Company Registration No. 2643004

Turkish Bank (UK) Limited

Report and Financial Statements

31 December 2011

Turkish Bank (UK) Limited

Report and financial statements 2011

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Chairman's statement

It would be remiss of me not to start this Statement by giving fulsome and grateful thanks to my predecessor, Mr. Tanju Ozyol, who retired from the Chairmanship of the Bank in June 2011. Mr. Ozyol's wise leadership has steered the Bank successfully through many difficult as well as successful times since its inception in 1991. He has left the Bank in a strong position in terms of capital, liquidity and strategic positioning which it is my objective to build upon. I am grateful to note that his knowledge is still available to me should it be needed as Mr. Ozyol continues as Chairman of the Group holding company.

In 2011 Turkish Bank (TBUK) began to see the benefits from the heavy investment in systems and products which has taken place over the previous five years. Despite the difficult trading conditions both for its UK clients in particular and its wider customer base in general, the Bank made good progress in 2011 in further penetrating its chosen market sectors in the Turkish-speaking communities in the UK. Against this, the strength of the Turkish economy and its banking system has led to a reduction in interest margins and has thus offered considerably less opportunities than seen previously to invest in higher yielding although relatively low risk assets. As a consequence, much of the impetus for the improvements, seen during the year, emanated from the strategic decision some four years ago to grow the community banking segment of the Bank.

The UK economy continues to almost stagnate, not helped by the tight budgetary controls emanating from the UK Treasury as well as the turmoil (at least at the time of writing) in the Eurozone. The continuing investment by the Bank of England in Quantitative Easing may yet have a longer-term negative effect on inflation against what appears to be only a modest beneficial short-term effect on the economy. I have a concern over these longer-term inflationary pressures, albeit at the time of writing the CPI is at last falling from its high of over 5% aided by the fact that the adverse effect of the increase in VAT in January 2011 is now out of the equation.

It seems that the Base Rate will remain at its current level of 0.5% throughout 2012 and into the first half of 2013 in order not to jeopardise any green shoots of growth which the UK economy may see in the coming months. I am nevertheless pleased to see that the Coalition Government remains steadfast in aiming to deal with the inherited budget deficit difficulties, despite the added downward pressure placed on the UK economy arising from the difficulties being experienced in the Eurozone. Rising unemployment and projected economic growth of less than 1% in the UK during 2012 make a difficult backdrop on which to further build the Bank's UK business. However, set against this is the potential to expand on the limited penetration to date by the Bank of the Turkish-speaking community to which has now been added the essential product of a debit card to help build the consumer part of the bank alongside the commercial sector the Bank remains very strong in both liquidity and capital.

The Turkish economy remains robust with inflation under control and the Central Bank and the Government taking on-going action since late 2010 to cool the growth in consumer spending. The current account deficit remains a concern but the short-term inflow of capital continues to be strong and the domestic deficit is not a factor for concern presently. A number of macro-economic tools are being used to meet the existing challenges and these continue to include increases in reserve requirements from the banks and strict regulation of the banks' liquidity ratios.

As mentioned above TBUK has made good progress during the year in expanding its role as a community bank to the Turkish-speaking people living in the UK. The six branches, all of which are situated in Central or Greater London, continue to provide excellent personal service to the local community based on strong cultural ties, something on which the Bank prides itself. It remains the only Turkish bank with a true retail operation in the UK, if not in the whole of Europe.

During the year the Bank improved its product range by making a considerable investment in bringing to its customers a debit card product. This is aimed at stimulating the current account base of the Bank and to further reach out to the community. Since its launch eight months ago, 75% of debit cards issued have been activated. This was recognised by our peers and TBUK was awarded the "Best New UK Debit Card of the Year" at a prestigious presentation at the Grosvenor Hotel in London in February 2012, despite stiff opposition from a number of other banks and card issuing companies. I congratulate the management and staff for the exceptional success achieved in launching this new product for the Bank. The Bank proposes to build on this success with further developments in its product range and improvements to existing services such as in internet banking.

During the year the Bank's underlying operating profit which excludes impairment charges on investment portfolio and a provision for ongoing regulatory matters improved considerably to £764,000 (2010: £310,000 profit before tax and reversal of impairment losses) meeting budgeted expectations which were increased during the course of the year. However, my Board and I decided that the rapid decline in the market value of the Bank's holdings of BTA Bank Bonds, which

Chairman's statement (Continued)

had been rescheduled in 2010 with initial success, warranted strong action. As a result, the value of these has been reduced to zero in the Bank's books pending the outcome of the latest rescheduling initiative now underway. An additional exceptional cost of £200,000 was taken by the Bank as the estimated cost of ongoing regulatory matters. Pre-tax profit for the year has been reduced therefore to £59,000 (2010: £543,000) as a consequence of these exceptional items.

The year showed a welcome increase in the income generated by the remittance products arising as a result of some business lost to competitors being recaptured through the improved provision of service quality and delivery. The increased earnings from various forms of account charges is further testament to the success of the strategy of penetrating the commercial banking market of the Turkish community in the UK. Foreign exchange earnings also reflect the success of the Bank's penetration into the domestic business sector and the equal success of its TRY remittance product.

Total resident lending registered a comparatively modest increase of some 3% to £42.7 million as the Bank refocused its attention on supporting a more diverse commercial clientele base with particular emphasis on small retail outlets rather than larger borrowing entities. The Turkish-speaking community in the UK is not immune from the stresses seen in the economy and as a consequence additional provisions in the resident lending book of £39,000 have been judged to be necessary. The Bank has an extremely cautious approach in assessing bad and doubtful debts.

Domestic deposits also grew modestly during 2010 and reached £36.6 million. The long-term target of the Bank continues to equate domestic lending levels with those of retail deposits. Until this can be brought to fruition, the non-resident deposits, which remain relatively steady at the equivalent of some £55 million, will continue to assist in funding domestic lending.

The record growth in the Turkish economy estimated to be 10% in 2011 contributed to non-resident advances increasing by 16% to £17 million, returning to the level seen in 2009 and before.

The burden of regulatory requirements has not eased over the past year and the cost to the Bank has again increased significantly in 2011. This is a burden the Group and the Bank is used to during its long 110 year history and is content to carry for the time being in order to ensure its own wellbeing as well but, more importantly, that of the broader banking industry.

We continue to be well capitalised and liquid and aim to remain so. As at 31 December 2011, the Bank's solvency ratio was 263% (2010 :273%) At the end of 2011, the Board sought a professional revaluation of the Bank's freehold premises and this has resulted in an increase in Tier 2 capital of £290,000.

During the last quarter of the year the Bank decided to strengthen its top management and Mr. Derek Rorrison has been appointed General Manager. I am sure he will make an immense contribution to the growth and profitability of the Bank.

Once again I acknowledge with thanks the loyalty and dedication of my colleagues in the Bank and I look forward to working with them. I am confident that during 2012 we will continue to offer to our customers our top quality services and products and, at the same time, protect the interest of all with whom the Bank deals especially our clients, staff and shareholders.

I Hakan Bortecene

Chairman

16 March 2012

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Report and financial statements 2011

Officers and professional advisors

Directors

I H Bortecene (Chairman)
R W Long
M E Erenman
D Blackmore
P Ryan
E Ozcelik

Secretaries

J. Kent was appointed on 10/06/11
K. Bissell resigned on 10/06/11

Registered office

84-86 Borough High Street
London SE1 1LN

Bankers

HSBC Bank plc
27-32 Poultry
London EC2P 2BX

Auditor

Deloitte LLP
Chartered Accountants
London

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2011.

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 people 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 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 Bank made good progress during the year in consolidating its position as a provider of commercial and retail banking services to the Turkish-speaking community in Greater London in particular and the United Kingdom in general. We also continue to provide a quality service to our non-resident customers and especially so to our High Net Worth clients.

Underlying operating profits excluding impairment charges on investment portfolio and a provision for ongoing regulatory matters improved considerably to £764,000 (2010: £310,000 profit before tax and reversal of impairment losses on investment portfolio). Regrettably the BTA Bond purchased in 2006 and rescheduled in 2010 has continued to be non-performing and the Board has taken the decision to write down the value of this part of the bond portfolio to zero. Further, an additional exceptional cost of £200,000 was taken by the Bank as the estimated cost of ongoing regulatory matters. This has resulted in pre-tax profits being reduced to some £59,000 (2010: £543,000) which is disappointing given the improvement which was achieved through the Bank's business activities.

Resident lending to the chosen market sectors in and around London held firm at some £42.7 million (2010- £41.7 million) reflecting in part the decline in demand seen in the marketplace and also as a result of the strategic shift in the lending portfolio away from property development with more focus on the retail sector. Provisions charges for resident lending to £39,000 for the year show an improvement on the previous year (2010- £93,000) showing the resilience of the Turkish community through the difficult times seen in the UK economy. The Bank continues to monitor closely its loan book to identify cases of financial stress with a view to providing assistance wherever this is possible.

2011 also saw a consolidation in the level of resident deposits as the Bank moved away from raising funds from the general public at the upper end of the interest rate spectrum. It remains the objective of the Bank however to pursue its strategy of working to match resident lending levels with that of resident deposits.

Non-resident deposits remained stable and at 31 December 2011 were £55 million (2010-£56.5 million) while advances to non-residents stood at £17 million against the total of £13.7m at the end of 2010.

In other areas the Bank saw further encouraging growth both in the level of fees from business accounts and, very encouragingly, a marked improvement of some 12.13% in income from the Bank's remittance products which since 2010 have included a very popular TRY offering.

During the year the Bank issued debit cards to its current account customers. It is pleasing to note that the card won the title of "Best New Plastic Card of the Year" at the annual Plastic Card Event held in London in February 2012. The Bank is working to build on this success by providing other card products in the coming 12 to 18 months. Additionally, the Bank is working with other Group members to improve internet banking product and progress on this is expected well before the end of this year.

The Bank continues to work towards further improving the quality of its services to all levels of its clientele. During the coming months the Bank will check regularly on satisfaction levels through customer surveys. Equally, we will

Directors' report (continued)

ensure that we keep pace with changes in the financial services industry by closely monitoring competition on the high street as well as in the wholesale markets.

We look this year to build on the underlying operating profits generated in 2011 despite the ever increasing burden of regulatory costs and to provide our clients with a quality service to which they are entitled.

Going Concern

After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Further details regarding the adoption of the going concern basis can be found in the Statement of accounting policies in the financial statements on page 14.

Principal risks and uncertainties

The Bank's activities expose it to a number of financial risks including credit risk, interest rate and currencies 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. Risk policies have been disclosed in note 28 of the financial statements.

Interest rate and currency 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 movements. With regard to interest rate risk the Bank has a hedged 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.

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 28 to the accounts.

Results and dividends

The loss for the year after taxation amounted to £65,000 (2010 – profit £350,000).

The directors do not recommend the payment of dividend (2010 - £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 £120 (2010 - £1,100).

Directors and their interests

The directors who served during the year were as follows:

I H Bortecene (Chairman)
M T Ozyol resigned on 10/06/11
R W Long
M E Erenman
E Ozcelik was appointed as a Director on 30/06/11
D.Blackmore*
Phil Ryan*
* members of audit committee
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Directors' report (continued)

Directors' indemnities

The company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

Audit Committee

The Bank has an Audit Committee comprising two independent non-executive directors who are experienced bankers. The Committee met on six occasions in 2011 (2010: four times).

Disclosure of information to auditor

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 auditor 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 Section 418 of the Companies Act 2006.

Auditor

In accordance with Section 485-488 of the Companies Act 2006, the Bank has elected to dispense with the obligation to appoint auditor annually. Accordingly, Deloitte LLP are therefore deemed to have been re-appointed as auditor of the Bank.

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

Secretary

J. Kent

16 March 2012

Statement of directors' responsibilities

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 financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards 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 Bank and of the profit or loss of the Bank for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed; and
- prepare the financial statements on the going concern basis.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of 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 United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S 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 2011 which comprise the profit and loss account, balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, 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 Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2011 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

Manbhinder Rana, F.C.A. (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditors

London, United Kingdom

March 2012

Profit and loss account
For the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Interest receivable:			
Interest receivable and similar income arising from debt securities		621	641
Other interest receivable and similar income		4,173	3,711
		4,794	4,352
Interest payable		(2,039)	(2,217)
Net interest income		2,755	2,135
Fees and commissions receivable		1,458	1,339
Fees and commissions payable		(90)	(38)
Dealing profits		183	159
Other operating income		7	9
Gain on sale of debt securities		56	-
		1,614	1,469
Total operating income		4,369	3,604
Administrative expenses	2	(3,108)	(2,784)
Depreciation and amortisation	11, 12	(448)	(415)
Other operating charges		(14)	(2)
Impairment (losses)/reversal on debt securities	10	(505)	233
Provision for liabilities	6	(200)	-
Impairment losses on loans and advances to customers	3	(35)	(93)
		(4,310)	(3,061)
Profit on ordinary activities before taxation	4	59	543
Tax on profit on ordinary activities	5	(124)	(193)
(Loss)/profit on ordinary activities after taxation	18	(65)	350

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 2011

	Notes	2011 £'000	2010 £'000
Assets			
Cash and balances at central banks		9,238	5,787
Loans and advances to banks	7	30,754	38,928
Items in the course of collection		171	2
Loans and advances to customers	8	64,597	53,363
Debt securities	10	10,125	12,729
Intangible fixed assets	11	161	131
Tangible fixed assets	12	7,668	7,527
Other assets	13	80	10
Prepayments and accrued income		387	296
Total assets		123,181	118,773
Liabilities			
Deposits by banks	14	9,046	3,590
Items in the course of transmission to other banks		22	62
Customer accounts	15	92,191	93,268
Derivative liabilities	29	65	37
Other liabilities	16	250	507
Accruals and deferred income		220	253
Provision for liabilities	6	200	-
		101,993	97,717
Equity			
Called up share capital	17	12,000	12,000
Profit and loss account	18	5,378	5,410
Available for sale reserve	18	(83)	43
Revaluation reserve	18	3,893	3,603
Total equity		21,188	21,056
Total liabilities and equity		123,181	118,773
Contingent liabilities			
Guarantees and assets pledged as collateral security		122	119
Other contingent liabilities	19	-	-
		122	119
Commitments	20	61,004	51,498

The Board of Directors approved these financial statements and authorised for issue on 16 March 2012.

Signed on behalf of the Board of Directors

I H Bortecene
Director

D. Blackmore
Director

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

Turkish Bank (UK) Limited

Cash flow statement
For the year ended 31 December 2011

	2011 £'000	2010 £'000
Net cash inflows inflow from operating activities	**3,295**	**8,470**
Taxation	(363)	(193)
Capital expenditure and financial investment (note 22)	(1,486)	(4,504)
Financing (note 22)	-	-
Returns on investments and servicing of finance (note 22)	-	-
Increase in cash (note 23)	4,418	3,773

Note to cash flow statement

Reconciliation of operating profit to net operating cash flows	2011 £'000	2010 £'000
Profit on ordinary activities before tax	59	543
Decrease/(increase) in prepayments and accrued income	177	(23)
Net increase in investment due to fair value change	126	322
Decrease in accruals and deferred income	(30)	(86)
Depreciation charge and amortisation	448	415
Impairment loss/(gain) on debt securities	537	(233)
Net cash inflows from trading activities	1,317	1,404
Net (increase)/decrease in collections	(209)	47
Net (increase)/decrease in loans and advances to banks and customers	(3,060)	63
Net (decrease)/increase in deposits by banks and customers	(5,346)	6,889
Net decrease in other assets	(70)	(10)
Net increase/(decrease) in derivative liabilities	28	(44)
Net (decrease)/increase in other liabilities	(57)	121
Net cash inflows from operating activities	**3,295**	**8,470**

Statement of total recognised gains and losses
For the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
(Loss)/profit for the financial year		(65)	350
Available-for-sale (loss)/gain	18	(126)	447
Tax effect of available for sale loss/(gain)	18	33	(125)
Surplus on property revaluation	18	290	-
Total recognised gains for the year		132	672

Notes to the accounts
For the year ended 31 December 2011

1. Accounting policies

(a) Basis of preparation

The financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial instruments and freehold properties, and in accordance with the applicable United Kingdom accounting standards and the Statements of Recommended Practice issued by the British Bankers' Association.

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 Directors' Report. In addition notes 28 and 29 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 a viable business model. 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 have 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, together with the related direct costs, are deferred to the useful life of the asset 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 amortised cost of a financial asset and of allocating interest income over a relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts thought the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised 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 held-to-maturity. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Available-for-sale investments 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.

Investments with fixed or determinable payments and fixed maturity dates that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortised cost using the effective interest method less any impairment, with revenue recognised on an effective yield basis.

(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 in 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 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%

1. Accounting policies (continued)

(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.

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. The last professional valuation was undertaken by Ringley, a chartered surveyor external to the Bank, in December 2011. 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 certain Segmental Information. Segment information has been disclosed in the financial statements where management believe that disclosing information is not prejudicial to the interests of the Bank.

2. Administrative expenses

	2011 £'000	2010 £'000
Staff costs during the year (including directors)		
Wages and salaries	1,680	1,548
Social security costs	142	144
Pension costs	30	54
	1,852	1,746
Other administrative expenses	1,256	1,038
	3,108	2,784

2. Administrative expenses (continued)

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

	2011 No.	2010 No.
Commercial banking activities	75	70

Directors’ remuneration during the year consisted of:

	2011 £’000	2010 £’000
Emoluments	120	134

The emoluments of the highest paid director for the year ended 31 December 2011 were £91,000 (2010 - £91,000).

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 loans and advances

	2011 £’000	2010 £’000
Impairment charge for the year	(39)	(93)
Recoveries	7	-
Net impairment charge for the year	(32)	(93)

During the year the Bank received £3,000 (2010 - £175) 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:

	2011 £’000	2010 £’000
Foreign currency gains	(183)	(159)
Operating lease rentals		
Land and buildings	79	79
Depreciation and amortisation		
Tangible fixed assets	224	376
Intangible fixed assets	44	39
Fees payable to the company’s auditors		
Audit of the company’s annual accounts	60	59
Tax services	10	12
	70	71

5. Tax on profit on ordinary activities

	2011 £'000	2010 £'000
Current tax		
United Kingdom corporation tax at 26.5% (2010 – 28%) based on profit for the year	(127)	(200)
Adjustment in respect of prior years	1	35
Total current tax	(126)	(165)
Deferred tax (Note 16)		
Reversal of timing differences	3	27
Prior year adjustment	(6)	(57)
Reversal of timing differences	5	2
	(124)	(193)

The current tax charge for the year is considerably higher than the standard rate of corporation tax at 26.5% as explained below

	2011 £'000	2010 £'000
Profit on ordinary activities before tax	57	543
Tax at 26.5% (2010: 28%) thereon	(15)	(152)
Effects of:		
Expenses not deductible for tax purposes	(73)	(16)
Depreciation in excess of capital allowances	(39)	(37)
Movement in short-term timing differences	-	5
Prior year adjustments	1	35
	(126)	(165)

6. Provision for liabilities

	2011 £'000	2010 £'000
As at 1 January 2011	-	-
Charge against profits	200	-
At 31 December 2011	200	-

Other provisions relate to the estimated cost of ongoing regulatory matters.

7. Loans and advances to banks

	2011 £'000	2010 £'000
Loans and advances to banks are repayable as follows:		
On demand	21,220	20,254
Within three months	9,535	15,449
Between three months and one year	-	3,225
	30,754	38,928

7. Loans and advances to banks (continued)

Included within loans and advances to banks is an amount of £51,000 in respect of group companies (2010 - £14,000). The interest received from group companies during the year was £14,000 (2010 - £6,132).

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

	2011 £'000	2010 £'000
In UK:		
On current account	12,980	3,904
On deposit account in money market lending	5,700	15,400
Outside UK:		
On current account	1,766	949
On deposit account		
- Money Market Lending	8,308	12,002
- Syndication Loan/Promissory Notes	2,000	6,673
	30,754	38,928

8. Loans and advances to customers

	2011 £'000	2010 £'000
Loans are repayable as follows:		
On demand	7,176	7,955
Within three months	9,715	3,531
Between three months and one year	5,842	6,216
Between one and five years	11,080	7,147
After five years	30,951	28,646
Provision for impairment losses	(167)	(132)
	64,597	53,363

Non-performing loans and advances to customers of £167,000 were fully provided at 31 December 2011 (2010 - £132,000).

Loans and advances to customers includes £169,829 (2010: £16,335) which has been placed in the problem loan category but no provision was made against them. All of these loans have been overdue for less than one year.

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

	2011				
	Fixed Rate Loan £'000		Floating Rate Loan £'000		Total £'000
	Secured	Unsecured	Secured	Unsecured	
Overdraft	-	-	6,835	341	7,176
Fixed term					
- Retail	-	-	28,740	231	28,971
- Corporation	4,969	16,249	7,389	10	28,617
	4,969	16,249	42,964	582	64,764
Provision for impairment	-	-	-	(167)	(167)
	4,969	16,249	42,964	415	64,597

8. Loans and advances to customers (continued)

	2010				
	Fixed Rate Loan £'000		**Floating Rate Loan £'000**		**Total £'000**
	Secured	**Unsecured**	**Secured**	**Unsecured**	
Overdraft	-	-	7,670	298	7,968
Fixed term					
- Retail	-	-	26,602	262	26,864
- Corporation	3,123	7,767	7,749	24	18,663
	3,123	7,767	42,021	584	53,495
Provision for impairment	-	-	-	(132)	(132)
	3,123	7,767	42,021	452	53,363

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

	2011 £'000					2010 £'000			
	GBP	**USD**	**EURO**	**TRY**	**Total**	**GBP**	**USD**	**EURO**	**Total**
UK	42,785	-	-	-	42,785	41,615	-	215	41,830
Non UK									
- Turkey	2,121	6,069	3,369	8,898	21,811	2,163	6,304	1,855	10,322
- Others	522	833	-	-	1,355	520	691	-	1,211
Total	45,428	6,902	3,369	8,898	64,597	44,298	6,996	2,070	53,363

9. Provisions for impairment losses

	2011 £'000	**2010** £'000
As at 1 January 2011	132	54
Charge against profits	39	93
Less: recoveries	(4)	-
Net impairment charge for the year	167	147
Less: loans written off	-	(15)
At 31 December 2011	167	132

Accounts overdrawn for more than 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.

10. Debt securities

Available for sale	**2011 £'000**	**2010 £'000**
Nominal value	5,154	7,418

Impairment loss	(505)	-
Accrued interest	63	123
Available-for-sale revaluation	(83)	43
Market value	4,629	7,584
Held to maturity		
Nominal value	5,414	5,062
Accrued interest	82	83
	5,496	5,145
Total	10,125	12,729

Investment in debt securities will mature as follows:

	2011 £'000	2010 £'000
Repayable:		
Less than one year	1,618	522
Between one and five years	6,384	9,522
After five years	2,123	2,685
	10,125	12,729

Segmental analysis of investment in debt securities is as follows:

	2011			2010		
	Fixed rate bonds £'000	Floating rate bonds £'000	Total £'000	Fixed rate bonds £'000	Floating rate bonds £'000	Total £'000
Sovereign bonds	3,396	-	3,396	5,282	-	5,282
Corporate bonds	6,385	344	6,729	7,447	-	7,447
	9,781	344	10,125	12,729	-	12,729

The debt securities comprise government and corporate bonds and are held as available for sale or held-to-maturity securities. The weighted average coupon rate of debt securities repayable after five years is 4.75% (2010 – 6.07%).

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

Securities classified as available for sale are measured at the closing market price on each reporting date and therefore these are classified as Level 1 for the purpose of fair value hierarchy.

10. Debt securities (continued)

The above balance includes debt securities of £1,618 which are due to mature in less than one year (2010: £522).

Analysis by currency of origin is as follows:

	2011				2010			
Origin of debt securities	**GBP**	**USD**	**TRY**	**Total**	**GBP**	**USD**	**EURO**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**

UK	2,123	-	-	2,123	2,656	-	-	2,656
Turkey	-	1,091	344	1,435	-	1,082	-	1,082
Croatian	-		-	-	-		1,834	1,834
Kazakhstan	-	2,606	-	2,606	-	3,139	-	3,139
Ukraine	-	1,273	-	1,273	-	1,314	-	1,314
US	2,024		-	2,024	2,023		-	2,023
Russia	-	664	-	664	-	681	-	681
Total	4,147	5,634	344	10,125	4,679	6,216	1,834	12,729

11. Intangible fixed assets

	Licences £'000
Cost	
At 1 January 2011	1,173
Additions	74
At 31 December 2011	1,247
Amortisation	
At 1 January 2011	1,042
Charge for the year	44
At 31 December 2011	1,086
Net book value	
At 31 December 2011	161
At 31 December 2010	131

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

12. 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 2011	7,149	653	67	2,482	10,351
Additions	-	-	-	255	255
Revaluations	290	-	-	-	290
At 31 December 2011	7,439	653	67	2,737	10,896
Depreciation					
At 1 January 2011	1,070	445	25	1,284	2,824
Charge for the year	115	52	13	224	404
At 31 December 2011	1,185	497	38	1,508	3,228
Net book value					
At 31 December 2011	6,254	156	29	1,229	7,668
At 31 December 2010	6,079	208	42	1,198	7,527

The land and buildings are occupied by the Bank for its own activities. Revaluation gain was recorded based on the professional valuation undertaken by Ringley, a chartered surveyor external to the Bank, in December 2011.

13. Other assets

	2011 £'000	2010 £'000
Tax receivables	58	-
Other assets	22	10
	80	10

14. Deposits by banks

	2011 £'000	2010 £'000
Deposits by banks are repayable as follows:		
On demand		
- Group	2,740	1,167
- Other	6,306	1,423
Within a year		
- Group	-	1,000
	9,046	3,590

The interest paid amount to group companies during the year is £22,778 (2010: £25,773).

14. Deposits by banks (continued)

Geographical analysis of deposit by banks is follows:

	2011 £'000	2010 £'000
In UK:		
On current account	-	63
Outside UK:		
On current account	3,033	2,527
On deposit account	6,013	1,000
	9,046	3,590

15. Customer accounts

	2011 £'000	2010 £'000
Customer deposits are repayable as follows:		
On demand	14,124	15,687
Within three months	53,865	57,117
Between three months and one year	21,055	19,205
Between one year and five years	3,147	1,259
	92,191	93,268

The balance includes customers' deposits of £89 million (2010: £92 million) which is due to mature in less than one year.

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

	2011 £'000			2010 £'000		
	Fixed rate interest	Floating rate interest	Total	Fixed rate interest	Floating rate interest	Total
Current account	-	10,229	10,229	-	10,669	10,669
Deposit account	-	23,370	23,370	-	23,555	23,555
Fixed deposit	58,592	-	58,592	59,044	-	59,044
	58,592	33,599	92,191	59,044	34,224	93,268

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

	2011 £'000						2010 £'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	34,552	628	462	1,138	-	36,780	35,258	233	395	510	-	36,396
Turkey	10,733	9,520	3,828	190	1	24,272	10,643	7,098	4,335	273	1	22,350
Cyprus	17,672	4,553	5,634	837	176	28,872	22,099	4,393	5,984	962	184	33,622
Others	236	1,715	274	42	-	2,267	164	177	448	111	-	900
Total	63,193	16,416	10,198	2,207	177	92,191	68,164	11,901	11,162	1,856	185	93,268

16. Other liabilities

	2011 £'000	2010 £'000

Amounts owed to group companies	34	58
Other taxes and social security costs	40	35
Corporate tax	-	212
Deferred tax liability	71	73
Obligation under finance lease and hire purchase	32	45
Other liabilities	73	84
	250	507

Deferred tax liabilities

	2011 £'000	2010 £'000
Opening balance at 1 January	72	45
Current year movement	(2)	(27)
Current year rate change	6	(2)
Prior year movement	(5)	57
Closing balance at 31 December	71	73

The closing deferred tax liability of £71,000 is made up of accelerated capital allowance of £54,000 and other timing differences of £17,000.

Obligation under finance lease and hire purchase

	2011 £'000	2010 £'000
Obligation under finance lease and hire purchase:		
Within one year	14	13
Between one and two years	17	15
Between two and five years	1	17
	32	45

Finance charges of £5,490 (2010: £6,957) were paid during the year in respect of obligation under finance lease.

17. Called up share capital

	Authorised		Called up, allotted and fully paid	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
12,000,000 Ordinary shares of £1 each	12,000	12,000	12,000	12,000

18. Reconciliation of movements in shareholders' funds and movements on reserves

	Called up share capital £'000	Profit and loss account £'000	Revaluation reserve £'000	Available for sale reserve £'000	Total Share holders Funds £'000
As at 1 January 2010	12,000	5,185	3,603	(404)	20,384
Profit for the year	-	350	-	-	350

Available for sale gains	-	-	-	447	447
Tax effect of the available for sale gain	-	(125)	-	-	(125)
As at 31 December 2010	12,000	5,410	3,603	43	21,056
As at 1 January 2011	12,000	5,410	3,603	43	21,056
Loss for the year	-	(65)	-	-	(65)
Available-for-sale gains	-	-	-	(126)	(126)
Tax effect of the available for sale gain	-	33	-	-	33
Revaluation Reserve	-	-	290	-	290
As at 31 December 2011	12,000	5,378	3,893	(83)	21,188

19. Other contingent liabilities

Other contingent liabilities comprise:

	2011 £'000	2010 £'000
Irrevocable letters of credit	-	

Included in irrevocable letters of credit are amounts in respect of group companies of £nil (2010 - £371,468).

20. 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.

	2011 £'000	2010 £'000
Formal standby facilities, credit lines and other commitments to lend:		
One year and over	40,514	34,604
Less than one year	20,490	16,894
	61,004	51,498

20. Commitments (continued)

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

		Land and buildings
	2011 £'000	2010 £'000
Operating leases which expire:		
Within one year	32	-
Between two and five years	47	32
More than five years	-	47

21. Assets and liabilities in foreign currencies

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

	2011 £'000	2010 £'000
Assets	45,323	36,786
Liabilities	45,281	36,770

22. Cash flow statement

Capital expenditure and financial investment	2011 £'000	2010 £'000
Net purchase of tangible and intangible fixed assets	(329)	(315)
Purchase of fixed asset investments	-	(5,928)
Proceed from disposal or maturity of investments	1,815	1,739
Net cash inflows /(outflows) from trading activities	1,486	(4,504)

Financing	2011 £'000	2010 £'000
Proceed from the issuance of share capital	-	-
	-	-

Returns on investments and servicing of finance	2011 £'000	2010 £'000
Dividend paid during the year	-	-
	-	-

23. Analysis of the balances of cash as shown in the balance sheet

	1 January 2011 £'000	Cash flows 2011 £'000	31 December 2011 £'000
Cash and balances at central banks	5,787	3,451	9,238
Loans and advances to other banks repayable on demand	20,253	967	21,220
	26,040	4,418	30,458

24. Analysis of changes in financing during the year

	Share capital £'000
Balance at 1 January 2011	12,000
Cash flow from financing	-
Other movements	-
Balance at 31 December 2011	12,000

25. Transactions with directors and managers

As at 31 December 2011, £24,372 was outstanding by way of loans to managers of the company (or persons connected with them) (2010 - £14,080). During the year, £15,768 (2010 - £14,380) was paid back and £26,060 drawdown by the managers (or persons connected to them) (2010 - £17,050).

26. Ultimate parent company

The ultimate parent and controlling company at 31 December 2011 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.

27. Related party transactions

The Bank has taken advantage of an exemption under FRS 8, relating to 100% subsidiaries, which exempts it from disclosing all related party transactions with group members. Other than those described in note 25, there are no other related party transactions.

28. 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 21) 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 (‘‘AGM’’), Wholesale & Markets, the Financial Controller and Treasury Dealer.
  - The Risk Committee is headed by the Non-Executive 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.

28. 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 Register 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 the 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; and
- 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 £105.5 million (2010: £105 million). Credit risk exposure of £41 million (2010: £52 million) is secured against the first charge on properties and lien on customers' deposits.

28. 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 £9.3 million (2010: £10.6 million) was outstanding as at 31 December 2011.

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 and therefore sensitivity analysis has not been presented.

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.

28. 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.

29. 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

29. 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 foreign currency swap contracts. The total notional amount of outstanding forward foreign exchange contracts that the Bank has committed is as below.

			2011
	Notional amount £'000	**Fair value assets £'000**	**Fair value Liabilities £'000**
Foreign currency swap contracts	9,249	-	65

			2010
	Notional Amount £'000	Fair value Assets £'000	Fair value Liabilities £'000
Foreign currency swap contracts	10,640	-	37

Foreign currency swaps totalling £9,249 million at the year end are due to mature in less than one month.

Interest rate risk

Exposure to interest rate movements arise where there is an imbalance between rate sensitive assets and liabilities. The table on page 35 and 36 reflect management's estimate of the interest rate sensitivity gap for the Bank as at 31 December 2011. 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 2010 and 2011 capital has been maintained at a level above minimum FSA requirements. Such levels have been established by reference to an Internal Capital Adequacy Assessment Process (''ICAAP'') assessment. The Bank's capital resources consist of Tier 1 Capital and Upper Tier 2 Revaluation Reserve.

The Bank holds 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:

	2011 £'000	2010 £'000
Tier 1 Capital		
Share Capital	12,000	12,000
Retained Earnings	5,378	5,410
Upper Tier 2 Capital		
Revaluation Reserve	3,893	3,603
Total regulatory capital	21,271	21,013

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

29. Financial instruments (continued)

Categories of financial instruments 2011

Assets	Loans and Receivables	Available for sale	Financial asset/ liabilities at amortised cost	Derivatives	Total

Cash and balances at central banks	9,238	-	-	-	9,238
Loans and advances to financial institutions	30,754	-	-	-	30,754
Items in the course of collection	171	-	-	-	171
Loans and advances to customers	64,597	-	-	-	64,597
Debt securities-available for sale	-	4,887	5,238	-	10,125
Other assets	24	-	-	-	24
Total financial assets	**104,784**	**4,887**	**5,238**	**-**	**114,909**
Total non financial assets					8,272
Total assets					**123,181**
Liabilities					
Deposits by banks	-	-	9,046	-	9,046
Items in the course of transmission to other banks	-	-	22	-	22
Customer accounts	-	-	92,191	-	92,191
Derivative liabilities	-	-	-	65	65
Other liabilities	-	-	179	-	179
Accruals and deferred income	-	-	118	-	118
Total financial liabilities	**-**	**-**	**101,556**	**65**	**101,621**
Total non financial liabilities					21,560
Total liabilities and equity					**123,181**

29. Financial instruments (continued)

Categories of financial instruments 2010

	Loans and Receivables	Available for sale	Financial assets/ liabilities at amortised cost	Derivative	Total
Assets					

Cash and balances at central banks	5,787	-	-	-	5,787
Loans and advances to financial institutions	38,928	-	-	-	38,928
Items in the course of collection	2	-	-	-	2
Loans and advances to customers	53,363	-	-	-	53,363
Debt securities-available for sale	-	7,490	5,239	-	12,729
Other assets	10	-	-	-	10
Total financial assets	**98,090**	**7,490**	**5,239**	**-**	**110,819**
Total non financial assets					7,954
Total assets					**118,773**

Liabilities

Deposits by banks	-	-	3,590	-	3,590
Items in the course of transmission to other banks	-	-	62	-	62
Customer accounts	-	-	93,268	-	93,268
Derivative liabilities	-	-	-	37	37
Other liabilities	-	-	187	-	187
Accruals and deferred income	-	-	83	-	83
Total financial liabilities	**-**	**-**	**97,190**	**37**	**97,227**
Total non financial liabilities					21,546
Total liabilities and equity					**118,773**

29. Financial instruments (continued)

Interest rate sensitivity gap analysis 2011

	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	8,506	-	-	-	-	732	9,238

Notes to the accounts
For the year ended 31 December 2011

Loans and advances to banks	30,754	-	-	-	-	-	30,754
Loans and advances to customers	51,807	3,393	2,123	7,216	226	(167)	64,598
Debt Securities	-	-	1,618	6,384	2,123	-	10,125
Other assets	-	-	-	-	-	8,466	8,466
	91,067	3,393	3,741	13,600	2,349	9,031	123,181
Liabilities							
Deposits by banks	9,046	-	-	-	-	-	9,046
Customer accounts	67,989	13,961	7,094	3,147	-	-	92,191
Other liabilities	-	-	-	-	-	756	756
Shareholders' funds	-	-	-	-	-	21,184	21,188
	77,035	13,961	7,094	3,147	-	21,940	123,181
Interest rate sensitivity gap	14,032	(10,568)	(3,353)	10,453	2,349	(12,906)	-
Cumulative gap	14,032	3,464	110	10,563	12,913	-	-

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 2011.

Other liabilities other then deferred tax liabilities of £71,000 (2010 – 73,000) classified as non interest bearing in the above table has contractual maturities of less than three months.

The bank has outstanding financial guarantee contract of £122k at the year end. The outstanding guarantees of £88k are due to mature within a year.

29. Financial instruments (continued)

Interest rate sensitivity gap analysis 2010

	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	-	-	-	-	-	5,787	5,787
Loans and advances to banks	35,703	3,225	-	-	-	-	38,928
Loans and advances to customers	42,329	982	5,123	4,830	231	(132)	53,363
Debt Securities	-	-	521	9,523	2,685	-	12,729
Other assets	-	-	-	-	-	7,966	7,966
	78,032	4,207	5,644	14,353	2,916	13,581	118,733
Liabilities							
Deposits by banks	2,590	-	1,000	-	-	-	3,590
Customer accounts	72,804	11,297	7,908	1,259	-	-	93,268
Other liabilities	-	-	-	-	-	859	859
Shareholders' funds	-	-	-	-	-	21,056	21,056
	75,394	11,297	8,908	1,259	-	21,915	118,773
Interest rate sensitivity gap	2,638	(7,090)	(3,264)	13,094	2,916	(8,294)	-
Cumulative gap	2,638	(4,452)	(7,716)	5,378	8,294	-	-

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 2010.

Other liabilities other then deferred tax liabilities of £71,000 classified as non interest bearing in the above table have contractual maturities of less than three months.

A liability (or negative) gap position exists when liabilities re-price 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 £167,000 (2010 - £132,000).

The weighted average interest rates are as follows: 1.52% (2010: 1.51%) for the loans and advances to banks; 7.01% (2010: 5.29%) for the loans and advances to customers; 5.85% (2010: 6.35%) for the debt securities; 5.88% (2010: 0.74%) for the deposits by banks; and 2.33% (2010: 2.18%) 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 £86,000 (2010: £194,000). 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.

29. 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 2011 £'000	Net currency position 2010 £'000
US Dollar	4	-
Euro	(3)	(3)
Japanese Yen	1	-
Swiss Franc	19	34
Other currencies	21	(14)
Total	42	17

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.

29. 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 2011.

	Carrying value 2011 £000	Fair value 2011 £000	Carrying value 2010 £000	Fair value 2010 £000
Financial assets				
Cash	9,238	9,238	5,787	5,787
Loans and advances to banks	30,754	30,754	38,928	38,928
Loans and advances to customers	64,597	64,597	53,363	53,363
Debt securities	10,125	10,125	12,729	12,729
Financial liabilities				
Deposits by banks	9,046	9,046	3,590	3,590
Customer accounts	92,191	92,191	93,268	93,268
Derivative liabilities	65	65	37	37