Company Registration No. 2643004

Turkish Bank (UK) Limited

Report and Financial Statements

31 December 2012

Turkish Bank (UK) Limited

Report and financial statements 2012

Contents

Chairman's statement

The UK economy continues to stagnate, partially due to the tight budgetary controls emanating from the UK Treasury but also due to the lack of growth within the UK's main trading partners. Whilst strict budgetary control is essential in order to keep the deficit under control, it does act as a brake on any economic growth. As yet I can see no sign of a real recovery; indeed I expect 2013 to be much the same as 2012. This means that interest rates will stay flat for the foreseeable future, and the latest report from the Bank of England Monetary Committee is that further quantitative easing is becoming more likely and the Bank is taking a longer term view in trying to reduce inflation.

As mentioned last year, inflationary pressures persist arising from the effects of Quantitative Easing and also rising import prices, although inflation has fallen from its peak level of 5% to around 3% at present. However the recent falls in the value of sterling will bring even greater inflationary pressures. The turmoil in the Eurozone seems to have abated for a period, but I fear that this will be a continuing feature of events over at least the next year.

The Turkish economy remains robust with inflation under control with the Central Bank and the Government taking on-going action since late 2010 to cool the growth in consumer spending. However there are signs that the growth has slowed quite rapidly with the annual growth rate down to 1.6% in the third quarter of 2012. The forecast growth rate for 2013 is 4%, which is very positive by the standards of the UK and Eurozone, but this is at risk due to the continuing lack of economic recovery in Turkey's main export markets. 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.

The continuing 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. Reduced yields are also a consequence of the otherwise welcome restoration of investment grade to Turkish Bonds by Fitch. Further pressure on yields may increase if, as expected, another rating agency also rerates Turkish bonds to investment grade. This may however present an opportunity for potential profit on Turkish bond holdings.

As a consequence, much of the impetus for the improvements in the Bank's performance seen during the year emanated from the strategic decision some six years ago to grow the community banking segment of the Bank. TBUK has made good progress during 2012 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 Western Europe.

During the year the Bank's profit before tax rose from £59,000 to £540,000. The profit in 2011 was hit by a £505,000 provision against the value of BTA bonds, but 2012 saw a partial recovery of £76,000 in profit on the sale of these bonds following a further reconstruction of the debt, this was part of a total profit of £214,000 of bond sales during the year. The results for the year were reduced by a further charge of £94,000 (2011: £200,000) arising from a fine by the FSA for lack of controls over correspondent banking relationships. The Bank has made strong strides this year to overcome this weakness and ensure proper controls are in place to cope with existing and future business.

As stated last year, the Bank's customers are not immune from the effects of the recession and the Bank has had to increase its provisions for impairment against loans to £112,000 from £35,000 in 2011. This was largely due to one non-performing loan.

The year showed a consolidation of the recovery seen last year in income generated by the remittance products, which increased 9% over the year, through the improved provision of service quality and delivery helping further recapture business lost in previous years.

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 has fallen slightly to £40.6 million a reduction of £2 million reflecting larger than usual repayments of loans and also as a result of the strategic shift in the lending portfolio away from property development with more focus on the retail sector. Domestic deposits grew by £5.2 million to £41.8 million so that these now exceed the value of domestic lending – a very welcome achievement of the Bank's intention to match

Chairman's statement (Continued)

domestic lending with domestic deposits rather than having to rely on non-resident deposits. These latter have fallen by £5.7 million to £50.2 million. Non- resident lending has also fallen slightly from £21.9 million to £19.5 million.

The Bank is in a strong position in terms of capital, liquidity and strategic positioning to take advantage of any upturn in the economy, but also is able to expand cautiously in its lending book and customer base to assist our target customers in their requirements. As at 31 December 2012, the Bank's solvency ratio was 258% (2011: 263%). The amount held in very liquid funds amounted to 36% of total assets (2011: 32%) and 48% of total liabilities (2011: 39%).

We continue to look for new and improved ways to serve our customers and strongly believe in the mantra of good customer service, which is the basis of a strong bank integrated within its community.

I wish to extend my thanks to Bob Long who has served the Bank for many years as the Managing Director and helped in developing the Bank in new areas and helping set high standards for the Bank. This is something that I am sure his successor David Stewart will continue. I am pleased to say that Bob has agreed to stay on as a Non-Executive Director to continue to offer us his experience.

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 2013 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

15 March 2013

Turkish Bank (UK) Limited

Report and financial statements 2012

Officers and professional advisors

Directors

I H Bortecene (Chairman)
D I Stewart was appointed on 01/10/12
R W Long
M E Erenman
D Blackmore
P Ryan
E Ozcelik

Secretaries

J. Kent

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 2012.

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 has made continued 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.

Profit before tax increased to £540,000 from £59,000 helped by the sale of BTA bonds which provided a partial recovery against the amounts previously written off and impacted results negatively last year by £505,000. The results were still held back by a further provision against a regulatory fine, for poor controls on correspondent banking, of £294,000 of which £200,000 had been provided last year. In addition, due largely to a significant provision against one non-performing loan, impairment losses have increased over the year from £35,000 to £112,000.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.

The results also benefited this year from a profit on sale of bonds of £214,000 (2011: £56,000) which includes the partial recovery on the sale of BTA bonds but also reflects a sale of bonds from countries that do not fit within the Bank's new strategy. The Bank has decided that in future the Bank will only invest in bonds from Governments /Banks / Companies issued in the UK or Turkey. Bonds that do not fit that criterion would be realised over time and most of these were sold in 2011 and 2012.

Resident lending to the chosen market sectors in and around London has reduced slightly to £40.6 million (2011- £42.7 million) reflecting in part the continuation of the recessionary environment and also as a result of the strategic shift in the lending portfolio away from property development with more focus on the retail sector. Customer deposits have held firm at £92.3 million (2011: £92.2 million), but within this resident deposits have increased to £41.8 million (2011: £36.6 million) so largely matching resident lending, achieving one of the Bank's objectives: to grow resident deposits so that they matched resident lending.

Non-resident lending also showed a reduction to £19.4 million (2011: £23.2 million), whilst non-resident deposits decreased to £50.5 million (2011: £55.6 million)

In other areas the Bank saw further growth both in the level of fees from business accounts and also an improvement of some 9% in income from the Bank's remittance products which since 2010 have included a very popular TRY offering.

The Bank continues to work towards further improving the quality of its services to all levels of its customer base and to 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. The Bank is working with other Group members to improve internet banking product and progress on this is expected before the end of the current year.

We look to this year to build on the underlying operating profits generated in 2012 despite the ever increasing burden of regulatory costs and to provide our clients with the quality service to which they are entitled.

Directors' report (continued)

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 currency 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 profit for the year after taxation amounted to £332,000 (2011 – loss £65,000).

The directors do not recommend the payment of dividend (2011 - £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 £850 (2011 - £120).

Directors and their interests

The directors who served during the year were as follows:

I H Bortecene (Chairman)
David I Stewart was appointed as a Director on 01/10/12
R W Long
M E Erenman
E Ozcelik
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 2012 (2011: four times).

Disclosure of information to the 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

J. Kent

Secretary

15 March 2013

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 2012 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 2012 and of its profit 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.

Tom Millar, F.C.A. (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

London, United Kingdom

15 March 2013

Profit and loss account
For the year ended 31 December 2012

	Notes	2012 £'000	2011 £'000
Interest receivable:			
Interest receivable and similar income arising from debt securities		489	621
Other interest receivable and similar income		4,553	4,173
		5,042	4,794
Interest payable		(2,212)	(2,039)
Net interest income		2,830	2,755
Fees and commissions receivable		1,572	1,458
Fees and commissions payable		(113)	(90)
Dealing profits		185	183
Other operating income		9	7
Gain on sale of debt securities		214	56
		1,867	1,614
Total operating income		4,697	4,369
Administrative expenses	2	(3,416)	(3,108)
Depreciation and amortisation	11, 12	(521)	(448)
Other operating charges		(14)	(14)
Impairment losses on debt securities	10	-	(505)
Provision for liabilities	6	(94)	(200)
Impairment losses on loans and advances to customers	3	(112)	(35)
Total operating expenses		(4,157)	(4,310)
Profit on ordinary activities before taxation	4	540	59
Tax on profit on ordinary activities	5	(208)	(124)
Profit on ordinary activities after taxation	18	332	(65)

The notes on pages 14 to 39 form an integral part of these financial statements.

All activities relate to continuing operations.

Turkish Bank (UK) Limited
Balance sheet
31 December 2012

	Notes	2012 £'000	2011 £'000
Assets			
Cash and balances at central banks		9,718	9,238
Loans and advances to banks	7	33,347	30,754
Items in the course of collection		75	171
Loans and advances to customers	8	60,122	64,597
Debt securities	10	6,492	10,125
Intangible fixed assets	11	186	161
Tangible fixed assets	12	7,387	7,668
Derivative assets		15	-
Other assets	13	70	80
Prepayments and accrued income		417	387
Total assets		117,829	123,181
Liabilities			
Deposits by banks	14	3,151	9,046
Items in the course of transmission to other banks		21	22
Customer accounts	15	92,310	92,191
Derivative liabilities	29	-	65
Other liabilities	16	279	250
Accruals and deferred income		432	219
Provision for liabilities	6	-	200
		96,193	101,993
Equity			
Called up share capital	17	12,000	12,000
Profit and loss account	18	5,673	5,378
Available for sale reserve	18	70	(83)
Revaluation reserve	18	3,893	3,893
Total equity		21,636	21,188
Total liabilities and equity		117,829	123,181
Contingent liabilities			
Guarantees and assets pledged as collateral security		75	122
Other contingent liabilities	19	-	-
		75	122
Commitments	20	1,154	1,140

The Board of Directors approved these financial statements and authorised for issue on 15 March 2013.

Signed on behalf of the Board of Directors

I H Bortecene
Director

D. I. Stewart
Director

The notes on pages 14 to 39 form an integral part of these financial statements.

Turkish Bank (UK) Limited

Cash flow statement
For the year ended 31 December 2012

	2012 £'000	2011 £'000
Net cash (out flows)/inflow from operating activities	**(13,230)**	**3,295**
Taxation	(159)	(363)
Capital expenditure and financial investment (note 22)	3,583	1,486
Financing (note 22)	-	-
Returns on investments and servicing of finance (note 22)	-	-
Decrease in cash (note 23)	(9,806)	4,418

<u>Note to cash flow statement</u>

Reconciliation of operating profit to net operating cash flows	2012 £'000	2011 £'000
Profit on ordinary activities before tax	540	59
(Increase)/decrease in prepayments and accrued income	(30)	177
Net increase in investment due to fair value change	153	126
Increase/(decrease) in accruals and deferred income	212	(30)
Depreciation charge and amortisation	521	448
Gain on sale of fixed asset investment	(214)	-
Impairment loss on debt securities	-	537
Net cash inflows from trading activities	1,182	1,317
Net decrease /(increase) in collections	94	(209)
Net decrease /(increase) in loans and advances to banks and customers	(8,404)	(3,060)
Net increase /(decrease) in deposits by banks and customers	(5,776)	5,346
Net decrease in other assets and liabilities	(246)	(127)
Net (decrease) /increase in derivative liabilities	(80)	28
Net cash (outflow)/inflows from operating activities	**(13,230)**	**3,295**

Statement of total recognised gains and losses
For the year ended 31 December 2012

	Notes	2012 £'000	2011 £'000
Profit /(loss) for the financial year		332	(65)
Available-for-sale gain/(loss)	18	153	(126)
Tax effect of available for sale (gain)/loss	18	(37)	33
Surplus on property revaluation	18	-	290
Total recognised gains for the year		448	132

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.

(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

	2012 £'000	2011 £'000
Staff costs during the year (including directors)		
Wages and salaries	1,796	1,680
Social security costs	157	142
Pension costs	43	30
	1,996	1,852
Other administrative expenses	1,420	1,256
	3,416	3,108

2. Administrative expenses (continued)

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

	2012 No.	2011 No.
Commercial banking activities	80	75

Directors' remuneration during the year consisted of:

	2012 £'000	2011 £'000
Emoluments	147	120

The emoluments of the highest paid director for the year ended 31 December 2012 were £91,000 (2011 - £81,000).

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

	2012 £'000	2011 £'000
Impairment charge for the year	(120)	(39)
Recoveries	8	4
Net impairment charge for the year	(112)	(35)

During the year the Bank received £800 (2011 - £3,000) 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:

	2012 £'000	2011 £'000
Foreign currency gains	(185)	(183)
Operating lease rentals		
Land and buildings	79	79
Depreciation and amortisation		
Tangible fixed assets	453	404
Intangible fixed assets	68	44
Fees payable to the company's auditor		
Audit of the company's annual accounts	62	60
Tax services	20	10
	82	70

5. Tax on profit on ordinary activities

	2012 **£'000**	**2011** **£'000**
Current tax		
United Kingdom corporation tax at 24.5% (2011 – 26.5%) based on profit for the year	(238)	(127)
Adjustment in respect of prior years	-	1
Total current tax	(238)	(126)
Deferred tax (Note 16)		
Reversal of timing differences	27	3
Prior year adjustment	-	(6)
Current tax rate adjustment	3	5
	(208)	(124)

The current tax charge for the year is considerably higher than the standard rate of corporation tax at 24.5% as explained below:

	2012 **£'000**	**2011** **£'000**
Profit on ordinary activities before tax	540	59
Tax at 24.5% (2011: 26.5%) thereon	(132)	(15)
Effects of:		
Expenses not deductible for tax purposes	(35)	(73)
Depreciation in excess of capital allowances	(67)	(39)
Movement in short-term timing differences	(4)	-
Prior year adjustments	-	1
	(238)	(126)

6. Provision for liabilities

	2012 £'000	**2011** £'000
As at 1 January 2012	200	-
Charge against profits	94	200
At 31 December 2012	294	200
Payment made	(294)	-
Closing balance	-	200

This relates to the estimated cost of regulatory matters which has been paid during the year.

7. Loans and advances to banks

	2012 **£'000**	**2011** **£'000**
Loans and advances to banks are repayable as follows:		
On demand	11,451	21,220
Within three months	19,739	9,534
Between three months and one year	2,157	-
	33,347	30,754

7. Loans and advances to banks (continued)

Included within loans and advances to banks is an amount of £65,000 in respect of group companies (2011 - £51,000). The interest received from group companies during the year was £11,000 (2011 - £14,000).

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

	2012 £'000	2011 £'000
In UK:		
On current account	3,429	12,980
On deposit account in money market lending	7,180	5,700
Outside UK:		
On current account	1,721	1,766
On deposit account		
- Money Market Lending	18,859	8,308
- Promissory Notes	2,158	2,000
	33,347	30,754

8. Loans and advances to customers

	2012 £'000	2011 £'000
Loans are repayable as follows:		
On demand	6,441	7,176
Within three months	9,581	9,715
Between three months and one year	8,894	5,842
Between one and five years	13,212	11,080
After five years	22,205	30,951
Provision for impairment losses	(211)	(167)
	60,122	64,597

Non-performing loans and advances totalled £333,000 at the year-end (2011 - £167,000).

Loans and advances to customers includes £260,827 (2011: £169,829) 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:

	2012				
	Fixed Rate Loan £'000		Floating Rate Loan £'000		Total £'000
	Secured	Unsecured	Secured	Unsecured	
Overdraft	-	-	5,951	490	6,441
Fixed term					
- Retail	-	-	30,567	198	30,765
- Corporation	3,500	14,825	4,799	3	23,127
	3,500	14,825	41,317	691	60,333
Provision for impairment			(85)	(126)	(211)
	3,500	14,825	41,232	565	60,122

8. Loans and advances to customers (continued)

	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

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

	2012 £'000					2011 £'000				
	GBP	USD	EURO	TRY	Total	GBP	USD	EURO	TRY	Total
UK	40,680	-	-	-	40,680	42,785	-	-	-	42,785
Non UK										
- Turkey	8,948	4,136	3,715	1,218	18,017	2,121	6,069	3,369	8,898	20,457
- Others	763	653	-	9	1,425	522	833	-	-	1,355
Total	50,391	4,789	3,715	1,227	60,122	45,428	6,902	3,369	8,898	64,597

9. Provisions for impairment losses

	2012 £'000	2011 £'000
As at 1 January 2012	167	132
Charge against profits	120	39
Less: recoveries	(8)	(4)
Net impairment charge for the year	112	35
Less: loans written off	(68)	-
At 31 December 2012	211	167

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	**2012 £'000**	**2011 £'000**
Nominal value	1,316	5,154
Impairment loss	-	(505)
Accrued interest	4	63
Available-for-sale revaluation	70	(83)
Market value	1,390	4,629
Held to maturity		
Nominal value	5,021	5,414
Accrued interest	81	82
	5,102	5,496
Total	6,492	10,125

Investment in debt securities will mature as follows:

	2012 £'000	**2011 £'000**
Repayable:		
Less than one year	-	1,618
Between one and five years	4,380	6,384
After five years	2,112	2,123
	6,492	10,125

Segmental analysis of investment in debt securities is as follows:

	2012			**2011**		
	Fixed rate bonds £'000	**Floating rate bonds £'000**	**Total £'000**	**Fixed rate bonds £'000**	**Floating rate bonds £'000**	**Total £'000**
Sovereign bonds	2,112	-	2,112	3,396	-	3,396
Corporate bonds	4,380	-	4,380	6,385	344	6,729
	6,492	-	6,492	9,781	344	10,125

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% (2011 – 4.75%).

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 £nil which are due to mature in less than one year (2011: £1,618).

Analysis by currency of origin is as follows:

	2012				2011			
Origin of debt securities	**GBP**	**USD**	**EURO**	**Total**	**GBP**	**USD**	**EURO**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
UK	2,112	-	-	2,112	2,123	-	-	2,123
Turkey	-	1,041	-	1,041	-	1,091	344	1,435
Kazakhstan	-	1,314	-	1,314	-	2,606	-	2,606
Ukraine	-	-	-	-	-	1,273	-	1,273
US	2,025	-	-	2,025	2,024		-	2,024
Russia	-	-	-	-	-	664	-	664
Total	4,137	2,355	-	6,492	4,147	5,634	344	10,125

11. Intangible fixed assets

	Licences £'000
Cost	
At 1 January 2012	1,247
Additions	93
At 31 December 2012	1,340
Amortisation	
At 1 January 2012	1,086
Charge for the year	68
At 31 December 2012	1,154
Net book value	
At 31 December 2012	186
At 31 December 2011	161

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

12. Tangible fixed assets

	Freehold land and buildings	Lease hold land and building	Lease Equipment	Fixtures, fittings and equipment	Total
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Cost/Revaluation					
At 1 January 2012	7,439	653	67	2,737	10,896
Additions	-	-	-	172	172
Revaluations					
Disposals	-	-	-	(12)	(12)
At 31 December 2012	7,439	653	67	2,897	11,056
Depreciation					
At 1 January 2012	1,185	497	38	1,508	3,228
Charge for the year	136	52	13	252	453
Disposals	-	-	-	(12)	(12)
At 31 December 2012	1,321	549	51	1,748	3,669
Net book value					
At 31 December 2012	6,118	104	16	1,149	7,387
At 31 December 2011	6,254	156	29	1,229	7,668

The land and buildings are occupied by the Bank for its own activities. No revaluation gain was recorded in the current year.

13. Other assets

	2012	2011
	£'000	£'000
Tax receivables	-	58
Other assets	70	22
	70	80

14. Deposits by banks

	2012	2011
	£'000	£'000
Deposits by banks are repayable as follows:		
On demand		
- Group	1,684	2,740
- Other	1,467	6,306
Within a year		
- Group	-	-
	3,151	9,046

The interest paid amount to group companies during the year is £3,606 (2011: £22,778).

14. Deposits by banks (continued)

Geographical analysis of deposit by banks is follows:

	2012 £'000	2011 £'000
In UK:		
On current account	27	-
Outside UK:		
On current account	2,753	3,033
On deposit account	371	6,013
	3,151	9,046

15. Customer accounts

	2012 £'000	2011 £'000
Customer deposits are repayable as follows:		
On demand	14,044	14,124
Within three months	48,998	53,865
Between three months and one year	28,128	21,055
Between one year and five years	1,140	3,147
	92,310	92,191

The balance includes customers' deposits of £91 million (2011: £89 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:

	2012 £'000			2011 £'000		
	Fixed rate interest	Floating rate interest	Total	Fixed rate interest	Floating rate interest	Total
Current account	-	11,867	11,867	-	10,229	10,229
Deposit account	-	18,181	18,181	-	23,370	23,370
Fixed deposit	62,262	-	62,262	58,592	-	58,592
	62,262	30,048	92,310	58,592	33,599	92,191

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

	2012 £'000						2011 £'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	39,513	687	912	1,005	-	42,117	34,552	628	462	1,138	-	36,780
Turkey	9,411	6,982	3,029	1,200	1	20,623	10,733	9,520	3,828	190	1	24,272
Cyprus	16,666	3,362	5,837	1,001	141	27,007	17,672	4,553	5,634	837	176	28,872
Others	1,264	1,122	154	23	-	2,563	236	1,715	274	42	-	2,267
Total	66,854	12,153	9,932	3,229	142	92,310	63,193	16,416	10,198	2,207	177	92,191

16. Other liabilities

	2012 £'000	2011 £'000
Amounts owed to group companies	33	34
Other taxes and social security costs	45	40
Corporate tax	58	-
Deferred tax liability	40	71
Obligation under finance lease and hire purchase	18	32
Other liabilities	85	73
	279	250

Deferred tax liabilities

	2012 £'000	2011 £'000
Opening balance at 1 January	71	72
Current year movement	(27)	(2)
Current year rate change	(4)	6
Prior year movement	-	(5)
Closing balance at 31 December	40	71

The closing deferred tax liability of £40,000 is made up of accelerated capital allowance of £28,000 and other timing differences of £12,000.

Obligation under finance lease and hire purchase

	2012 £'000	2011 £'000
Obligation under finance lease and hire purchase:		
Within one year	17	14
Between one and two years	1	17
Between two and five years	-	1
	18	32

Finance charges of £3,540 (2011: £5,490) were paid during the year in respect of obligation under finance lease.

17. Called up share capital

	Authorised		Called up, allotted and fully paid	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
12,000,000 Ordinary shares of £1 each	12,000	12,000	12,000	12,000

Notes to the accounts
For the year ended 31 December 2012

18. 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 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
As at 1 January 2012	12,000	5,378	3,893	(83)	21,188
Profit for the year	-	332	-	-	332
Available-for-sale gains	-	-	-	153	153
Tax effect of the available for sale gain	-	(37)	-	-	(37)
As at 31 December 2012	12,000	5,673	3,893	70	21,636

19. Other contingent liabilities

Other contingent liabilities comprise:

	2012	2011
	£'000	£'000
Irrevocable letters of credit	-	-

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.

	2012	2011
	£'000	£'000
Formal standby facilities, credit lines and other commitments to lend:		
One year and over	21	-
Less than one year	1,133	1,140
	1,154	1,140

20. Commitments (continued)

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

	Land and buildings	
	2012	**2011**
	£'000	**£'000**
Operating leases which expire:		
Within one year	32	32
Between two and five years	47	47
More than five years	-	-

21. Assets and liabilities in foreign currencies

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

	2012	**2011**
	£'000	**£'000**
Assets	36,316	45,323
Liabilities	36,256	45,281

22. Cash flow statement

	2012	**2011**
Capital expenditure and financial investment	**£'000**	**£'000**
Net purchase of tangible and intangible fixed assets	(265)	(329)
Proceed from disposal or maturity of investments	3,847	1,815
Net cash inflows from investing activities	3,582	1,486

	2012	**2011**
Financing	**£'000**	**£'000**
Proceed from the issuance of share capital	-	-
	-	-

	2012	**2011**
Returns on investments and servicing of finance	**£'000**	**£'000**
Dividend paid during the year	-	-
	-	-

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

	1 January 2012	**Cash flows 2012**	**31 December 2012**
	£'000	**£'000**	**£'000**
Cash and balances at central banks	9,238	480	9,718
Loans and advances to other banks repayable on demand	20,156	(10,286)	9,870
	29,394	(9,806)	19,588

24. Analysis of changes in financing during the year

	Share capital £'000
Balance at 1 January 2012	12,000
Cash flow from financing	-
Other movements	-
Balance at 31 December 2012	12,000

25. Transactions with directors and managers

As at 31 December 2012, £16,494 was outstanding by way of loans to managers of the company (or persons connected with them) (2011 - £24,372). During the year, £13,752 (2011 - £15,768) was paid back and £5,874 drawdown by the managers (or persons connected to them) (2011 - £26,060). The transactions with related parties are on standard commercial terms.

26. Ultimate parent company

The ultimate parent and controlling company at 31 December 2012 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 competence.

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 subcommittee, the Risk Committee, (Chaired by a Non-Executive Director) oversees risk management, and sets the framework and risk appetite. The Risk Committee overviews all risks and controls and in particular the Risk Management System operated by the Bank and is also responsible for monitoring emerging risks and keeping the Board advised. It also is the Committee that takes the lead on the RRP, ICAAP and ILAA plus associated risk documents. The risk appetite sets out detailed tolerance limits within which the business operates, and this is supported by Bank Policies. All Policies are approved by the Board and subject to review at least once each calendar year.
- The Audit Committee (Chaired by a Non-Executive Director) reports to the Board and is responsible for ensuring that the controls set out by the Board and Risk Committee and by various policies are carried out in practice and remain effective. The Internal Audit function reports direct to the Audit Committee and the external auditor is invited to all meetings of the Audit Committee, which meets at least quarterly.
- There are then various committees at functional level to oversee the implementation of risk management and associated policies. The principal committees are:

28. Risk management framework (continued)

- Assets and Liabilities Committee (ALCO), which manages the market and liquidity risks, and now reports direct to the Board (through the Risk Committee on certain issues such as the RRP) . ALCO is responsible for the RRP and also the CFP and its members have direct responsibility for the ICAAP and ILAA .
- Senior Management Committee (SMC) – responsible for day to day management of the business under the direction of the Managing Director.
- Risk Sub-Committee – day to day responsibility for risk reporting through the SMC to the Risk Committee. This involves all management taking a role in the Risk Management System overseen by the Risk and Compliance Officer. The Risk Sub Committee has a number of sub-committees to help monitor and control other areas of risk
  - Business Continuity
  - AML
  - TCF
  - Operations
  - Credit
  - Care Lending
  - Health and Safety
  - IT

The Business Development Committee is responsible for developing business, marketing and product development.

Credit Risk Management

Credit risk, with its closely associated concentration 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 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 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, and the impact of concentration risk.

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.

28. Risk management framework (continued)

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 also monitors, as part of its credit risk assessment, its concentration risk in various sectors.

The Bank's maximum exposure to credit risk at the year end is £100 million (2011: £105.5 million). Credit risk exposure of £40 million (2011: £41 million) is secured against the first charge on properties and lien on customers' deposits.

ICAAP (Internal Capital Adequacy Assessment Process)

The ICAAP is managed by ALCO and presented to the Risk Committee then Board for challenge and approval. The ICAAP process identifies the risks that are involved in the business and the amount of capital that should be held against each of the risks. As an outcome from this process the bank has determined that it should hold additional capital for the following risks:

- Credit Risk (including concentration risk)
- Market Risk
- Operational Risk (including Systems and Controls; Personnel and Reputational)
- Currency and FX Risk
- Interest Rate Risk

These risks are discussed further in this section

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. 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 £9.1 million (2011: £9.3 million) was outstanding as at 31 December 2012.

28. Risk management framework (continued)

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.

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.

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. It has been further enhanced the introduction over the last two years of a dedicated Risk Management System which records and assesses individual risks to ensure they are properly monitored and controlled.

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’’.

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

28. Risk management framework (continued)

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 managers.

Monitoring at portfolio levels is carried out by Head Office committees, under the overview of the Risk and Compliance Manager, 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.

Operational risk also includes any risks arising from Systems and Controls failures, Reputational Risk and Key Personnel Risk, all of which are managed through the Risk Management System.

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 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.

			2012
	Notional amount £'000	**Fair value assets £'000**	**Fair value Liabilities £'000**
Foreign currency swap contracts	9,080	15	-

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

Foreign currency swaps totalling £9,080 million (2011: £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 2012. Assets and liabilities are included at the earliest date at which the applicable interest rate can change.

29. Financial instruments (continued)

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 2011 and 2012 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:

	2012 **£'000**	**2011** **£'000**
Tier 1 Capital		
Share Capital	12,000	12,000
Retained Earnings	5,673	5,378
Upper Tier 2 Capital		
Retained Earnings	-	-
Revaluation Reserve	3,893	3,893
Total regulatory capital	21,566	21,271

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

29. Financial instruments (continued)

Categories of financial instruments 2012

Assets	Loans and Receivables	Available for sale	Financial assets/ liabilities at amortised cost	Derivatives	Total
Cash and balances at central banks	9,718	-	-	-	9,718
Loans and advances to financial institutions	33,347	-	-	-	33,347
Items in the course of collection	75	-	-	-	75
Loans and advances to customers	60,122	-	-	-	60,122
Debt securities-available for sale	-	1,390	5,102	-	6,492
Derivative Assets	-	-	-	15	15
Other assets	70	-	-	-	70
Total financial assets	**103,332**	**1,390**	**5,102**	**15**	**109,839**
Total non financial assets					7,990
Total assets					**117,829**
Liabilities					
Deposits by banks	-	-	3,151	-	3,151
Items in the course of transmission to other banks	-	-	21	-	21
Customer accounts	-	-	92,310	-	92,310
Other liabilities	-	-	279	-	279
Accruals and deferred income	-	-	432	-	432
Total financial liabilities	-	-	**96,193**	-	**96,193**
Equity					21,636
Total liabilities and equity					**117,829**

29. Financial instruments (continued)

Categories of financial instruments 2011

Assets	Loans and Receivables	Available for sale	Financial assets/ 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	80	-	-	-	80
Total financial assets	**104,840**	**4,887**	**5,238**	**-**	**114,965**
Total non financial assets					8,216
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	-	-	250	-	250
Accruals and deferred income	-	-	219	-	219
Provision for liabilities	-	-	200	-	200
Total financial liabilities	**-**	**-**	**101,928**	**65**	**101,993**
Equity					21,188
Total liabilities and equity					**123,181**

29. Financial instruments (continued)

Interest rate sensitivity gap analysis 2012

	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	9,004	-	-	-	-	714	9,718
Loans and advances to banks	31,190	2,157	-	-	-	-	33,347
Loans and advances to customers	49,490	2,831	5,725	1,977	310	(211)	60,122
Debt Securities	-	-	-	4,380	2,112	-	6,492
Other assets	-	-	-	-	-	8,150	8,150
	89,684	4,988	5,725	6,357	2,422	8,653	117,829
Liabilities							
Deposits by banks	3,151	-	-	-	-	-	3,151
Customer accounts	63,042	14,582	13,545	1,140	-	-	92,310
Other liabilities	-	-	-	-	-	732	732
Shareholders' funds	-	-	-	-	-	21,636	21,636
	66,193	14,582	13,545	1,140	-	22,368	117,829
Interest rate sensitivity gap	23,491	(9,594)	(7,820)	5,217	2,422	(13,715)	-
Cumulative gap	23,490	13,896	6,076	11,293	13,715	-	-

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 2012.

Other liabilities other than deferred tax liabilities of £40,000 (2011 – £71,000) classified as non interest bearing in the above table have contractual maturities of less than three months.

The bank has outstanding financial guarantee contracts of £75,000 (2011 - £122,000) at the year end. The outstanding guarantees of £75,000 are due to mature within a year (2011 - £88,000).

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 Bank	8,506	-	-	-	-	732	9,238
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	-	-	-	-	-	21,188	21,188
	77,035	13,961	7,094	3,147	-	21,944	123,181
Interest rate sensitivity gap	14,032	(10,568)	(3,353)	10,453	2,349	(12,913)	-
Cumulative gap	14,032	3,464	111	10,564	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 than deferred tax liabilities of £40,000 (2011 - £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 reprise 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 £211,000 (2011 - £167,000).

The weighted average interest rates are as follows: 1.42% (2011: 1.52%) for the loans and advances to banks; 6.14% (2011: 7.01%) for the loans and advances to customers; 5.14% (2011: 5.85%) for the debt securities; 0.06% (2011: 5.88%) for the deposits by banks; and 2.44% (2011: 2.33%) 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 £184,000 (2011: £86,000). However, management believes that Bank interest rate risk is limited since the majority of customers' deposits are repriced 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 2012 £'000**	**Net currency position 2011 £'000**
US Dollar	4	4
Euro	(1)	(3)
Japanese Yen	-	1
Swiss Franc	46	19
Other currencies	11	21
Total	60	42

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 2012.

	Carrying value 2012 £000	Fair value 2012 £000	Carrying value 2011 £000	Fair value 2011 £000
Financial assets				
Cash	9,718	9,718	9,238	9,238
Loans and advances to banks	33,347	33,347	30,754	30,754
Loans and advances to customers	60,122	60,122	64,597	64,597
Debt securities	6,492	6,568	10,125	10,211
Derivative assets	15	15	-	-
Financial liabilities				
Deposits by banks	3,151	3,151	9,046	9,046
Customer accounts	92,310	92,310	92,191	92,191
Derivative liabilities	-	-	65	65