 of the Companies Act 1985, the Bank has elected to dispense with the obligation to appoint auditors annually. Accordingly, Deloitte LLP are therefore deemed to have been re-appointed as auditors of the company.

Approved by the Board of Directors and signed on behalf of the Board

Secretary

K. Bissell

6 March 2009

Statement of directors’ responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year and have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standard and applicable laws). The financial statements are required by law to give a true and fair view of the state of affairs of the Bank and of the profit or loss of the Bank for that period.

In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable Accounting Standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Bank and to enable them to ensure that the annual report and financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report to the members of Turkish Bank (UK) Limited

We have audited the financial statements of Turkish Bank (UK) Limited for the year ended 31 December 2008 which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes 1 to 28. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Bank’s members, as a body, in accordance with section 235 of the Companies Act 1985. 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 Bank and the Bank’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

The directors' responsibilities for preparing the Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report and the Chairman's Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Bank’s affairs as at 31 December 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Deloitte LLP
Chartered Accountants and Registered Auditors
London

6 March 2009

Profit and loss account
For the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Interest receivable:			
Interest receivable and similar income arising from debt securities		524	711
Other interest receivable and similar income		6,528	7,388
		7,052	8,099
Interest payable		(4,650)	(5,763)
Net interest income		2,402	2,336
Fees and commissions receivable		1,255	1,301
Fees and commissions payable		(22)	(20)
Dealing profits		153	93
Other operating income		10	8
		1,396	1,382
Total operating income		3,798	3,718
Administrative expenses	2	(2,692)	(2,711)
Depreciation and amortisation	10, 11	(480)	(428)
Other operating charges		(5)	(8)
Impairment losses on financial assets	3	(19)	(18)
		(3,196)	(3,165)
Profit on ordinary activities before taxation	4	602	553
Tax on profit on ordinary activities	5	(215)	(219)
Profit on ordinary activities after taxation	17	387	334

The notes on pages 14 to 38 form an integral part of these financial statements.

All activities relate to continuing operations.

Turkish Bank (UK) Limited

Balance sheet
31 December 2008

	Notes	2008 £'000	2007 £'000
Assets			
Cash and balances at central banks		390	301
Loans and advances to banks	6	42,223	78,901
Items in the course of collection		18	9
Loans and advances to customers	7	58,474	43,406
Debt securities-available for sale	9	7,111	8,495
Intangible fixed assets	10	74	227
Tangible fixed assets	11	7,334	6,899
Other assets	12	522	32
Prepayments and accrued income		248	256
Total assets		116,394	138,526
Liabilities			
Deposits by banks	13	13,330	40,112
Items in the course of transmission to other banks		141	15
Customer accounts	14	83,330	77,715
Derivative liabilities	28	155	-
Other liabilities	15	255	290
Accruals and deferred income		176	156
		97,387	118,288
Equity			
Called up share capital	16	10,000	10,000
Profit and loss account	17	8,085	7,053
Available for sale reserve	17	(2,681)	(418)
Revaluation reserve	17	3,603	3,603
Total equity		19,007	20,238
Total liabilities and equity		116,394	138,526
Contingent liabilities			
Guarantees and assets pledged as collateral security		238	175
Other contingent liabilities	18	42	64
		280	239
Commitments	19	52,668	44,652

The Board of Directors approved these financial statements on 6 March 2009.

Signed on behalf of the Board of Directors

M T Özyol
Director

M D Bendon
Director

The notes on pages 14 to 38 form an integral part of these financial statements.

Cash flow statement
For the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Net cash (outflow)/ inflow from operating activities	21	(14,802)	1,299
Taxation			
UK corporation tax paid		(80)	(112)
Capital expenditure and financial investment			
Net purchase of tangible and intangible fixed assets		(762)	(227)
Disposal of tangible fixed asset		-	-
Cash proceed on maturity of available for sale assets		1,512	3,073
		750	2,734
Increase in cash and cash equivalents	22	(14,132)	4,033

Statement of total recognised gains and losses
For the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Profit for the financial year		387	334
Unrealised gain on revaluation of freehold properties	17	-	1,069
Available-for-sale losses	17	(2,263)	(424)
Tax effect of available for sale losses	17	645	127
Total recognised gains for the year		(1,231)	1,106
Total gains and losses recognised since last annual report and financial statements		(1,231)	1,106

1 Accounting policies

(a) Basis of preparation

The financial statements have been prepared in accordance with applicable UK Accounting Standards and Statements of Recommended Practice issued by the British Bankers' Association and in accordance with the special provisions of Part VII Ch. 2 of the Companies Act 1985 applicable to banking groups and banking companies. The financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial instruments and freehold properties.

The policies have been consistently applied in the current and preceding year.

The Bank's business activities, together with the factors likely to affect its future development, performance and position together with its cash flows, liquidity position and borrowing facilities are described in the Director Report. In addition note 27 and 28 to the financial statements includes the Bank's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Bank has considerable financial resources and viable business. As a consequence, the directors believe that the Bank is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the directors have a reasonable expectation that the company and the Bank has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

(b) Revenue recognition

(i) Interest income

Interest income on financial assets classified as loans and receivables or available for sale is calculated using the effective interest rate method, which is the rate that discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

(ii) Rendering of services and commissions

Fees that are an integral part of generating an involvement with a resulting financial instrument together with the related direct costs, are deferred and recognised as part of the effective interest rate.

If it is probable that a specific lending arrangement will be entered into, the commitment fee received and, together with the related direct costs, is deferred and recognised as part of the effective interest rate. If the commitment expires without making the loan, the fee is recognised as revenue on expiry. If it is unlikely that a specific lending arrangement will be entered into, the commitment fee is recognised as revenue on a time proportion basis over the commitment period.

Fees earned for banking services provided are recognised as revenue as the services are provided.

(c) Impairment of financial assets

If there is objective evidence that an impairment loss on financial assets 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 (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss is recognised in the profit or loss account.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit or loss account.

1. Accounting policies (continued)

(d) Loans and receivables

Loans and receivables are measured at initial recognition at fair value and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in the profit and loss account in line with the accounting policy set out in 1 (c) above.

The effective interest rate method is a method of calculating the amortized cost of a financial asset and of allocating interest income over a relevant period. The effective interest rate is the rate that exactly discount estimated future cash receipts thought the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognized on an effective interest basis for debt instruments other than those financials assets.

(e) Debt securities

Investments in debt securities are classified as available-for-sale, and are measured at subsequent reporting dates at fair value. For available-for-sale investments, gains and losses arising from changes in fair value are recognised directly in equity until the security is disposed off or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the profit or loss for the period. Foreign exchange gains and losses, interest recognised under the effective interest rate method and impairment losses are taken to the profit and loss account. Impairment losses recognised in profit or loss for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

(f) Pension schemes

Contributions to a defined contribution scheme are charged to the profit and loss account so as to reflect the amounts payable to the pension schemes in respect of the accounting period.

(g) Foreign currency translation

Transactions in foreign currencies are recorded at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the mid-day rates of exchange ruling on the balance sheet date. All differences arising are taken to the profit and loss account.

(h) Derivatives

Derivative contracts consist of foreign currency swap contracts, which are outstanding at the balance sheet date. Derivatives are measured at fair value, with changes in the fair value recognised are marked to market to the profit and loss account. The Bank's activities expose it primarily to the financial risks of changes in foreign exchange rates and interest rates.

The Bank uses derivative financial instruments (primarily foreign currency swaps) to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and forecasted transactions. The Bank does not use derivative financial instruments for speculative purposes. The Bank has not designated any of the its derivative contracts in hedging relationships for hedge accounting purposes.

(i) Depreciation

Depreciation is provided on all tangible fixed assets, except freehold land, at rates calculated to write off the cost, less estimated residual value, of each asset evenly over its expected useful life, as follows:

Freehold buildings	Over 50 years
Short leasehold land and buildings	Over the lease term
Fixtures, fittings and equipment	5% to 20%
Assets under finance lease	20%
Motor Vehicle	20%

(j) Current and deferred taxation

Current tax including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

1. Accounting policies (continued)

Current and deferred taxation (continued)

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included within the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

(k) Leasing and hire purchase commitments

Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset have passed to the Company, and hire purchase contracts are capitalised in the balance sheet and are depreciated over the shorter of the lease term and their useful lives. The capital elements of future obligations under the leases and hire purchase contracts are included as liabilities in the balance sheet, while the interest elements are charged to the profit and loss account over the period of the lease to produce a constant rate of charge on the balance of capital repayments outstanding.

Rentals under operating leases are charged to the profit and loss account on a straight-line basis over the term of the lease.

(l) Intangible assets – Software licences

Software licences are included at cost and amortised in equal annual instalments over a period of five years which is their estimated useful economic life. Provision is made for any impairment loss.

(m) Property revaluations

The accounting policy for freehold land and buildings is to revalue them annually. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date. There have been no material movements in the valuation of these freeholds in 2008. The last professional valuation was undertaken by Ringley, a chartered surveyor external to the Bank, in December 2008. Valuations were made on the basis of open market value for existing use.

(n) Financial liabilities

All financial liabilities are measured at amortised cost using the effective interest rate method.

(o) Segment Analysis

Due to the nature of the business, the directors believe that it will be seriously prejudicial to the interests of the Bank to disclose Segmental Information.

2 Administrative expenses

	2008 £'000	2007 £'000
Staff costs during the year (including directors)		
Wages and salaries	1,486	1,561
Social security costs	151	187
Pension costs	47	20
	1,684	1,768
Other administrative expenses	1,008	943
	2,692	2,711

The average monthly number of employees during the year was made up as follows:

	2008 No.	2007 No.

Commercial banking activities	64	63

2. Administrative expenses (continued)

Directors' remuneration during the year consisted of:

	2008 £'000	2007 £'000
Emoluments	142	184

The emoluments of the highest paid director for the year ended 31 December 2008 were £100,000 (2007 - £100,000).

The company operates a stakeholder pension arrangement, whereby the staff contribute, and the company makes a contribution with reference to current National Insurance rates.

3 Impairment losses on financial assets

	2008 £'000	2007 £'000
Impairment charge for the year	(23)	(19)
Recoveries	4	1
Net impairment charge for the year	(19)	(18)

During the year the Bank received £ Nil (2007 - £ nil) in respect of loans which were previously written off in prior years which is included in other operating income.

4 Profit on ordinary activities before taxation

Profit is stated after charging/(crediting):

	2008 £'000	2007 £'000
Foreign currency gains	(153)	(93)
Operating lease rentals		
Land and buildings	61	56
Depreciation and amortisation		
Tangible fixed assets	285	237
Intangible fixed assets	195	191
Fees payable to the company's auditors for the audit of the company's annual accounts	53	51
Total audit fees	53	51
Other services pursuant to legislation		
Tax services	13	14
Advisory fees	-	2
Total non-audit fees	13	16

Notes to the accounts
For the year ended 31 December 2008

5 Tax on profit on ordinary activities

	2008 £'000	2007 £'000
Current tax		
United Kingdom corporation tax at 28.5% (2007 - 30%) based on profit for the year	218	195
Adjustment in respect of prior years	(3)	15
Total current tax	215	210
Deferred tax (Note 15)		
Reversal of timing differences	-	9
	215	219

	2008 £'000	2007 £'000
Profit on ordinary activities before tax	602	553
Tax at 28.5% (2007: 30%) thereon	172	166
Effects of:		
Expenses not deductible for tax purposes	48	37
Capital allowances in excess of depreciation	(7)	(14)
Movement in short term timing differences	5	5
Marginal Relief	-	1
Prior year adjustments	(3)	15
	215	210

6 Loans and advances to banks

	2008 £'000	2007 £'000
Loans and advances to banks are repayable as follows:		
On demand	23,750	37,971
Within three months	18,312	36,431
Between three months and one year	161	4,499
	42,223	78,901

Included within loans and advances to banks are amounts of £0.28m in respect of group companies (2007 - £1.55m).

The interest received from group companies during the year is £108,961 (2007 - £197,090).

6. Loans and advances to banks (continued)

Geographical analysis of loans and advances to banks is as follows:

	2008 £'000	2007 £'000
In UK:		
On current account	1,851	1,789
On deposit account in money market lending	31,970	68,058
Outside UK:		
On current account	1,938	219
On deposit account		
- Money Market Lending	6,303	4,336
- Syndication Loan/Prom Notes	161	4,499
	42,223	78,901

7 Loans and advances to customers

	2008 £'000	2007 £'000
Loans are repayable as follows:		
On demand	8,592	5,957
Within three months	5,553	2,248
Between three months and one year	8,974	2,488
Between one and five years	9,484	10,708
After five years	25,907	22,031
Provision for impairment losses	(36)	(26)
	58,474	43,406

Non-performing loans and advances to customers of £36,000 were fully provided at 31 December 2008 (2007 - £26,000).

Loans and advances to customer includes £33,767 (2007: 26,000) which has been placed in the problem loan category other than those fully provided.

The following information is given in respect of the nature and type of loans and advances to customers:

	2008				
	Fixed Rate Loan £'000		Floating Rate Loan £'000		Total £'000
	Secured	Unsecured	Secured	Unsecured	
Overdraft	-	-	5,166	270	5,436
Fixed term					
- Retail	-	-	20,195	281	20,476
- Corporation	19,981	7,636	4,974	7	32,598
	19,981	7,636	30,335	558	58,510
Provision	-	-	-	(36)	(36)
	19,981	7,636	30,335	522	58,474

7. Loans and advances to customers (continued)

	2007				
	Fixed Rate Loan £'000		**Floating Rate Loan £'000**		**Total £'000**
	Secured	Unsecured	Secured	Unsecured	
Overdraft	-	-	4,268	136	4,404
Fixed term					
- Retail	-	-	17,738	179	17,917
- Corporation	3,001	14,987	3,118	5	21,111
	3,001	14,987	25,124	320	43,432
Provision	-	-	-	(26)	(26)
	3,001	14,987	25,124	294	43,406

The following information is given in respect of origin and currency of loans and advances.

	2008 £'000				**2007 £'000**			
	GBP	**USD**	**EURO**	**Total**	**GBP**	**USD**	**EURO**	**Total**
UK	28,494	-	-	28,494	23,475	-	-	23,475
Non UK								
- Turkey	3,302	20,859	4,047	28,208	1,871	13,897	1,439	17,207
- Others	677	1,095	-	1,772	810	1,914	-	2,724
Total	32,473	21,954	4,047	58,474	26,156	15,811	1,439	43,406

8 Provisions for impairment losses

	2008	**2007**
	£'000	£'000
As at 1 January 2008	26	13
Charge against profits	23	19
Less: recoveries	(4)	(1)
Net impairment charge for the year	45	31
Less: loans written off	(9)	(5)
At 31 December 2008	36	26
Loans and advances to customers (note 7)	36	26
	36	26

Accounts overdrawn for more then 60 days are reported monthly to a subcommittee of the Credit Committee. Provision is made on the advice of Credit Committee if an exposure is deemed to be at risk of non-recovery. All the provisions are approved by the Board of Directors.

9 Debt securities – available for sale

	2008 £'000	2007 £'000
Nominal Value	9,549	8,715
Accrued interest	243	198
Available-for-sale revaluation	(2,681)	(418)
Market value	7,111	8,495

Investment in debt securities will mature as follows:

	2008 £'000	2007 £'000
Repayable:		
Less than 1 year	-	1,515
Between one and five years	3,980	3,060
After five years	3,131	3,920
	7,111	8,495

Segmental analysis of investment in debt securities is as follows:

	2008			2007		
	Fixed rate bonds £'000	Floating rate bonds £'000	Total £'000	Fixed rate bonds £'000	Floating rate bonds £'000	Total £'000
Sovereign bonds	3,186	2,018	5,204	4,156	2,060	6,216
Corporate bonds	1,907	-	1,907	2,279	-	2,279
	5,093	2,018	7,111	6,435	2,060	8,495

The debt securities comprise of government and corporate bonds and are held as available for sale securities. The weighted average coupon rate of debt securities repayable after five years is 6.22% (2007 - 6.46%).

The Bank does not have any intention to purchase securities below Investment Grade with maturity more than 10 years.

Securities held as collateral against the lending to banks as at 31 December 2008 amounted to £nil (2007: £1.04 million).

The above balance includes debt securities of £nil which are due to mature in less than one year period. (2007: £1.5 million).

9. Debt securities - available for sale (continued)

Analysis by currency of origin is as follows:

	2008				2007			
Origin of debt securities	**GBP**	**USD**	**EURO**	**Total**	**GBP**	**USD**	**EURO**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
UK	484	-	-	484	1,524	-	-	1,524
Turkey	-	-	4,567	4,567	-	-	3,710	3,710
Brazil	-	-	-	-	-	499	-	499
Kazakhstan	-	1,423	-	1,423	-	1,771	-	1,771
Ukraine	-	637	-	637	-	991	-	991
Turkey	484	2,060	4,567	7,111	1,524	3,261	3,710	8,495

10 Intangible fixed assets

	Licences £'000
Cost	
At 1 January 2008	978
Additions	42
At 31 December 2008	1,020
Amortisation	
At 1 January 2008	751
Charge for the year	195
At 31 December 2008	946
Net book value	
At 31 December 2008	74
At 31 December 2007	227

The intangible fixed assets comprise of software licences purchased and are being amortised over five years.

11. Tangible fixed assets

	Freehold land and buildings £'000	Land and buildings, short leasehold £'000	Lease Equipment £'000	Fixtures, fittings and equipment £'000	Total £'000
Cost/Revaluation					
At 1 January 2008	6,808	579	-	1,630	9,017
Additions	341	4	28	347	720
Disposals				(168)	(168)
At 31 December 2008	7,149	583	28	1,809	9,569
Depreciation					
At 1 January 2008	729	304	-	1,085	2,118
Charge for the year	111	41	-	133	285
Disposals	-	-	-	(168)	(168)
At 31 December 2008	840	345	-	1,050	2,235
Net book value					
At 31 December 2008	6,309	238	28	759	7,334
At 31 December 2007	6,079	275	-	545	6,899

The land and buildings are occupied by the Bank for its own activities.

12. Other assets

	2008 £'000	2007 £'000
Corporate tax	178	22
Deferred tax	298	-
Other assets	46	10
	522	32

13. Deposits by banks

	2008 £'000	2007 £'000
Deposits by banks are repayable as follows:		
On demand		
- Group	7,576	8,703
- Other	1,698	3,540
Within three months		
- Group	4,056	10,048
- Other	-	17,821
	13,330	40,112

The interest paid amount to group companies during the year is £836,599 (2007: £1,096,821).

13. Deposits by banks (continued)

Geographical analysis of deposit by banks is follows:

	2008 £'000	2007 £'000
In UK:		
On current account	36	40
On deposit account	-	13,062
Outside UK:		
On current account	2,845	2,767
On deposit account	10,449	24,243
	13,330	40,112

14. Customer accounts

	2008 £'000	2007 £'000
Customer deposits are repayable as follows:		
On demand	10,556	10,559
Within three months	49,645	54,456
Between three months and one year	23,129	11,929
Between one year and five years	-	771
	83,330	77,715

The balance includes customers' deposits of £83.3 million (2007: £76.9 million) which is due to mature in less than one year period.

The following information is given in respect of the nature and type of customer deposits:

	2008 £'000			2007 £'000		
	Fixed rate interest	Floating rate interest	Total	Fixed rate interest	Floating rate interest	Total
Current account	-	5,690	5,690	-	4,990	4,990
Deposit account	-	17,310	17,310	-	22,516	22,516
Fixed deposit	60,330	-	60,330	50,209	-	50,209
	60,330	23,000	83,330	50,209	27,506	77,715

The following information is given in respect of currency and origin of customer deposits:

	2008 £'000						2007 £'000					
	GBP '000'	USD '000'	EUR '000'	TRY '000'	Others '000'	Totals '000'	GBP '000'	USD '000'	EUR '000'	TRY '000'	Others '000'	Totals '000'
UK	19,408	393	58	558	-	20,417	24,005	496	232	410	1	25,144
Turkey	9,397	12,933	5,241	220	1	27,792	7,369	10,056	2,861	147	1	20,434
Cyprus	23,713	3,898	5,700	171	122	33,604	22,238	4,561	3,609	734	-	31,142
Others	258	284	677	298	-	1,517	247	133	366	249	-	995
Total	52,776	17,508	11,676	1,247	123	83,330	53,859	15,246	7,068	1,540	2	77,715

15. Other liabilities

	2008 £'000	2007 £'000
Amounts owed to group companies	64	49
Other taxes and social security costs	35	39
Deferred tax liability	-	60
Obligation under finance lease and hire purchase	27	-
Other liabilities	129	142
	255	290

Deferred tax assets / (liabilities)

	2008 £'000	2007 £'000
Deferred tax liabilities as at 1 January	(60)	(55)
Current year movement	358	(5)
Closing balance at 31 December	298	(60)

Obligation under finance lease and hire purchase

	2008 £'000	2007 £'000
Obligation under finance lease and hire purchase:		
Within one year	5	-
Between one and two years	5	-
Between two and five years	17	-
	27	-

16. Called up share capital

	Authorised		Called up, allotted and fully paid	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000
10,000,000 Ordinary shares of £1 each	10,000	10,000	10,000	10,000

Notes to the accounts
For the year ended 31 December 2008

17. **Reconciliation of movements in shareholders' funds and movements on reserves**

	Called up share capital	**Profit and loss account**	**Revaluation reserve**	**Available for sale reserve**	**Total Share holders Funds**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
As at 1 January 2007	10,000	6,592	2,534	6	19,132
Revaluations	-	-	1,069	-	1,069
Profit for the year	-	334	-	-	334
Available-for-sale gains / (losses)	-	-	-	(424)	(424)
Tax effect of the available for sale loss	-	127	-	-	127
As at 31 December 2007	10,000	7,053	3,603	(418)	20,238
As at 1 January 2008	10,000	7,053	3,603	(418)	20,238
Profit for the year	-	387	-	-	387
Available-for-sale gains / (losses)	-	-	-	(2,263)	(2,263)
Tax effect of the available for sale loss	-	645	-	-	645
As at 31 December 2008	10,000	8,085	3,603	(2,681)	19,007

18. **Other contingent liabilities**

Other contingent liabilities comprise:

	2008	**2007**
	£'000	**£'000**
Irrevocable letters of credit	42	64

Included in irrevocable letters of credit are amounts in respect of group companies of £42,330 (2007 - £63,659).

19. **Commitments**

The amounts shown below are intended to provide an indication of the volume of business transacted and not of the underlying credit or other risks.

	2008	**2007**
	£'000	**£'000**
Formal standby facilities, credit lines and other commitments to lend:		
One year and over	37,171	32,346
Less than one year	15,497	12,306
	52,668	44,652

19. Commitments (Continued)

There are annual commitments under non-cancellable operating leases as follows:

	Land and buildings 2008 £'000	2007 £'000
Operating leases which expire:		
Within one year	-	-
Between two and five years	32	-
More than five years	31	56

20. Assets and liabilities in foreign currencies

The aggregate amounts of assets and liabilities denominated in foreign currencies were as follows:

	2008 £'000	2007 £'000
Assets	39,696	37,477
Liabilities	39,643	37,399

21. Reconciliation of operating profit to net cash inflow from operating activities

	2008 £'000	2007 £'000
Profit on ordinary activities before tax	602	553
Increase in prepayments and accrued income	8	(15)
Increase/(decrease) in accruals and deferred income	20	(7)
Depreciation charge and amortisation	480	428
Profit on disposal of fixed assets	-	(2)
Net cash inflow from trading activities	(1,110)	957
Net (increase)/decrease in collections	(9)	247
Net decrease /(increase) in loans and advances to banks and customers	7,389	(14,696)
Net (decrease)/increase in deposits by banks and customers	(21,167)	14,892
Net decrease in other assets	20	13
Net increase in investment due to exchange gain	(2,391)	(86)
Net decrease/(increase) in derivative liabilities	155	(27)
Net decrease/(increase) in other liabilities	91	(1)
Net cash (outflow)/inflow from operating activities	(14,802)	1,299

22. Analysis of net funds

	1 January 2008 £'000	Cash flows 2008 £'000	31 December 2008 £'000
Cash and balances at central banks	301	89	390
Loans and advances to other banks repayable on demand	37,971	(14,221)	23,750

	38,272	(14,132)	24,140

23. **Analysis of changes in financing during the year**

	Share capital £'000
Balance at 1 January 2008	10,000
Cash flow from financing	-
Other movements	-
Balance at 31 December 2008	10,000

24. **Transactions with directors and managers**

As at 31 December 2008, £8,339 was outstanding by way of loans to managers of the company (or persons connected with them) (2007 - £8,314). During the year, £25 was paid back and £10,000 draw down by the managers (or persons connected to them) (2007 - £10,646).

25. **Ultimate parent company**

The ultimate parent and controlling company at 31 December 2008 was Turkish Bank Limited, which is incorporated in Cyprus. The parent company of the largest and smallest group of which the Bank is a member and for which consolidated accounts are prepared is Turkish Bank Limited. Copies of its group accounts can be obtained from 84-86 Borough High Street, London SE1 1LN.

26. **Related party transactions**

The Bank has taken advantage of an exemption under FRS 8, relating to 90% (or more) subsidiaries, which exempts it from disclosing all related party transactions with group members. Other than those described in note 24, there are no other related party transactions.

27. **Risk management framework**

Risk taking is central to banking activity. The Bank evaluates business opportunities in terms of a prudent risk-reward relationship.

The risks that the Bank takes on are reasonable, well controlled, within its financial resources and credit competent.

The diversity of our business requires us to identify, measure and manage risks effectively. At Turkish Bank (UK) Ltd. (TBUK), the risk is managed through an organisational structure including risk management and the monitoring of processes that are closely aligned with the activities of the Group and in line with the guidelines given by the Regulators.

The following key principles form part of TBUK's approach to risk management

- The Board, through its subcommittees, the Audit Committee and the Business Development Committee (BDC) oversee risk management, review and approve Bank Policies (of which there are 20) and tolerance limits wherever required. All Policies are approved by the Board and subject to review at least once each calendar year.
- Nine committees at functional level oversee the implementation of risk management and associated policies. The principal committees are:
    - Assets and Liabilities Committee (ALCO), which manages the Market and liquidity risks whose members are the Managing Director, Assistant General Manager Compliance, Assistant General Manager, Wholesale & Markets, the Financial Controller and Treasury Dealer.

- The Risk Committee is headed by the Managing Director and comprises the two AGM's, the Internal Auditor, the IT Controller and the Financial Controller, who acts as the secretary to the Committee. The Committee allows the Bank to manage Credit, Market and Operational risk on an integrated basis.

27. Risk management framework (continued)

- The Credit Committee is responsible for controlling credit risk and implementing the Credit Policies as authorised by the Board. All decisions require unanimous agreement at each level of lending authority as prescribed by the Board.
- The HR Committee is responsible for overseeing the HR Policy of which the HR Handbook is an integral part.
- All management participate in risk assessment by means of the Risk Universe which is reviewed at least annually under the direction of the AGM Compliance.

Credit Risk Management

Credit risk is the risk of loss due to the failure of a borrower to meet its credit obligations in accordance with agreed contract terms.

Credit risk makes up the largest part of Bank's risks exposure. TBUK's credit process is guided by a well-established credit policy, rules and guidelines continuing a close-to-the-market approach with an aim to maintain a well-diversified portfolio of credit risk which produces a reliable and consistent return.

Credit risk policies are established by the Credit Committee and approved by the Board through its BDC. The Bank has a system of checks and balances in place around the extension of credit that are:

- an independent credit management function;
- multiple credit approvers; and
- an independent audit and risk review function.

The Credit Risk Policy reflects TBUK's tolerance for risk i.e. credit risk appetite and the level of expected return. This, as a minimum, reflects TBUK's strategy to grant credit based on various products, economic sectors, client segments etc, target markets giving due consideration to risks specific to each target market.

Salient features of our Risk approval process are delineated below:

- Every extension of credit to any counterparty requires unanimous approval by the pre-defined level of authority sanctioned by the board.
- All business groups must apply consistent standards in arriving at their credit decisions.
- Every material change to a credit facility requires approval at the appropriate, pre-defined level.
- Credit approval authority is assigned to individuals according to their qualifications and experience.

The Bank uses risk rating systems where appropriate to supplement the credit risk measurement procedure for exposures exceeding a certain threshold. Risk rating of counterparties is an essential requirement of the credit approval process in these instances.

Stress testing on the credit portfolio is performed at least twice each year and more often if required and complies with the guidelines issued by the FSA.

The disbursement, administration and monitoring of credit facilities are managed by the Central Credit Unit (CCU). CCU is also responsible for collateral / documents management.

The Bank monitors its credit portfolio on a continuing basis. Procedures are in place to identify, at an early stage, credit exposures for which there may be a risk of loss. The objective of this early warning system is to address potential problems while various options may still be available. Early detection of problem loans is a tenet of our credit culture and is intended to ensure that greater attention is paid to such exposure. The Bank has an established Problem Loan Review Unit to focus on expediting recoveries from problem credits. The unit negotiates with problem borrowers and recommends restructuring and rescheduling of problem credits to the Credit Committee. In cases where the possibilities of economically viable means of recovery are exhausted, legal proceedings are initiated.

The Bank's maximum exposure to credit risk at the year end is £108 million (2007: £131 million)

27. Risk management framework (continued)

Country Risk

The Bank has established limits for Cross Border Transfer Risk (CBTR) based on the ratings assigned by internationally recognised rating agencies. CBTR arises from exposure to counterparties in countries other than the country where exposure is located. We define transfer risk as arising where an otherwise solvent and willing debtor is unable to meet its obligation due to the imposition of Governmental or regulatory controls restricting its ability to perform under its obligation towards its foreign liabilities.

Market Risk Management

It is the risk of loss due to adverse movements in market rates or prices, such as foreign exchange rates, interest rates and market prices. TBUK only operates positions housed in its Banking book within strict Board approved guidelines. Currently Market Risk reporting is made to the Supervisor on the ''Standard Method'' base.

The banking book stems from mismatches in the structural assets and liabilities positions. Market risk is managed by ALCO supported by Financial Control under the supervision of BDC. Treasury front office is responsible to ALCO for the market risk it generates while the other responsible area for market risk on the banking book is the Risk Committee.

Derivatives

Transactions currently permitted include foreign currency, Forward Rate Agreements. At present the Bank is only dealing in Foreign Exchange Currency Swaps on a very limited scale and purely on a back-to-back basis without carrying any open position in its books. Policies in line with UK GAAP instructions have been formulated and are operative. A total notional amount equivalent to £7.6 million was outstanding as at 31 December 2008. There is no outstanding position of derivates as at 31 December 2007.

Interest Rate Risk

Interest rate risk is the risk that an investment value will change due to a change in the absolute level of interest rates i.e. the spread between two rates, in the shape of the yield curve, or in any other interest rate relationship.

A substantial part of the Bank's assets and liabilities are subject to floating rates hence are re-priced simultaneously. However, the Bank is exposed to interest rate risk as a result of mismatches on a relatively small portion of its assets and liabilities. The major portion related to this risk is reflected in the banking book owing to the retail activities and investments. The overall potential impact of the mismatches on the earnings in the short-term and economic value of the portfolio in the longer term is not material and is being managed within the tolerance limits approved by the Board.

Foreign Exchange Risk

The Bank's assets are typically funded in the same currency as that of the business transacted to eliminate foreign exchange exposure. However, the Bank is obliged to maintain a very reasonable open position in various currencies resulting from the trade related transactions handled by the Bank.

Foreign Exchange risks are controlled and monitored through the limits monitored by ALCO and approved by the FSA. The regulatory limit for foreign exchange is relatively small compared to the size of the Bank; hence the risk generated through foreign exchange activities is not significant.

End of the day positions are marked to market according to the guidelines of UK GAAP and sensitivity is conducted in line with the internal market risk policy of the Bank. The intra-day positions are managed by Treasury. Going forward the Bank will adopt VAR approaches to measure and monitor foreign exchange risk.

Liquidity Risk Management

Liquidity Risk is the risk that the Group will be unable to meet its cash flow obligations as they become due, because of an inability to liquidate assets, or to obtain adequate funding.

The ALCO has the responsibility for the formulation of overall strategy and oversight of the asset/liability management function.

27. Risk management framework (continued)

Liquidity Risk Management (continued)

Liquidity Risk is the risk that the Group will be unable to meet its cash flow obligations as they become due, because of an inability to liquidate assets, or to obtain adequate funding.

The ALCO has the responsibility for the formulation of overall strategy and oversight of the asset/liability management function.

The Bank follows a comprehensive liquidity risk management policy duly approved by ALCO and Board. The policy stipulates maintenance of various ratios, funding preferences and evaluation of Bank's liquidity under normal and crisis situation (stress testing). To comply with the policy, the Bank has also conducted a behavioural study on its core deposits to evaluate their stickiness, which may not reflect in their maturity profile. Such evaluation forms part of the liquidity management process to project realistically the reliance on such funding sources. As a result of close monitoring and strict policies towards reliance on core deposits, the Bank has been able to avoid concentration / reliance on volatile deposits in its books.

Operational Risk

Operational Risk controls were enhanced through 2005 by the introduction of new software, namely Temenos (T24) that allows an overall control of transactions centrally by Compliance Unit. The Board has approved the Operational Risk Policy.

The policy covers the core governing principles for operational risk management and provides guidelines to identify, control, monitor, measure and report operational risk in a consistent manner across the Bank. The online authorisations level based control infrastructure is one of the main tools that prevent the Operational Risk realisations. Besides Internal Control Unit is able to perform "Transaction Based Control" with the new software (T24).

Operational Risk is now calculated according to the ''Basic Indicator Approach'' and the Bank's objective is to calculate Operational Risk by the ''Standard Method'' as per Basel Capital Accord.

Risk monitoring process is preformed at both transaction and portfolio levels.

Monitoring at transaction levels is a function of the managers of business units where transactions are actually carried out, which is described as Local Monitoring. In cases where the managers originate business themselves exercising their discretionary authorities, monitoring is performed by their immediate line mangers.

Monitoring at portfolio levels is carried out by Head Office committees or by the Managing Director depending on the nature of risks involved and described as Central Monitoring. Information required for monitoring at a portfolio level is provided by the relative Head Office department manager using information gleaned from appropriate Management reports.

Monitoring of financial risks also covers related operational, statutory and regulatory risks.

28. Financial instruments

The Bank maintains a proprietary investment portfolio whereby capital funds are invested in fixed and floating interest rate Zone A and Zone B Government and Corporate Bonds. Additionally, the Bank has financial assets in the form of cash, loans and advances to banks and loans and advances to customers. The Bank also has financial liabilities in the form of deposits by banks and customer accounts.

The Bank does not assume in the normal course of business any significant foreign exchange exposures. The Bank is exposed to movements in interest rates and manages this exposure on a continuous basis within limits set by the Board. Short-term foreign exchange swaps are utilised, where cost-efficient, as a funding mechanism, principally to convert sterling capital funds to US dollars. The Bank does not utilise derivatives to assume any form of credit or market risk. The Bank utilises derivatives for economic hedging purposes.

The directors of the Bank have established policies relating to large exposures, interest rate gapping, foreign exchange exposure, liquidity management and credit provisioning. In addition, the Bank operates within limits set by the directors relating to country exposure, credit exposure and risk asset maturities. These

28. Financial instruments (continued)

policies and limits are reviewed on a regular basis, and any amendment to these policies and limits require the consent of the Board of Directors.

Derivative financial instruments:

At the balance sheet date the derivative assets and liabilities comprise of foreign currency swap contracts. The total notional amount of outstanding forward foreign exchange contracts that the Bank has committed is as below.

			2008
	Notional amount	**Fair value assets**	**Fair value liabilities**
	£'000	**£'000**	**£'000**
Foreign currency swap contracts	7,597	-	155

			2007
	Notional amount	**Fair value assets**	**Fair value Liabilities**
	£'000	**£'000**	**£'000**
Foreign currency swap contracts	-	-	-

Interest rate risk

Exposure to interest rate movements arise where there is an imbalance between rate sensitive assets and liabilities. The table below reflects management's estimate of the interest rate sensitivity gap for the Bank as at 31 December 2008. Assets and liabilities are included at the earliest date at which the applicable interest rate can change.

Capital risk management

The Bank policy in respect of capital adequacy is to maintain a strong capital base so as to retain investor, creditor and market confidence. During the years ended 31 December 2007 and 2008 capital has been maintained at a level above minimum FSA requirements. Such levels have been established by reference to an internal ICAAP assessment. The Bank's capital resources consist of Tier 1 Capital and Upper Tier 2 Revaluation Reserve.

The Bank hold their cash with a number of reputable financial institutions. All cash and cash equivalents are short-term, highly liquid investments that are readily convertible into known amounts of cash.

The Bank's capital requirements are set and monitored by the FSA. Regulatory capital consists solely of Tier 1 capital, which includes ordinary share capital and retained earnings

The Company's regulatory capital position was as follows:

	2008 £'000	2007 £'000
Tier 1 Capital		
Share Capital	10,000	10,000
Retained Earnings	8,085	7,053
Upper Tier 2 Capital		
Revaluation Reserve	3,603	3,603
Total regulatory capital	21,688	20,656

The Bank has complied with all capital requirements throughout the period as required by the FSA.

28. Financial instruments (continued)

Categories of financial instruments 2008

Assets	Loans and Receivables	Available for sale	Financial liabilities at amortised cost	Derivatives	Total
Cash and balances at central banks	390	-	-	-	390
Loans and advances to banks	42,223	-	-	-	42,223
Items in the course of collection	18	-	-	-	18
Loans and advances to customers	58,474	-	-	-	58,474
Debt securities-available for sale	-	7,111	-	-	7,111
Other assets	46	-	-	-	46
Total financial assets	**101,256**	**7,111**	-	-	**108,262**
Total non financial assets					8,132
Total assets					**116,394**

Liabilities

Deposits by banks	-	-	13,330	-	13,330
Items in the course of transmission to other banks	-	-	141	-	141
Customer accounts	-	-	83,330	-	83,330
Derivative liabilities	-	-	-	155	155
Other liabilities	-	-	255	-	255
Accruals and deferred income	-	-	176	-	176
Total financial liabilities	**-**	**-**	**97,232**	**155**	**97,387**
Total non financial liabilities	-	-	-	-	19,007
Total liabilities and equity	**-**	**-**	**97,232**	**155**	**116,394**

28. Financial instruments (continued)

Categories of financial instruments 2007

Assets	Loans and Receivables	Available for sale	Financial liabilities at amortised cost	Derivative	Total
Cash and balances at central banks	301	-	-	-	301
Loans and advances to banks	78,901	-	-	-	78,901
Items in the course of collection	9	-	-	-	9
Loans and advances to customers	43,406	-	-	-	43,406
Debt securities-available for sale	-	8,495	-	-	8,495
Other assets	10	-	-	-	10
Total financial assets	**122,627**	**8,495**	**-**	**-**	**131,122**
Total non financial assets					7,404
Total assets					**138,526**

Liabilities					
Deposits by banks	-	-	40,112	-	40,112
Items in the course of transmission to other banks	-	-	15	-	15
Customer accounts	-	-	77,715	-	77,715
Derivative liabilities	-	-	-	-	-
Other liabilities	-	-	230	-	230
Accruals and deferred income	-	-	156	-	156
Total financial liabilities	**-**	**-**	**118,288**	**-**	**118,228**
Total non financial liabilities					20,298
Total liabilities and equity					**138,526**

28. Financial instruments (continued)

Interest rate sensitivity gap analysis 2008

	Less than 3 months £'000	3-6 months £'000	6-12 months £'000	1-5 years £'000	More than 5 years £'000	Non-interest £'000	Total £'000
Assets							
Cash and balances at central banks	-	-	-	-	-	390	390
Loans and advances to banks	42,062	161	-	-	-	-	42,223
Loans and advances to customers	35,693	1,367	4,674	11,432	5,344	(36)	58,474
Debt Securities	2,018	-	-	1,961	3,132	-	7,111
Other assets	-	-	-	-	-	8,196	8,196
	79,773	1,528	4,674	13,393	8,476	8,550	116,394
Liabilities							
Deposits by banks	13,330	-	-	-	-	-	13,330
Customer accounts	60,202	15,763	7,365	-	-	-	83,330
Other liabilities	-	-	-	-	-	727	727
Shareholders' funds	-	-	-	-	-	19,007	19,007
	73,532	15,763	7,365	-	-	19,734	116,394

Notes to the accounts
For the year ended 31 December 2008

Interest rate sensitivity gap	6,241	(14,235)	(2,691)	13,393	8,476	11,184	-
Cumulative gap	6,241	(7,994)	(10,685)	2,708	11,184	-	-

The table above provides only an indication of the sensitivity of the Bank's earnings to movements in interest rates and is consistent with the position throughout 2008.

Other assets other then deferred tax asset of £298,000 classified as non interest bearing in the above table has contractual maturities of less than three months.

28. Financial instruments (continued)

Interest rate sensitivity gap analysis 2007

	Less than 3 months £'000	3-6 months £'000	6-12 months £'000	1-5 years £'000	More than 5 years £'000	Non-interest £'000	Total £'000
Assets							
Cash and balances at central Bank	-	-	-	-	-	301	301
Loans and advances to banks	74,402	2,524	1,975	-	-	-	78,901
Loans and advances to customers	28,238	1,049	1,372	7,751	5,023	(27)	43,406
Debt Securities	1,016	-	500	3,059	3,920	-	8,495
Other assets	-	-	-	-	-	7,423	7,423
	103,656	3,573	3,847	10,810	8,943	7,697	138,526
Liabilities							
Deposits by banks	40,112	-	-	-	-	-	40,112
Customer accounts	65,015	8,559	3,370	771	-	-	77,715
Other liabilities	-	-	-	-	-	461	461
Shareholders' funds	-	-	-	-	-	20,238	20,238
	105,127	8,559	3,370	771	-	20,699	138,526
Interest rate sensitivity gap	(1,471)	(4,986)	477	10,039	8,943	(13,002)	-
Cumulative gap	(1,471)	(6,457)	(5,980)	4,059	13,002	-	-

The table above provides only an indication of the sensitivity of the Bank's earnings to movements in interest rates and is consistent with the position throughout 2007.

Other liabilities other then deferred tax liability of £60,000 classified as non interest bearing in the above table has contractual maturities of less than three months.

A liability (or negative) gap position exists when liabilities reprice more quickly than assets during a given period and tends to benefit net interest income in a declining interest rate environment. An asset (or positive) gap position exists when assets reprice more quickly than liabilities during a given period and tends to benefit interest income in a rising interest rate environment. The Bank's off balance sheet items carry no interest rate risk. Loans and advances to customers have been shown net of provisions totalling £36,000 (2007 - £26,000).

The weighted average interest rates are as follows; 2.47% (2007: 5.92%) for the loans and advances to banks, 5.37% (2007: 7.19%) for the loans and advances to customers, 6.70% (2007: 6.36%) for the debt securities, 1.17% (2007: 5.03 %) for the deposits by banks and 3.05% (2007: 4.98%) for the customer accounts.

Interest rate sensitivity analysis

The sensitivity analysis has been determined based on the exposure to interest rate fluctuation for both derivative and non derivative instruments at the balance sheet date. At reporting date, if interest rate had been 50 basis points higher/lower and all other variables were held constant the bank's net profit would increase/decrease by £175,000 (2007: £184,000). However, management believes that Bank interest rate risk is limited since the majority of customers deposits are reprised within three months as per the terms of their issue.

28. Financial instruments (continued)

Liquidity risk

The Bank is regulated in the United Kingdom by the Financial Services Authority (FSA), which, from time to time, sets required liquidity mismatch parameters. The Bank manages the liquidity structure of its assets, liabilities and commitments so that cash flows are appropriately balanced to ensure that all funding obligations are met when due and the required mismatch parameters are not exceeded. The policy of the Bank is to match to maturity as far as is practicable and the Treasury Department will not take on large exposures or placements that cannot easily be matched in the market as to currency or maturity.

Currency risk

Currency of denomination	**Net currency position 2008 £'000**	**Net currency position 2007 £'000**
US Dollar	12	22
Euro	7	12
Japanese Yen	-	5
Swiss Franc	11	1
Other currencies	23	38
Total	53	78

The above table sets out those currency exposures that the Bank has at the year-end. The amounts shown in the table take into account the effect of any currency swaps and forward contracts entered into to manage these currency exposures and are consistent with the position throughout the year. The disclosures include all monetary assets and liabilities including short-term debtors and creditors. Those assets and liabilities denominated in sterling have been excluded.

For the purposes of the net currency disclosure above, sterling has been used as the Bank's functional currency.

The Bank enters into short-term foreign exchange swap transactions for funding purposes. These currency swap transactions are utilised purely for economic hedging purposes. The Bank does not apply hedge accounting.

28. Financial instruments (continued)

Carrying value and fair value

The fair value of debt securities and derivative financial liabilities are market prices.

Fair value of other assets and other liabilities cannot be calculated with sufficient reliability due to the absence of current and active market for such assets and liabilities and a reliable date regarding market rates for similar instruments.

In the opinion of management, the fair value of remaining financial assets and liabilities are not significantly different from their carrying value since assets and liabilities are either short-term in nature or in the case of customer loans and deposits are frequently reset.

Set out is a comparison by category of carrying values and fair values of the Bank's financial assets, liabilities and swaps and forward transactions as at 31 December 2008.

	Carrying value 2008 £000	Fair value 2008 £000	Carrying value 2007 £000	Fair value 2007 £000
Financial assets				
Cash	390	390	301	301
Loans and advances to banks	42,223	42,223	78,901	78,901
Loans and advances to customers	58,474	58,474	43,406	43,406
Debt securities	7,111	7,111	8,495	8,495
Financial liabilities				
Deposits by banks	13,330	13,330	40,112	40,112
Customer accounts	83,330	83,330	77,715	77,715
Derivative liabilities	155	155	-	-