AL RAYAN BANK

Annual Report and Financial Statements

For the year ended 31 December 2017

Al Rayan Bank PLC | Registered number 4483430

Banking you can believe in

alrayanbank.co.uk

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Banking you can believe in

Chairman's Statement

Robert Sharpe
Chairman
Al Rayan Bank PLC

"A year of progress and profit"

I am pleased to report that 2017 was another positive year for Islamic banking in the UK, and one of significant progress and increased profit for Al Rayan Bank. Building upon the success of previous years we delivered our highest ever annual profit before tax, continued to introduce additional experience and skills to our workforce and increased customer numbers by an average of 41 new account openings every day. This is thanks to the attractiveness of our product propositions, the loyalty of our customers, the support of our parent, Masraf Al Rayan, the continued guidance and support of the Sharia Supervisory Committee scholars and, of course, our employees.

On behalf of the entire Board, I would like to express my sincere thanks to all our stakeholders.

The Bank remains committed to a growth strategy implemented in 2014, following the Bank's acquisition by Masraf Al Rayan; to employ the right financial disciplines, to provide the shareholders with a quality of earnings and to build a high credit quality and stable asset book. Our profit before tax for 2017 rose by 15% to £9.45 million (2016: £8.18 million); a growth fuelled by a 26% increase in total assets which reached £1.81 billion in 2017 (2016: £1.43 billion), and a 28% increase in total liabilities which reached £1.68 billion (2016: £1.31 billion).

Our Sharia compliant Home Purchase Plans (HPP) have become a preferred method of property financing for a significant number of people, with 74% more people choosing to fund their residential property purchases with Al Rayan Bank in 2017 than in the previous year. We are delighted that, for the first time, a significant proportion of these new customers were from outside of the Muslim faith; we believe that a quarter of all new HPP customers in 2017 were from non-Muslim applicants.

It has also been a year of continued development for the Bank's Commercial and Premier Banking divisions, both of which have increased their contribution to the Bank's overall performance. Commercial Banking generated its largest ever gross asset sales and income from fees, whilst our Premier Banking branch in Knightsbridge generated 41% of all customer deposits.

During the year we also made investments in our infrastructure, opening new Commercial offices in London's West End to make our services more accessible to clients and support the rapidly growing Commercial team. The Bank continued to enhance its IT infrastructure including upgrading the core banking system and making further improvements to the cyber-security framework and international payment processes. Work was also completed on preparing for the transition, in 2018, to IFRS 9 financial instruments. New savings and HPP products were launched cementing our position as the market leader in Sharia compliant retail banking products.

The Bank also made its mark on the global financial map when it became the first Islamic bank in UK history to receive a public credit rating from Moody's. Citing Al Rayan Bank's sound asset risk profile, robust capitalisation and sufficient liquid resources as credit strengths, Moody's judged the Bank's Counterparty Risk Assessment to be Aa3 (equivalent AA-). Its Baseline Credit Assessment (BCA) was judged to be A2 (A) with the support of our parent Masraf Al Rayan, and Baa2 (BBB) independently.

In addition, significant headway was made in developing our pioneering Sharia compliant structured funding instrument. The Sukuk backed by our HPP product subsequently saw a successful launch in quarter 1, 2018 on the London Stock Exchange. This issue was more than 150% subscribed and raised £250m of diversified funding for the Bank.

> "Building upon the success of previous years we delivered our highest ever annual pre-tax profits, enhanced our workforce and increased customer numbers

↑15% Pre-tax profit

↑26% Total assets

↑28% Total liabilities

↑74% Residential property financing

OUTLOOK

We continue to operate in a competitive market. We do this successfully, but conscious of the fact that we may have to confront some headwinds in 2018 arising from the fragility of the UK economy and the unknown issues associated with the UK's decision to leave the European Union.

We will continue to focus on delivering compelling Sharia compliant products for the customers we serve. The Bank's strategic priorities will continue to be concentrated on:

- Transforming its culture, its technology and its business models
- Serving its customers brilliantly
- Growing sustainable profitability and providing targeted returns for its shareholders

Lastly, I would like to give my sincere thanks to my Board colleagues, the Executive team and all our employees for their dedication and determination in successfully delivering against the Bank's objectives in 2017. We are all committed to maintaining Al Rayan Bank as the largest and one of the most successful Sharia compliant banks in the UK.

Robert Sharpe
Chairman

28 March 2018

> Al Rayan Bank is the first Islamic bank in UK history to receive a public credit rating from Moody's

Report of the Sharia Supervisory Committee

The management of Al Rayan Bank PLC is responsible for ensuring that the Bank conducts its business in accordance with the principles of the Sharia.

It is the responsibility of the Sharia Supervisory Committee to form an independent opinion, based on the review of the operations, agreements and transactions conducted by the Bank. It is the responsibility of the Bank's management to implement the decisions of the Sharia Supervisory Committee.

In compliance with the Terms of Reference of the Bank's Sharia Supervisory Committee, we submit the following report:

بسم الله الرحمن الرحيم

(In the name of Allah, the Most Gracious, the Most Merciful)

To the Members of Al Rayan Bank PLC
For the period from 1 January 2017 to 31 December 2017

السلام عليكم ورحمة الله و بركاته

We have reviewed the documentation relating to the products and transactions entered into by Al Rayan Bank PLC for the period from 1 January 2017 to 31 December 2017.

According to the management, the audit review conducted by the Head of Sharia Compliance & Product Development (our representative in the Bank) and documents evidencing the facts, the Bank's funds were raised and invested during this period on the basis of agreements approved by us.

During this Sharia Compliance Audit Review, which was conducted by our representative in the Bank, we found 1 Sharia compliance audit issue rated as B[1] and 24 Sharia compliance audit issues rated as C[1]. All the Sharia compliance audit issues found during this audit review occurred due to either misjudgement or human errors in implementing the Sharia controls by the Bank's staff and did not have any material effects on the Bank's overall compliance with Sharia. All issues found have been fully addressed with the management of the Bank. Thus, the overall Sharia compliance rating of Al Rayan Bank, for the period from 1 January 2017 to 31 December 2017, was Satisfactory. Therefore, based on the Sharia Compliance Audit Report of our representative and representations received from the management, in our opinion, the transactions and the products entered into or offered by the Bank during the period from 1 January 2017 to 31 December 2017 were in compliance with the rules and principles of Sharia and fulfil the specific directives, rulings and guidelines issued by us. However, we note that there is a room for improvement, based on the findings of the Sharia Compliance Audit Report, in implementing the Sharia controls and minimising any potential errors.

The Bank does not pay zakat on behalf of its shareholders and it is the sole responsibility of the individual shareholders to make their zakat payments.

We ask Allah the Almighty to grant us all the success and straightforwardness.

و السلام عليكم ورحمة الله و بركاته

Dr. Abdul Sattar Abu Ghuddah
Chairman of the Sharia Supervisory Committee
28 March 2018

[1] Definition of Sharia compliance audit issue ratings:

- **A** These represent the highest level of significance, in relation to Sharia requirements and controls, and generally pose material risk to the Bank if not resolved in a timely manner.
- **B** Pose less risk but could have an adverse impact on the Bank's compliance with Sharia if the underlying issues are not properly addressed.
- **C** Opportunities to enhance the existing control environment to ensure continued compliance with Sharia requirements and the SSC guidelines.

Strategic Report

Al Rayan Bank PLC (the 'Bank' or the 'Company') is a subsidiary of Al Rayan UK Limited, a majority owned subsidiary of Masraf Al Rayan Q.P.S.C (MAR), one of Qatar's most well established and largest banks. MAR acquired the Bank in January 2014.

As part of the MAR Group of companies, the Bank has a long-term commitment to Islamic finance, with the credibility and stability to deliver for its customers and shareholders. The Bank's brand strategy is rooted in aspirational and responsible banking, with a strong emphasis on customer experience and service. The Bank offers consumers of all faiths a different approach to banking:

"Banking you can believe in"

Al Rayan Bank PLC is a UK registered bank, and since 2004 has remained the UK's largest wholly Sharia compliant retail bank. It offers an extensive range of banking services and the largest number of Islamic retail financial products in the UK.

The Bank is authorised by the Prudential Regulatory Authority (PRA) and regulated by the PRA and the Financial Conduct Authority (FCA).

Current products include Home Purchase Plans (HPP), Commercial Property Finance (CPF), current accounts and a range of savings accounts catering for different needs. The Bank has also introduced Sharia compliant business banking to the UK and offers a wide range of institutional and business banking products and services.

The Bank is controlled by an independent Board of Directors and the responsibility for its day to day management has been entrusted to the Chief Executive Officer, Sultan Choudhury.

Vision & Values

The Bank's vision and values guide its decision making process and approach to its customers, performance and growth.

The Bank is realising its vision through a deep understanding of its customers and by creating appropriate products and services which meet their needs. This supports the Bank's objective of maintaining growth with sustained profitability and effective risk management.

Over the past 13 years the Bank has successfully proven the validity of the concept of a wholly Sharia compliant retail bank in the UK. It has introduced a range of products to the market that have been well received by its customers – be they Muslims wanting to bank in accordance with their faith, or non-Muslims, drawn by the Bank's responsible and ethical finance approach and attractive profit rates.

The Bank has built a thriving branch and office network throughout the UK, including a Premier branch in Knightsbridge and a dedicated new Commercial office in the heart of London's West End. The Bank prides itself on delivering excellent customer service, be it through one of its direct channels or through intermediaries.

VISION

To be the UK's first choice ethical, Sharia compliant bank

VALUES

Dedicated
We will build strong, enduring relationships, delivering an experience that delights our customers.

Sharia compliant
Everything we do will be in line with our values. Following the Sharia, we will conduct our activity in a fair, ethical and socially responsible manner.

Aspirational
We will be professional and will fulfil our promises, delivering high quality products and services.

Dependable
As part of the Masraf Al Rayan Group of companies, we have a long-term commitment to Islamic finance, with the credibility and stability to deliver for our customers.

Pioneering
We will be a dynamic, inspiring and pioneering organisation, which offers unique solutions to our customers.

In 2017 the Bank made history, strengthened its leadership team, completed a number of operational projects and expanded its footprint in the UK.

The Bank also focused on strengthening its infrastructure and risk management framework to deliver growth and more efficient profitability going forward.

Making History

Al Rayan Bank became the first Islamic bank in the UK to receive a public credit rating. Moody's issued the Bank a rating of Aa3 in November 2017 which will allow the Bank access to markets which were previously unavailable to it.

Work began towards becoming the first Islamic bank in Western Europe to issue an Asset Backed Sukuk, which was subsequently launched in February 2018.

The Bank's Chief Executive Officer, Sultan Choudhury, was named an Officer of the Most Excellent Order of the British Empire (OBE) in recognition of his longstanding services to Islamic finance.

Leadership Team

The Bank welcomed its new Chief Risk Officer, and a new Risk Enhancement Plan has been established.

New Offices

Al Rayan Bank expanded its footprint in the UK by opening a dedicated Commercial office in Central London to support growth of this business division.

Project Delivery

Significant investment was made to strengthen the Bank's operational infrastructure. There were a number of upgrades, notably to the Bank's core banking system and cyber-security framework.

Progress was made on regulatory projects such as preparation for IFRS 9 and GDPR. Preparation also began on a number of further regulatory projects.

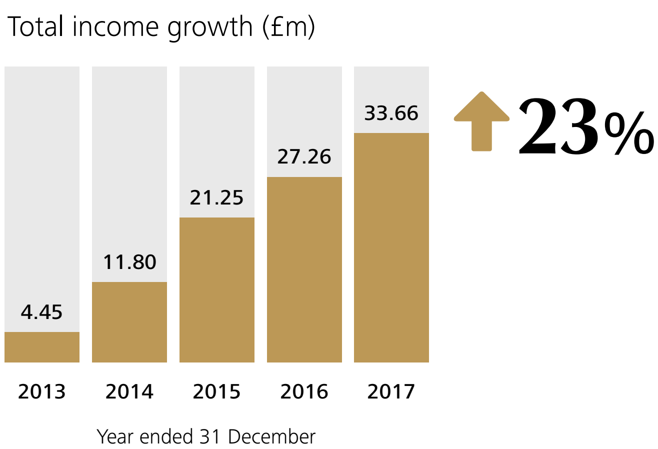
The financial statements for the year ended 31 December 2017 are shown on pages 21 to 49. The profit before tax for the year is £9.45m (2016: £8.18m). This is an increase of 15% year on year and demonstrates a continuation of the Bank's growth trend. Total operating income grew by 23% over the same period, increasing to £33.66m (2016: £27.26m).

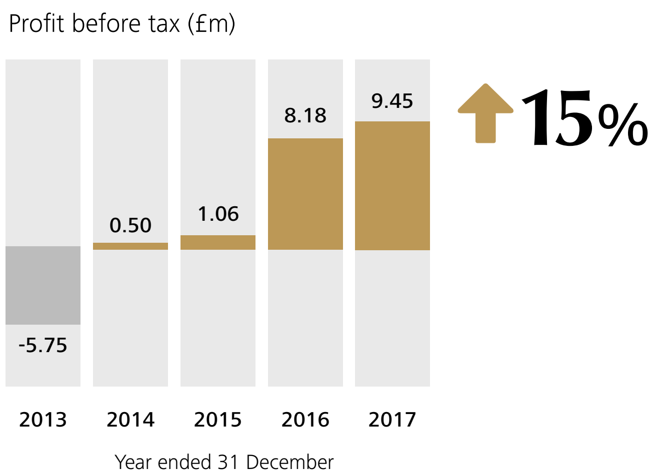
Profit after tax was impacted by the Bank now incurring a tax charge in the year of £0.83m. This compares to the prior year where there was a tax credit of £1.31m, due to higher recognition of additional deferred tax asset in 2016. The table below summarises key financial metrics:

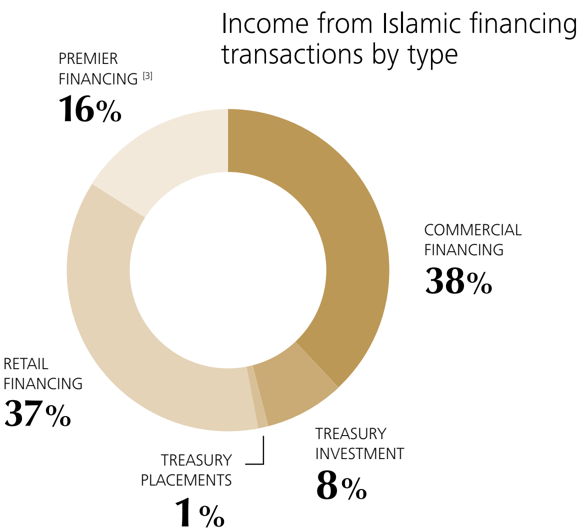
Key financial metrics

	2017	2016
Profit before tax	£9.45m	£8.18m
Profit after tax	£8.62m	£9.50m
Cost to income ratio	72%	70%
Return on equity [2]	7.3%	6.6%
Common equity tier 1 ratio	14.6%	17.1%
Liquidity coverage ratio	337%	502%

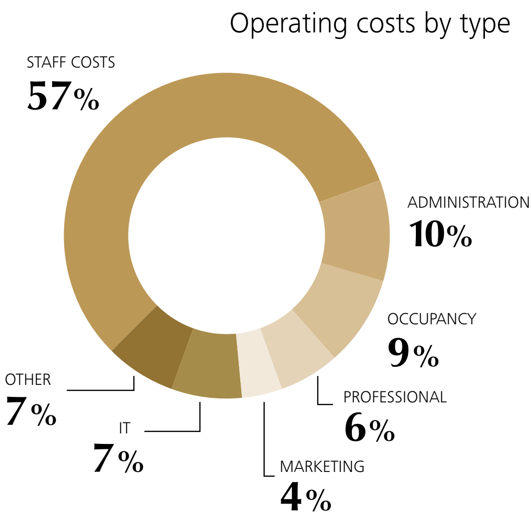
The charts below illustrate year on year growth and analysis of income, assets and costs by type:







2017 total £50.62m (2016: £41.08m)



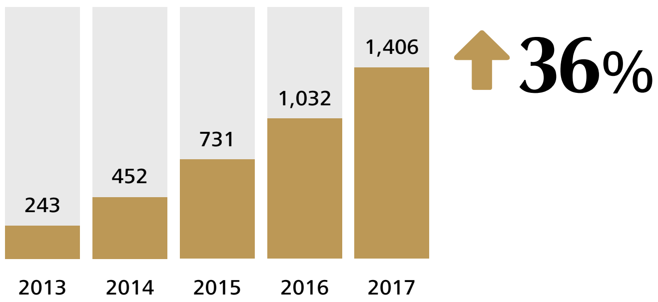
2017 total £24.20m (2016: £19.07m)

2. Return on equity is calculated on profit before tax

3. Premier refers to HPP financing made to clients of the Premier branch in Knightsbridge

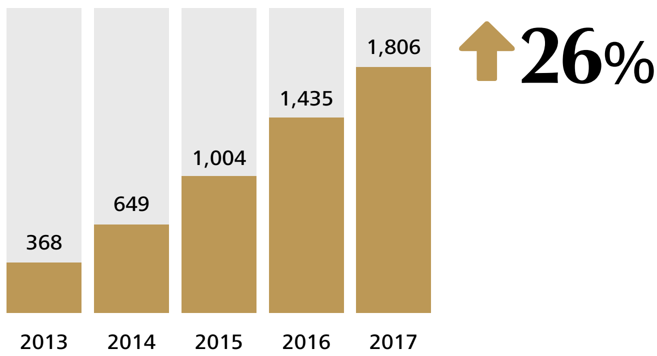
The Bank is now generating sustained profitability reflecting the increase in asset levels. The majority of the Bank's recurring income is generated by its financing assets which continue to grow, increasing by 36% for year ended 31 December 2017.

Financing assets (£m)



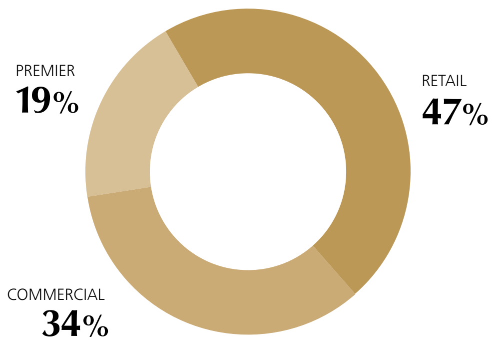
Year ended 31 December

Total assets (£m)



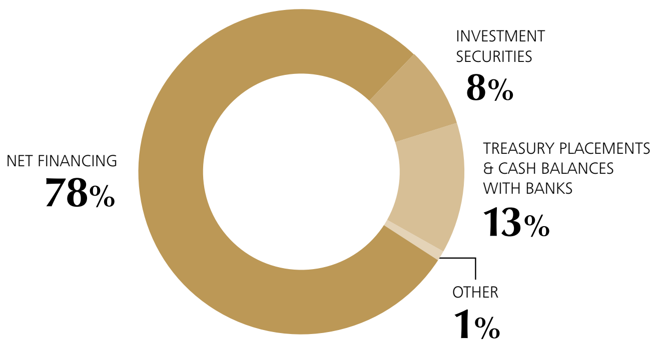
Year ended 31 December

Financing assets by sector (2017)



2017 total £1,406m (2016: £1,032m)

Total asset breakdown (2017)

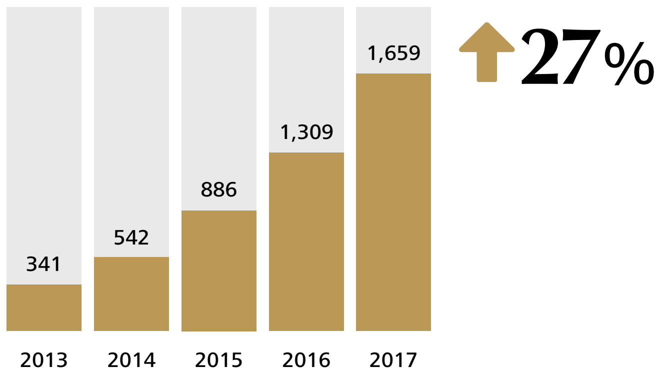


2017 total £1,806m (2016: £1,435m)

The Bank's total balance sheet has grown steadily, increasing by 26% in 2017.

Deposits have also shown sustained growth in line with the increase in financing assets and good progress has been made on launching new deposit products to broaden market reach.

Total deposits (£m)



Year ended 31 December

The Strategic Plan

The Bank's strategic intent is to continue to generate sustained profitability through excellent customer service, whilst achieving a lower cost to income ratio.

This strategic intent is underpinned by five key imperatives (shown below) which are fully integrated into the Bank's plans and risk management framework. This enables the Bank to make better, risk-informed, strategic business decisions on a day to day basis.

5 KEY IMPERATIVES

- Capital efficient asset growth
- Increase fee income
- Lower cost diversified funding
- Robust risk management capability
- Drive service quality & efficiency

The Bank's strategic focus for the coming years is summarised below:

The Strategic Plan serves both as a guide to the Bank's employees on its future development and as a blueprint for its external stakeholders, to inform them about the Bank's work and the strategic priorities it has established for the coming years.

Distribution strategy

The Bank aims to provide its customers with a seamless experience through any one of its distribution channels.

BRANCH AND OFFICE NETWORK	OTHER CHANNELS
KNIGHTSBRIDGE, LONDON Personalised, bespoke premier banking services and a comprehensive range of Sharia compliant retail and commercial financial solutions are provided to High Net Worth (HNW) customers, primarily from the Gulf Cooperation Council (GCC) region	**BUSINESS DEVELOPMENT MANAGERS** Field-based BDMs facilitate HPP sales
COMMERCIAL OFFICE, LONDON Specialist Commercial Property Finance team to support the Bank's growing financing portfolio within this business sector	**INTERMEDIARIES** Intermediaries provide an efficient and effective route for marketing products including HPP and CPF
NATIONAL BRANCH AND OFFICE NETWORK Provide retail and Small and Medium Enterprise (SME) customers with a counter/cashiering service, and access to the Bank's range of personal and business products	**VOICE** A dedicated and highly trained Customer Services team and HPP and deposit sales teams are based at the Bank's operational headquarters in Birmingham
BRANCHES Birmingham; Leicester; Manchester; Edgware Road, London; and Whitechapel, London. A counter/cashiering service is provided for customers as well as sales of the Bank's range of personal and SME products	**DIGITAL** Web and online service facilitates account opening, payment transactions and product information
AGENCIES Glasgow; Blackburn; Bradford/Leeds; Birmingham; Luton; Greater London namely Ilford, Wembley and Tooting	**POST** Processing of postal applications is completed at the Bank's operational headquarters

Our market and competition

The Bank is well positioned to help shape the future of responsible finance in the UK and enjoys distinct competitive advantages. Its parent, MAR, is an established and successful sponsor with the skills, experience and expertise to help the Bank achieve its growth ambitions. Alignment with the MAR brand has enabled the Bank to attract customers from the GCC region and build a compelling proposition for HNW customers. Furthermore, the Bank:

- is the leading provider of a wide range of Sharia compliant retail products in the UK, and the main provider of Islamic home finance in the country. It is increasing its market share of Sharia compliant financing for GCC and CPF markets.
- provides a credible alternative to traditional banking. Its Islamic finance model is responsible and fair, and its savings products consistently deliver competitive and market-leading rates of return.
- has established a loyal customer base amongst Muslims and non-Muslims alike, demonstrating the popularity of ethical banking across all faiths.
- possesses a strategically located branch network which has assisted in maximising the Bank's exposure within the UK.
- employs staff who are dedicated and passionate about working for the Bank, appreciating the culture and environment of a Sharia compliant, ethical organisation.
- is agile enough to embrace change, whilst delivering steady growth.

The Bank undertakes competitor analysis to understand the evolving landscape, and to make informed strategic decisions. It remains well placed to take advantage of growing demand by virtue of its strong foundations, specialist experience built up over a number of years, and range of products and services.

Liquidity and funding

Liquidity

The Bank has a low liquidity risk appetite. One of its key objectives is to ensure that it retains sufficient liquid resources in line with regulatory liquidity requirements. The Bank has developed a plan to ensure that liquidity requirements are effectively managed in light of all applicable regulations and planned asset growth.

Funding

- Retail funding

  The strategy for funding is underpinned by acquisition of stable funding through retail deposits, which are closely managed with well-priced products catering for the differing requirements of customers.

  Branches continue to be an important source of stable retail funding. Rates are monitored and managed to attract a longer behavioural weighted average deposit life to match the asset that is being underwritten, thus minimising the risk of maturity transformation.

- Wholesale funding

  Wholesale funding to date has predominantly been sourced from prominent GCC counterparties. The Bank continues to diversify its wholesale funding mix and has taken significant steps to achieve this during the year:

  - In November 2017 Moody's issued the Bank an Aa3 rating which will allow the Bank to access funding previously unavailable to it and potentially reduce cost of funding.
  - The set-up of a £250m Asset Backed Sukuk, which was subsequently launched in February 2018, was finalised.

Principal risks and uncertainties

The Bank regards the monitoring and controlling of risks as a fundamental part of the management process. Senior management The Board has responsibility to ensure that appropriate risk management systems and controls exist for the determination, assessment and management of the principal risks facing the Bank and approve the risk appetite for these risks in the context of achieving the Bank's strategic objectives.

In line with the above, the Bank has performed an assessment of the principal risks that it faces and their impact on its liquidity, solvency, forward performance and the effective delivery of its operating model and strategy.

Risk Management Framework

The Bank's Risk Management Framework (RMF) and its underlying control systems are the principal tool to identify, monitor and report on the risks to which the Bank is exposed. This provides reasonable assurance against the risk of material misstatement or forward loss.

The RMF is aligned to regulatory requirements and is supported by appropriate policies, processes and procedures. These ensure risks are managed appropriately and are proportionate to the size of the Bank and nature of its products.

The Bank has grown rapidly in recent years and as it prepares for future growth it has made the strategic decision to embark on a plan to further enhance and mature the existing RMF to align with industry best practice. This initiative will embed scalable functionality and infrastructure to support the business and its sustainability, aligned to its future aspirations.

The effectiveness of internal controls is regularly reviewed by the Board and includes reporting from the business lines, risk and audit.

Principal risks are the primary risks that the Bank faces which could impact the delivery of its strategy:

PRINCIPAL RISK	DESCRIPTION	MITIGATION
OPERATIONAL RISK	The risk of direct or outsource loss from the failure of systems, process, people or external events	▶ Policies and processes aligned to the Bank's structure and operating model ▶ Regular risk event and loss escalation, reporting and remediation ▶ Monitoring of remediation, change and transition programmes ▶ Investment in system infrastructure, technology and digital strategies
COMPLIANCE & FINANCIAL CRIME RISK	The risk of direct loss or sanctions resultant from the failure to comply with applicable laws, regulations and legislation, including, for example Treating Customers Fairly, Anti-Money Laundering	▶ Simple understandable products aligned to core offering ▶ Provide strong policies, governance and rigour to the approval of new products and initiatives ▶ Maintain and embed policies, processes and controls ▶ Ongoing staff awareness, training and assurance mechanisms ▶ Regulatory change horizon scanning
CREDIT RISK	The risk that customers are unable to honour their financial obligations to the Bank	▶ Conservative risk appetite, supporting policy framework with appropriate concentration risk limits ▶ Provide products, and in markets, where the Bank has specific expertise ▶ Obtain appropriate level of supporting asset cover security ▶ Maintain and embed robust policies and guidelines ▶ Regularly review performance against risk appetite ▶ Perform portfolio stress testing to confirm resilience
SHARIA & REPUTATIONAL RISK	Failure to meet the expectations of our customers, investors, regulators or other parties	▶ Products, policies and behaviours aligned to the ethical code of the Bank ▶ Independent Sharia advisory, oversight and challenge ▶ Maintain open and honest relationships with regulators and all stakeholders
MARKET RISK	The risk of reductions in earnings and/or value, from unfavourable market movements	▶ The Bank does not undertake proprietary trading ▶ Profit rates and currency obligations are matched where possible and the Bank seeks to minimise market risk in all transactions ▶ Basis risk is minimised by matching profit rate reference base for assets and liabilities
PRUDENTIAL RISK	The risk of failure from not holding sufficient or appropriate reserves to support growth, regulatory requirements, or to repay obligations when required	▶ Daily monitoring ▶ Adequacy of liquidity buffer and 90 day forward test ▶ Robust forecasting and testing of forward capital plan ▶ Contingency funding and Risk & Resolution Plan invocation ▶ Capital and liquidity sensitivity and stress testing
REGULATORY CHANGE	The regulatory environment continues to evolve and change. The industry is now subject to a number of regulatory bodies including but not limited to the Financial Policy Committee, the Bank of England, PRA, FCA. Changes and higher expectations coming out of the regulatory bodies can lead to increased cost of doing business additional capital requirements.	▶ The Bank actively monitors regulatory changes, engages with regulators and industry bodies to keep abreast of current development and respond as appropriate ▶ Undertake horizon scanning and forward planning to ensure compliance with new regulatory requirements

Outlook for 2018

Economic outlook

The UK's decision to leave the EU in 2016 brought about a significant amount of uncertainty and volatility in the markets. This uncertainty continued to cast a shadow on the economy in 2017. The economy, however, proved to be resilient, post the Brexit vote, with economic indicators holding relatively strong. GDP did slow down in 2017 as inflation rose, which consequently saw the base rate increase from 0.25% to 0.50% in November 2017, with further increases forecast in 2018. This inevitably will lead to a reduction in household disposable incomes.

Overall the full impact of Brexit on the UK economy and the financial services sector is still unknown – it is likely that this will only truly be known after the arrangements between the UK and EU are finalised. The UK Government has stated that it is a key priority to ensure that there is an adequate transition period, avoiding a 'cliff edge' both at the moment of withdrawal following the Article 50 process and as the UK and EU move towards a new relationship.

The Bank also continually monitors, both independently and together with its parent, potential risks associated with any political and economic uncertainties in the wider GCC region. Presently, there has been no adverse impact to the Bank's business or plans, resulting from events during 2017 in the region.

The Bank is regularly engaged in forward-looking stress testing and assessing risks based on both PRA defined stresses and management's own internal severe stress scenarios. It is considered that no additional specific stress tests are required to take account of any Brexit-related risks as the relevant risk drivers that might be impacted by the next stages of Brexit are those that have already been covered under the stress scenarios identified by the Bank's management. Specific stress scenarios are incorporated into the Bank's planning and risk management processes relating to events in the GCC region.

Business outlook

The Bank remains committed to its current strategy. This will be evolved to take account of the changing competitive landscape and operating environment.

In 2018 the Bank will steadily grow its financing asset book, building on an increasing range of financing products. This growth will continue to support the Bank's overall objective of increasing profitability in a consistent and controlled manner, whilst improving efficiency and its cost to income ratio.

However, 2018 will also be a year of significant investment for the Bank. There will be a focus on investing in the Bank's systems, processes, risk management and people to ensure that it has solid foundations and is prepared for the next phase of the Bank's future development.

Therefore, it is considered that the Bank is well positioned to respond to future challenges based on its quality asset book, Board & management focus, dedicated employees and a dynamic approach to managing change associated with the enhancements being made to its operational and risk management infrastructure.

Signed on behalf of the Board

Sultan Choudhury
Chief Executive Officer

28 March 2018

Al Rayan Bank PLC
44 Hans Crescent, Knightsbridge, London, SW1X 0LZ

Directors' Report

The Directors present their report and financial statements for the year ended 31 December 2017.

Directors and Directors' interests

The Directors who held office during the year ended 31 December 2017 and subsequently are as follows:

- Robert Sharpe (Chairman) (b) (c)
- Adel Mohammed Tayeb Mustafawi (b) (c)
- Sultan Choudhury (c)
- Ahmed Swaleh Abdisheikh (a) (b) (c)
- Malcolm Brookes (a)
- Richard Sommers (c)

a. Denotes member of Audit Committee
b. Denotes member of Remuneration and Nomination Committee
c. Denotes member of Risk, Compliance and Credit Committee

Adel Mustafawi and Ahmed Abdisheikh have a current association with Masraf Al Rayan Q.P.S.C and are, therefore, not considered independent.

No Director had any interest in the ordinary shares of the Bank in the current or preceding year per the register of Directors' interests.

Subsequent to 31 December 2017, Robert Sharpe and Sultan Choudhury stepped down as members of the Risk, Compliance and Credit Committee. Additionally, Richard Sommers was appointed as a member of the Audit Committee.

Significant Shareholders

The following shareholders had interests in the ordinary shares of the Bank in excess of 3% as at 31 December 2017:

Significant shareholders (more than 3%)

	2017	2016
Al Rayan Bank (UK) Ltd	98.34%	98.34%

On 3 February 2014, Al Rayan (UK) Ltd acquired 4,345,789,979 ordinary shares of £0.01 each of the Bank. This represented approximately 95.59% of the existing share capital of the Bank at that time. On 3 February 2014, Al Rayan (UK) Ltd subscribed to an additional allotment of 7,575,400,000 ordinary shares of £0.01 each taking its effective shareholding in the Bank to 98.34%. The remaining 1.66% is owned by minority shareholders.

The shareholding in Al Rayan UK Ltd is as follows: MAR 70% (2016: 70%) and Qatar Holding LLC 30% (2016: 30%).

Sharia Supervisory Committee members

The Sharia Supervisory Committee (SSC) members during the year were as follows:

- Dr. Abdul Sattar Abu Ghuddah (Chairman)
- Sheikh Nizam Yaqoobi
- Mufti Abdul Kadir Barkatullah

The report of the Sharia Supervisory Committee is set out on page 5.

Dividends

The Directors do not recommend the payment of a dividend for the year ending 31 December 2017 (2016: £nil).

Political contributions

The Bank made no political contributions during the year ending 31 December 2017 (2016: £nil).

Employees

The Bank recognises the importance of effective communication with staff. Communication includes employee feedback and is encouraged through a variety of methods. It is the Bank's policy to ensure that all employees and applicants for employment are afforded equal opportunity in line with UK employment law.

Going concern

Accounting standards require the Directors to assess the Bank's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the Directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks' published by the Financial Reporting Council in April 2016.

In order to assess the appropriateness of the going concern basis the Directors considered the Bank's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them. The Bank has been supported by capital injections from its parent. Further amounts are forecast to be received in 2018 in line with prior agreements. Additionally, however, the Bank is profitable on a sustained basis and generates additional regulatory capital once these profits have been verified.

After performing this assessment, the Directors concluded that it was appropriate for the Company to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

Financial risk management

The Bank's approach to financial risk management is outlined in the strategic report and in Note 29.

Subsequent events

Events subsequent to 31 December 2017 have been highlighted in Note 30.

Future Developments

Future developments are outlined in the Chairman's statement.

Disclosure of information to the auditor

Each of the persons who is a Director at the date of approval of this annual report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- the Director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Auditor

During 2017 the Board invited applicants to tender for the Bank's audit. As a result, the Board recommended that Deloitte LLP be appointed as the Bank's auditors. The appointment was confirmed at the Annual General Meeting (AGM) held in April 2017.

Deloitte LLP have expressed their willingness to continue in office as auditor and a resolution to reappoint them will be proposed at the forthcoming AGM.

By order of the Board

Sultan Choudhury
Chief Executive Officer

28 March 2018

Al Rayan Bank PLC
44 Hans Crescent, Knightsbridge, London, SW1X 0LZ

Statement of Directors' responsibilities in respect of the Strategic Report, the Directors' Report and the financial statements

The Directors are responsible for preparing the strategic report, the Directors' 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 they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the 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 estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent auditor's report to the Members of Al Rayan Bank PLC

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Al Rayan Bank plc (the 'company') which comprise:

- the statement of comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 31.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

SUMMARY OF OUR APPROACH	
KEY AUDIT MATTERS	The key audit matters that we identified in the current year were: ▶ Revenue recognition from investment in financing asset under the amortised cost basis; and ▶ Impairment of investment in financing assets.
MATERIALITY	The materiality that we used in the current year was £472k which was determined on the basis of 5% of profit before tax.
SCOPING	All of the company's activities are based in and audited directly by the audit team from the UK.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

- We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Revenue recognition from investment in financing asset under the amortised cost basis

Key audit matter description

Income from financing assets is recognised under the amortised cost basis using the Effective Profit Rate (EPR) approach, in accordance with IAS 39, "Financial instruments: Recognition and measurement", where future expected profits, including any fees paid or received, are discounted over the estimated behavioural life of the asset. A detail of the applicable accounting policy and breakdown is disclosed in note 4 on page 28 and note 6 on page 32 of the financial statements respectively.

The financing assets portfolio comprises of the investments in Commercial Property Finance (CPF) and Home Purchase Plan (HPP) and has grown significantly in the last few years. The estimated behavioural life of the CPF and HPP assets and the method used to allocate all the directly attributable costs over the behavioural life are areas of significant judgement. These assumptions are sensitive and have a significant impact on revenue recognition. Therefore we consider this as an estimation risk and a potential fraud risk.

How the scope of our audit responded to the key audit matter

Our procedures included evaluating the design and implementation of key controls surrounding the estimated behavioural life of the investment in CPF and HPP and allocation of directly attributable costs over the behavioural life.

We evaluated the model and the assumptions used in it by analysing the historic behavioural life of the investments made and repayments received in the previous years and also analysed the reasonableness of the behavioural life in comparison to our knowledge of the industry, expected redemption levels and other factors affecting future behaviour. As part of our procedures, we tested the accuracy and completeness of the data used in determining the behavioural life of the investments in CPF and HPP.

We have analysed the behavioural life assumption under possible scenarios to assess the impact on income from financing asset balances due to the absence of sufficient historic information.

We critically assessed the fees received or paid as part of the EPR model against the prescribed criteria of IAS 39 and tested their inclusion as transaction costs in the EPR model.
We reviewed the appropriateness of the disclosure regarding possible changes in the behavioural life assumption.

Key observations

The behavioural life assumption applied in the EPR model is towards the conservative end of an acceptable range and we concluded that the reported revenue figure is appropriate and in line with the requirements as outlined in IAS 39.

Impairment of investment in financing assets

Key audit matter description

A model is used to determine the provision for impairment against the Bank's investment in financing assets i.e. CPF and HPP. Different probabilities of default are used in the model to determine the level of collective provision for impairment. In absence of entity specific historical data of defaults, management and the Credit Committee then consider these probabilities against a lower limit level of provision based on external data.

Considering the level of judgement involved, we considered this to be an estimation risk and a potential fraud risk.
A description of the accounting policy and the breakdown is mentioned in note 4 on page 29 and note 14 on page 36 of the financial statements.

How the scope of our audit responded to the key audit matter

Our procedures included evaluating the design and implementation of the control surrounding management's assumption of probabilities of default.

We challenged management's assumptions for impairment provisions and external data used in the model with reference to our industry knowledge and factors that may trigger a default event.

On a sample basis, we tested the underlying information for completeness and accuracy and checked the formulation of various inputs in the model.

We reviewed a sample of performing loans to assess whether any IAS 39 loss indicators were present.

We reviewed the appropriateness and presentation of disclosures with relevant accounting standards.

Key observations

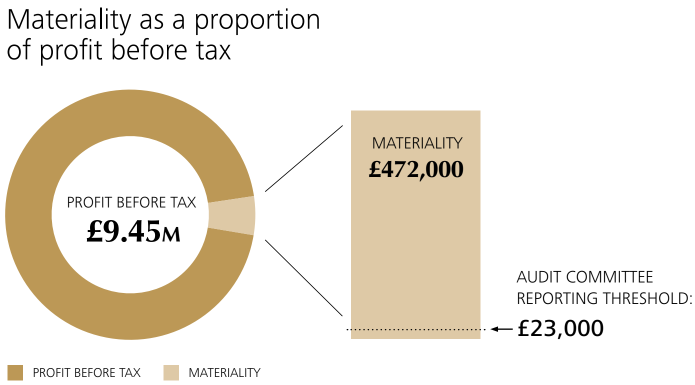
We have identified that the impairment provisions recognised by Al Rayan Bank are within, but towards the conservative end, of a reasonable range and are therefore consider that the reported impairment provision are appropriate.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

MATERIALITY	BASIS FOR DETERMINING MATERIALITY	RATIONALE FOR THE BENCHMARK APPLIED
£472,000	We determined materiality based on 5% of profit before tax .	We considered profit before tax as the most appropriate benchmark as it represents profitability and affects the decision making of the users of the financial statements.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £23,000, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the company and its environment, including controls and assessing the risk of material misstatement. The company's operations are based in the UK and all material balances are audited directly by our UK audit team.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

▶ We have nothing to report in respect of these matters.

Responsibilities of directors

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, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the Directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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.
- We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

- We have nothing to report in respect of this matter.

OTHER MATTERS

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the Company on 27 April 2017 to audit the financial statements for the year ending 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is one year, covering the year ending 31 December 2017.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

K. J. Cooper

Kieren Cooper
Senior Statutory Auditor for and on behalf of Deloitte LLP

28 March 2018

Deloitte LLP
Statutory Auditor, Chartered Accountants
Birmingham, UK

Financial Statements

Statement of comprehensive income

For the year ended 31 December 2017

	NOTE	2017 £'000s	2016 £'000s
Income from Islamic financing transactions	6	50,619	41,081
Returns to banks and customers	6	(18,681)	(15,672)
Net income from Islamic financing transactions		**31,938**	25,409
Fee and commission income	7	931	693
Fee and commission expense	7	(482)	(117)
Net fee and commission income		**449**	576
Gain on disposal of investment securities		1,276	880
Foreign exchange (loss)/income		(5)	393
Other income		1,271	1,273
Total income		**33,658**	27,258
Net impairment on financial assets	14	(448)	(449)
Staff costs	8	(13,025)	(9,308)
General and administrative expenses		(9,438)	(8,229)
Depreciation	16	(781)	(678)
Amortisation	17	(516)	(409)
Total operating expenses		**(24,208)**	(19,073)
Profit before tax		**9,450**	8,185
Tax (charge)/credit	11	(830)	1,316
Profit for the year		**8,620**	9,501
Other comprehensive income			
Items that are or may be subsequently reclassified to profit or loss: Change in fair value of investment securities taken to equity including reversal of AFS reserve on disposal		(3,142)	326
Other comprehensive (loss)/income for the year		(3,142)	326
Total comprehensive income for the year		**5,478**	9,827

- The results from the year are derived entirely from continuing activities.
- The notes on pages 25 to 49 are an integral part of these financial statements.

Statement of financial position

As at 31 December 2017

	NOTE	2017 £'000s	2016 £'000s
Assets			
Cash	12	2,692	2,412
Treasury placements and cash balances with banks	13	228,822	217,304
Net investment in consumer finance	14	9	43
Net investment in Home Purchase Plans	14	930,386	638,314
Net investment in Commercial Property Finance	14	475,787	394,221
Investment securities	15	154,207	168,242
Property and equipment	16	6,112	6,431
Intangible assets	17	716	935
Deferred tax asset	18	5,545	6,097
Other assets	19	2,032	1,692
Total assets		1,806,308	1,435,691
Liabilities and equity			
Liabilities			
Deposits from banks	20	62,219	83,571
Deposits from customers	21	1,596,656	1,225,244
Subordinated financing	22	10,000	-
Other liabilities	23	8,671	3,592
Total liabilities		1,677,546	1,312,407
Equity			
Share capital	24	121,219	121,219
Share premium		54,807	54,807
Available for sale (AFS) reserve		(1,162)	1,980
Retained deficit		(46,198)	(54,817)
Profit stabilisation reserve		96	95
Total equity		128,762	123,284
Total liabilities and equity		1,806,308	1,435,691

▶ The notes on pages 25 to 49 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 28 March 2018 and were signed on its behalf by:

Sultan Choudhury
Chief Executive Officer

Al Rayan Bank PLC
Registration number: 04483430

Statement of changes in equity

For the year ended 31 December 2017

	Share capital	Share premium	AFS reserve	Retained deficit	Profit stabilisation reserve	Total
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
Balance at 1 January 2016	121,219	54,807	1,654	(64,299)	76	113,457
Profit for the year	-	-	-	9,501	-	9,501
Other comprehensive income	-	-	1,206	-	-	1,206
Reclassification of AFS reserve on disposal of investment	-	-	(880)	-	-	(880)
Transfer to profit stabilisation reserve	-	-	-	(19)	19	-
Balance at 31 December 2016	**121,219**	**54,807**	**1,980**	**(54,817)**	**95**	**123,284**
Profit for the year	-	-	-	8,620	-	8,620
Other comprehensive income	-	-	(1,866)	-	-	(1,866)
Reclassification of AFS reserve on disposal of investment	-	-	(1,276)	-	-	(1,276)
Transfer to profit stabilisation reserve	-	-	-	(1)	1	-
Balance at 31 December 2017	121,219	54,807	(1,162)	(46,198)	96	128,762

▶ The notes on pages 25 to 49 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2017

	NOTE	2017 £'000s	2016 £'000s
Cash flows from operating activities			
Profit before tax		9,450	8,185
Adjustments for:			
Depreciation	16	781	678
Amortisation	17	516	409
Gain on disposal of investment securities		(1,276)	(880)
Impairment charge and write off on financial assets		448	496
		9,919	8,888
Changes in:			
Treasury placements	13	59,388	(21,353)
Investment in consumer finance		34	52
Investment in Home Purchase Plans		(292,072)	(120,967)
Investment in Commercial Property Finance		(81,566)	(184,306)
Other assets		(340)	(723)
Deposits from banks		(21,352)	(72,145)
Deposits from customers		371,412	492,140
Other liabilities		5,079	1,549
Deferred tax asset		552	-
Net cash inflow from operating activities		51,054	103,135
Cash flows from investing activities			
Sales/(purchase) of investment securities		10,896	(44,823)
Purchase of property and equipment	16	(462)	(1,118)
Purchase of intangible assets	17	(297)	(721)
Net cash inflow/(outflow) from investing activities		10,137	(46,662)
Cash flows from financing activities			
Subordinated financing	22	10,000	-
Net cash inflow from financing activities		10,000	-
Net change in cash and cash equivalents		71,191	56,473
Foreign exchange (loss)/gains		(5)	393
Cash and cash equivalents at 1 January	12	159,352	102,486

► The notes on pages 25 to 49 are an integral part of these financial statements.

Notes to the Financial Statements

1. Reporting entity

Al Rayan Bank PLC (the 'Bank' or the 'Company') is a public unlisted bank, limited by shares, domiciled in England, UK. The address of the Bank's registered office is 44 Hans Crescent, Knightsbridge, London, SW1X 0LZ. The address of the Bank's operational headquarters is 24a Calthorpe Road, Edgbaston, Birmingham, B15 1RP. The Bank is primarily involved in retail and corporate banking services.

The financial statements of the Bank are presented as at and for the year ended 31 December 2017. The financial statements are presented in pound sterling, which is the Bank's functional currency.

2. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and approved by the Directors.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

3. New standards and interpretations adopted by the EU

(a) IFRS 9 adoption 2018

IFRS 9 'Financial Instruments' was published in July 2014 and is effective for periods beginning on or after 1 January 2018. This replaces IAS 39 'Financial Instruments: Recognition and Measurement' and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

Classification and measurement

IFRS 9 will require financial assets to be classified on the basis of two criteria:
1. the business model within which financial assets are managed; and
2. their contractual cash flow characteristics (whether the cash flows represent 'solely payments of principal and profit').

Financial assets will be measured at amortised cost if they are held within a business model whose objective is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and profit. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and their contractual cash flows represent solely payments of principal and profit. Other financial assets are measured at fair value through profit or loss.

IFRS 9 business model and the contractual cash flow characteristic tests have been performed and concluded to have no material impact to the Bank compared with IAS 39.

Impairment

Impairment will be based on a more forward looking expected credit loss (ECL) approach for financial assets classified as amortised cost and fair value through other comprehensive income, rather than the incurred loss approach applied under IAS 39.

At initial recognition, financial assets are categorised as 'stage 1' and an impairment provision is required for ECL resulting from default events projected within the next 12 months (12-month ECL). Subsequently, financial assets are considered to be in 'stage 2' when their credit risk has increased significantly since initial recognition, so it is appropriate to recognise lifetime ECL. The Bank will assess exposures to be in stage 2 when the accounts are more than 30 days past due or there has been a significant increase in the lifetime probability of default (PD) compared to initial recognition. The Bank considers both quantitative and qualitative factors based on early warning indicators and expert credit risk assessment when making the determination.

Financial assets will be included in 'stage 3' when there is objective evidence that the exposure is credit impaired, with expected credit losses still calculated on a lifetime basis. Objective evidence used to determine whether exposures are impaired includes, if they are more than 90 days past due or otherwise considered to be in default (including possession, insolvency and assets beyond term expiry). Criteria of application is consistent with the definition of default used for internal credit risk management purposes. The population of stage 3 exposures will be similar to that of impaired exposures under IAS 39. The impairment provision will be determined using the same calculation as stage 2, but with the PD set to 100%. The core ECL impairment model has been run in parallel to the IAS 39 calculated impairment provisions for HPP, CPF and Treasury assets.

ECLs are calculated at the individual exposure level using three main components, i.e. a probability of default (PD), a loss given default (LGD) and the exposure at default (EAD). The LGD represents losses expected on default, taking into account the mitigating effect of any collateral, its expected value when realised and the time value of money. The EAD represents the expected balance at default, taking into account acquisition, rent payments and capital repayments from the balance sheet date to the default event. The Bank adjusts PDs and LGDs to incorporate the impact of potential future economic scenarios when calculating ECLs.

Hedge accounting

The IFRS 9 hedge accounting requirements aim to simplify hedge accounting and permit application to a wider population of economic hedge relationships. IFRS 9 does not explicitly address macro hedge accounting strategies, which are particularly important for banks and building societies. As a result, IFRS 9 includes an accounting policy choice to continue applying the IAS 39 hedge accounting requirements, for which the Bank will continue to do so as at 1 January 2018. There is no impact on transition to the Bank as there were no designated hedging relationships as at the year end.

Transition

The classification, measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Bank does not intend to restate comparatives.

The Bank’s asset books are relatively immature and data volumes are minimal with low default experience. This has resulted in a higher level of expert judgement being applied to the modelled ECL estimates. The Bank will continue to monitor its ECL calculations and incorporate adjustments should empirical evidence emerge where applicable. However, the Bank expects that its IFRS 9 ECL provision will not be materially different to the existing IAS 39 impairment provision. Management will have the key estimations over loss given default (LGD) and probabilities of default (PD) for expected credit losses under IFRS 9 going forward. Note 5 provides more detail on LGD and PD. Additionally, per the updated requirements from IFRS 9 there will be additional estimations that Management may undertake for staging and estimation of the forward looking macro-economic environment. Material judgments will be reviewed on an on-going basis by the Credit Committee as part of the IFRS 9 governance process.

b) Other new and revised IFRSs in issue

Amendments to IAS 16 and IAS 38: ‘Clarification of acceptable methods of depreciation and amortisation; effective 1 January 2018 and endorsed by the EU on 22 November 2016. The amendments introduce a rebuttable presumption that the use of revenue base amortisation methods for intangible assets is inappropriate.

The presumptions can be overcome only when revenue and the consumptions of the economic benefits of the intangible asset are ‘highly correlated’, or when the intangible asset is expressed as a measure of revenue. While this is not an outright ban, it creates a high hurdle for when these methods may be used for intangible assets. The Bank intends to adopt the standard on the date it becomes effective.

The above changes would not have any material impact on the Bank’s financial statements if applied.

IFRS 15 ‘Revenue from contracts with customers’ effective 1 January 2018 and endorsed by the EU on 22 September 2016. The standard replaces IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31. It applies to contracts with customers but does not apply to insurance contracts, financial instruments or lease contracts, which fall under the scope of other IFRSs. The standard introduces a new revenue recognition model that recognises revenue either at a point in time or over time. The model features a contract-based-5-step analysis of transactions to determine whether, how much, and when revenue is recognised.

The above changes did not have any material impact on the Bank’s financial statements.

IFRS 16 ‘Leases’ introduces a single, on-balance sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance including IAS 17 ‘Leases’, IFRIC 4 ‘Determining whether an arrangement contains a Lease’, SIC-15 ‘Operating Leases – Incentives’ and SIC-27 ‘Evaluating the Substance of Transactions Involving the Legal Form of a Lease’.

An entity applies IFRS 16 for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted if IFRS 15 ‘Revenue from Contracts with Customers’ has also been applied. [IFRS 16:C1].

4. Significant accounting policies

Going Concern

Accounting standards require the Directors to assess the Bank's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the Directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks' published by the Financial Reporting Council in April 2016.

In order to assess the appropriateness of the going concern basis the Directors considered the Bank's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them. The Bank continues to be supported by capital injections from its parent, which include an amount of £10m received on 24 March 2017. Further amounts are forecast to be received in 2018 in line with prior agreements. Additionally, however, the Bank is profitable on a sustained basis and generates additional regulatory capital once these profits have been verified.

After performing this assessment, the Directors concluded that it was appropriate for the Company to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset and required to bring the asset to its intended condition and location.

(ii) Subsequent costs

The cost of replacing part of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of the day to day servicing of property and equipment are recognised in the statement of comprehensive income as incurred.

(iii) Depreciation

Depreciation is recognised in the statement of comprehensive income on a straight line basis over the estimated useful life of each part of an item of property and equipment as follows:

Computer equipment	3 years
Fixtures, fittings and office equipment	5 years
Leasehold improvements	10 years or over the life of the lease, whichever is shorter
Land and buildings	100 years or over the life of the lease, whichever is shorter

Depreciation methods, useful lives and residual values are reassessed at each reporting date.

Intangible assets

Licences acquired by the Bank are stated at cost less accumulated amortisation and accumulated impairment losses. These are intangibles with a finite useful life.

Expenditure on internally developed software is recognised as an asset when the Bank is able to complete the development and use the software in a manner that will generate future economic benefits and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and are amortised over its estimated useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and impairment.

Subsequent expenditure on software assets and licences is capitalised when it meets recognition criteria. All other expenditure on software or licences is expensed as incurred.

Amortisation is recognised in the statement of comprehensive income on a straight line basis over the estimated useful life of the software or the licence term, from the date that it becomes available for use. The estimated useful life of software is three years.

Treasury placements and cash balances with banks

Treasury placements are mainly Commodity Murabaha or Wakala transactions.

Commodity Murabaha is an Islamic financing transaction, which represents an agreement whereby the Bank buys a commodity and sells it to a counterparty based on a promise received from that counterparty to buy the commodity per specific terms and conditions. The selling price comprises of the cost of the commodity and a pre-agreed profit margin. Wakala is an Islamic financing transaction, which represents an agreement whereby the Bank provides a certain sum of money to an agent, who invests it per specific conditions in order to achieve an expected specified return. The agent is obliged to return the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala.

Commodity Murabaha receivables are recognised upon the sale of the commodity to the counterparty. Wakala receivables are recognised upon placement of funds with other institutions.

Treasury placements qualify as financial instruments recorded as financing and receivables. They are initially recognised at fair value and are subsequently measured at amortised cost.

Income from Treasury placements is recognised on an effective profit basis. The effective profit rate is the rate that exactly discounts the estimated future cash payments and receipts through the agreed payment term of the contract to the carrying amount of the receivable. The effective profit is established on initial recognition of the asset and is not revised subsequently.

The calculation of the effective profit rate includes all fees paid or received, transaction costs, and discounts or premiums that are an integral part of the effective profit rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of the financial asset.

Balances with banks are stated at cost and are non-return bearing.

Consumer finance accounts

Islamic consumer financing transactions represent an agreement whereby the Bank buys a commodity or goods and then sells it to the customer with an agreed profit mark up with settlement of the sale price being deferred for an agreed period. The customer may subsequently sell the commodity purchased to generate cash.
Consumer finance assets will be recognised on the date that the commodity or good is sold by the Bank.

Consumer finance account balances are initially recorded at fair value and are subsequently measured at amortised cost. The amortised cost is the amount at which the asset is measured at initial recognition, minus repayments received relating to the initial recognised amount, plus the cumulative amortisation using an effective profit method of any difference between the initial amounts recognised and the agreed sales price to the customer, minus any reduction for impairment.

Income is recognised on an effective profit basis over the period of the contract. The effective profit rate is the rate that exactly discounts the estimated future cash payments and receipts through the agreed payment term of the contract to the carrying amount of the receivable. The effective profit is established on initial recognition of the asset and is not revised subsequently.

The calculation of the effective profit rate includes all fees paid or received, transaction costs, and discounts or premiums that are an integral part of the effective profit rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Home Purchase Plans (HPP) and Commercial Property Finance (CPF)

HPP and CPF are provided using the Diminishing Musharaka (reducing partnership) and Murabaha principles of Islamic financing. The Bank will enter into an agreement to jointly purchase a property and rental income will be received by the Bank relating to that proportion of the property owned by the Bank at any point in time. The other party to the agreement will make separate payments to purchase additional proportions of the property from the Bank, thereby reducing the Bank's effective share.

The transaction is recognised as a financial asset upon legal completion of the property purchase and the amount receivable is recognised at an amount equal to the net investment in the transaction. Where initial direct costs are incurred by the Bank such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging the transaction, these costs are included in the initial measurement of the receivable and the amount of income over the term will be reduced. Rental income is recognised to provide a constant periodic rate of return on the Bank's net investment.

HPP and CPF are classified as financing and receivable, recognised initially at fair value and subsequently at amortised cost.

Investment securities (available for sale financial assets)

Investment securities are non-derivative financial assets that are designated as available for sale (AFS) and are not classified into the categories described above. The assets are intended to be held for an indefinite period of time but may be sold in response to liquidity requirements or changes in profit rates or exchange rates. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value through other comprehensive income. Gains and losses arising from changes in the fair value of AFS financial assets, other than foreign exchange gains and losses from monetary items, are recognised directly within a separate component of equity, until the financial assets are derecognised or impaired at which time the cumulative gain or loss previously recognised within equity is transferred to the statement of comprehensive income.

Deposits from banks and customers

Profit sharing accounts are based on the principle of Mudaraba whereby the Bank and the customer share an agreed percentage of any profit earned on the customer's deposit. The customer's share of profit is paid in accordance with the terms and conditions of the account. The profit calculation is undertaken at the end of each calendar month.

Customer Wakala deposits consist of an Islamic financing transaction, which represents an agreement whereby the customer appoints the Bank as agent to invest a certain sum of money, per specific conditions in order to achieve an expected specified return. The Bank, as agent, is obliged to return the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala.

Derecognition of financial assets and liabilities

The Bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards or ownership of the financial asset are transferred. Any remaining interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or have expired.

Impairment of financial assets

At each statement of financial position reporting date, the Bank assesses whether there is objective evidence that financial assets are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. Unsecured financing is excluded from this assessment as they are not considered to be individually significant. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar risk characteristics.

Objective evidence that financial assets are impaired includes default or delinquency by the counterparty, extending or changing repayment terms, indications that a counterparty may go into bankruptcy, or other observable data relating to the group of assets such as adverse changes in the payment status of counterparties, or economic conditions that correlate with defaults in the group.

In assessing collective impairment, the Bank uses analysis of historical trends to identify the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic conditions are such that actual losses are likely to be greater or less than suggested by historical analysis. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the estimated cash flows discounted at the assets' original effective profit rate. Losses are recognised in the statement of comprehensive income and reflected against the asset's carrying value.
When a subsequent event causes the amount of expected impairment losses to decrease, the impairment loss is reversed through the statement of comprehensive income.

Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the statement of comprehensive income.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to resell. In assessing value in use, the estimated future cash flows are discounted to their present value. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of cost of funds and, where appropriate, the risks specific to the liability. Provisions are split between individual and collective provisions.

Profit stabilisation reserve

The profit stabilisation reserve is used to maintain returns payable to customers on Mudaraba based savings accounts. Returns payable on these profit sharing accounts are credited to customers in accordance with the terms and conditions of the account. Any surplus returns arising from the investment of funds are then credited to this reserve. In the case of inadequate returns generated by these funds, the Bank will maintain the return to depositors by utilising this reserve

Fees and commissions

Fees and commission income that relates mainly to transaction and service fees are recognised as the related services are performed. Fees and commission expenses that relate mainly to transaction and service fees are expensed as incurred.

Fees relating to CPF deals and HPP transactions are recognised using an Effective Profit Rate (EPR) methodology. The EPR model is a method of allocating income and expense over the relevant life of the product. The model includes all fees relating to the transaction.

The effective fees recognised during the year from the EPR model are reflected in the income from financing assets.

Income tax expense

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the statement of financial position reporting date, and any adjustment to tax payable in respect of previous years. Deferred tax is provided using the statement of financial position method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Lease payments made

Payments made under operating leases are recognised in the statement of comprehensive income on a straight line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense over the term of the lease.

Employee benefits

Obligations for contributions to defined contribution pension plans are recognised as an expense in the statement of comprehensive income when they are due.

Short term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period for which employees have provided services. Bonuses are recognised to the extent that the Bank has a present obligation to its employees that can be measured reliably.

Cash and cash equivalents

Cash and cash equivalents include notes and coins in hand, unrestricted balances held with central banks and highly liquid financial assets which are available on demand or with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value and are used by the Bank in the management of its short-term commitments. Cash and cash equivalents exclude assets with original maturities greater than three months.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Other receivables

Trade and other receivables are stated at their nominal amount (discounted if material) less impairment losses.

Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency at exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate ruling at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period and the amortised cost in foreign currency translated at the exchange rate ruling at the end of the period. Foreign currency differences arising on retranslation are recognised in the statement of comprehensive income.

5. Critical accounting judgements and key sources of estimation uncertainties

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Management discussed with the Audit Committee the development, selection and disclosure of the Bank's critical accounting policies and estimates, and the application of these policies and estimates.

There were no critical accounting judgements undertaken during the year. The estimations of uncertainties are set out below.

(a) Allowance for credit losses

Assets accounted for at amortised cost are evaluated for impairment on the basis described in Note 4. The specific counterparty component of the total allowances for impairment applies to claims evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about each counterparty's financial situation and the realisable value of any underlying collateral.

Key estimates used by Management are as follows:

Loss given default (LGD)
The impairment is dependent on the loss on the receivables in the event of default. This is assessed with reference to the realisable value of collateral and the outstanding account balance.

Probability of default (PD)
Describes the likelihood of a default occurring due to the customer's inability to meet their payment obligations. The Bank applies judgement to estimate the probability of default.

Each impaired asset is assessed on its merits, and the estimates of cash flows considered recoverable are approved by the Credit function.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of claims with similar economic characteristics when there is objective evidence to suggest that they contain impaired claims, but the individual impaired items cannot yet be identified (except for Consumer finance). Consumer finance portfolios are assessed for impairment on a collective basis for accounts that are either impaired or not impaired. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors.

In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions.

Management performed sensitivity analysis on the provision model. An increase / (decrease) in the PD by 10%, resulted in a (decrease) / increase of £131k in profit or loss. Additionally, management performed sensitivity analysis on the LGD by deflating the values of the underlying collateral by 10%. This resulted in a decrease in net income of £1.5m.

(b) Deferred tax asset recognition

The deferred tax asset recognised at 31 December 2017 has been recognised on the basis that the Directors believe it is probable that sufficient future taxable profits will be generated against which it can be utilised. In arriving at this conclusion, the Directors have estimated the future profit performance for the bank which is subject to several variables.

Management performed sensitivity analysis on the recognition of deferred tax. A reduction in foreseeable profits was assessed by increasing the haircuts applied by a further 10%, which resulted in an increase of £212k as the deferred tax charge to be recognised resulting from a decrease in the deferred tax asset.

(c) Effective Profit Rate (EPR)

The EPR method is the rate that exactly discounts the estimated stream of cash payments or receipts, without consideration of future credit losses, over the expected life (behavioural life) of the financial instrument.

Management has limited historical experience of customer behaviours due to the relative immaturity of the portfolios. The Bank makes critical estimations on expected behavioural life and product switch behaviours based on their own expert credit judgement of the portfolio. These estimations are subjected to changes in internal and external factors and may result in adjustments to the carrying value of financing assets which must be recognised to the profit or loss.

To assess the impact of the aforementioned estimations to the carrying value of the financing assets, Management performed sensitivities on the behavioural lives and product switch behaviours.

The behavioural life was sensitised by reducing them by 20% for both the HPP and CPF portfolios which resulted in a debit to the carrying value of the financing assets and a corresponding credit to the profit or loss of £310k.

Additionally, estimation on the product switch behaviours and the reversion rate for fixed and discounted variable products with a fixed promotion period were sensitised. These sensitivities compared scenarios considering a percentage switch between another fixed (F) or discounted variable (DV) product or revert to a standard variable rate (SVR) product for the aforementioned portfolio and assessed the resulting in a cumulative impact on the profit or loss. The table below highlights the scenarios:

Scenario	**Profit/(loss) impact** £'000s
50% Switch to F / DV – 50% Reversion	951
75% Switch to F / DV – 25% Reversion	215
100% Switch to F / DV – 0% Reversion	(533)

6. Net income from Islamic financing transactions

	2017 £'000s	2016 £'000s
Treasury placements	423	488
Consumer finance	2	5
Home Purchase Plan	27,765	21,936
Commercial Property Finance	19,498	15,407
Investment securities	2,931	3,245
Income from Islamic financing transactions	**50,619**	41,081
Deposits from banks	(1,653)	(1,162)
Deposits from customers	(17,028)	(14,510)
Returns to banks and customers	**(18,681)**	(15,672)
Net income from Islamic financing transactions	**31,938**	25,409

7. Net fees and commission income

	2017 £'000s	2016 £'000s
Fees and commission income		
Retail customer banking fees	844	227
ATM commission	84	77
Other	3	389
Total fees and commission income	**931**	693
Fee and commission expense		
ATM interchange fees	(21)	(26)
Electronic transaction fees	(461)	(91)
Total fees and commission expense	**(482)**	(117)
Net fees and commission income	**449**	576

8. Staff costs

	2017 £'000s	2016 £'000s
Wages and salaries	11,696	8,214
Social security costs	905	726
Contributions to defined contribution pension plans	319	281
Other staff costs	105	87
Total	**13,025**	9,308

The following table summarises the average number of employees within the bank during the year:

	2017			2016		
	Front office	**Back office**	**Total**	Front office	Back office	Total
Average for the period	104	111	215	96	81	177

9. Auditor's remuneration

Included within operating expenses are the following amounts payable to the auditor (excluding VAT):

	2017 £'000s	2016 £'000s
Audit of these financial statements	144	96
Audit related assurance services	18	26
Other assurance services	15	-
Corporate finance services	45	-
Other services	28	15
Services relating to taxation-compliance	-	27
Total	**250**	164

10. Directors' emoluments

	2017					2016				
	Salary	Bonus	Benefits in kind	Pension contributions	Total	Salary	Bonus	Benefits in kind	Pension contributions	Total
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
S Choudhury	166	65	1	17	249	136	85	1	31	253
Total	**166**	**65**	**1**	**17**	**249**	136	85	1	31	253

The emoluments, consisting entirely of fees, of the non-executive Directors who served during the year were as follows:

	2017 £'000s	2016 £'000s
A M T Mustafawi	20	26
A S Abdisheikh	23	31
M Brookes	55	53
R Sommers	38	-
R Sharpe	81	71
Total	**217**	181

11. Tax

Tax expenses	2017 £'000s	2016 £'000s
Current tax expense		
Current year	**(278)**	-
Deferred tax		
Current year	(15)	1,316
Adjustment in respect of previous periods	178	-
Effect of changes in tax rates	(715)	-
Deferred tax charge/(credit)	(552)	1,316
Total income tax charge/(credit)	**(830)**	1,316

Reconciliation of effective tax rate	2017 £'000s	2016 £'000s
Profit before tax	9,450	8,185
Tax on profit at standard UK tax rate of 19.25% (2016: 20%)	1,819	1,637
Effects of:		
Adjustments in respect of prior years	(178)	2
Expenses not deductible	11	-
Tax rate changes	715	-
Exempt amounts	76	(3,091)
Amounts not recognised	(1,613)	136
Total income tax charge/(credit)	**830**	(1,316)

Information relating to deferred tax is presented in Note 18.

Finance (No.2) Act 2015 included legislation to reduce the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020. These rate reductions were substantively enacted on 26 October 2015. An additional reduction to 17%, effective from 1 April 2020, was legislated in Finance Act 2016 which was substantively enacted on 6 September 2016. The deferred tax asset at 31 December 2017 has been calculated using the applicable rates enacted at the balance sheet date.

12. Cash and cash equivalents

	2017 £'000s	2016 £'000s
Cash	2,692	2,412
Balances with banks available on demand	101,543	156,940
Treasury placements with original maturity less than 3 months	126,303	-
Total cash and cash equivalents	**230,538**	159,352

13. Treasury placements and cash balances with banks

	2017 £'000s	2016 £'000s
Repayable on demand	101,543	156,940
3 months or less but not repayable on demand	126,303	-
1 year or less but over 3 months	976	60,364
Total treasury placements and cash balances with banks	**228,822**	217,304

A breakdown of treasury placements and cash balances with banks by geographic regions is shown in Note 29.

Balances maturing in 1 year or less but over 3 months include a balance of £976,187 (2016: £810,833) representing repayable security deposits held by banks that have issued a guarantee to cover the Bank's future customer card transactions with MasterCard. These deposits do not earn a return.

14. Net investment in financing assets

	2017			2016		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
Net investment in consumer finance	32	(23)	9	255	(212)	43
Net investment in Home Purchase Plans	931,614	(1,228)	930,386	639,138	(824)	638,314
Net investment in Commercial Property Finance	**475,946**	**(159)**	**475,787**	394,424	(203)	394,221

	Specific provision	Collective provision	Total provision
	£'000s	£'000s	£'000s
Balance at 1 January 2017	35	1,239	1,274
Charge for the year	-	448	448
Amounts written off during the year	(35)	(277)	(312)
Balance as at 31 December 2017	**-**	**1,410**	**1,410**
Balance at 1 January 2016	35	1,084	1,119
Charge for the year	-	449	449
Amounts written off during the year	-	(294)	(294)
Balance as at 31 December 2016	**35**	**1,239**	**1,274**

This impairment allowance relates to consumer finance, Home Purchase Plan and Commercial Property Finance.

15. Investment securities

	2017	2016
	£'000s	£'000s
Quoted Sukuk	154,207	168,242
Total	**154,207**	168,242

16. Property and equipment

	Computer Equipment	Office Equipment	Leasehold Improvements	Fixtures & Fittings	Land & Buildings	Total
2017	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
Cost						
Balance at 1 January 2017	3,281	177	4,692	741	3,709	12,600
Additions	174	61	187	19	21	462
Balance at 31 December 2017	**3,455**	**238**	**4,879**	**760**	**3,730**	**13,062**
Depreciation						
Balance at 1 January 2017	2,649	144	2,977	358	41	6,169
Depreciation charge for the year	364	17	261	101	38	781
Balance at 31 December 2017	3,013	161	3,238	459	79	6,950
Net book value at 31 December 2017	**442**	**77**	**1,641**	**301**	**3,651**	**6,112**
2016						
Cost						
Balance at 1 January 2016	2,819	156	4,319	548	3,640	11,482
Additions	462	21	373	193	69	1,118
Balance at 31 December 2016	**3,281**	**177**	**4,692**	**741**	**3,709**	**12,600**
Depreciation						
Balance at 1 January 2016	2,335	136	2,748	267	5	5,491
Depreciation charge for the year	314	8	229	91	36	678
Balance at 31 December 2016	2,649	144	2,977	358	41	6,169
Net book value at 31 December 2016	**632**	**33**	**1,715**	**383**	**3,668**	**6,431**

The Bank owns the operational headquarters and leases its branch premises under operating leases. The leases typically run for 10 years, with options to renew the lease after that date. Lease payments are reviewed after periods stipulated in the agreements to reflect market rentals.

17. Intangible assets

Intangible assets, 2016-17

2017	Computer licences £'000s	Purchased & developed software £'000s	Total £'000s
Cost			
Balance at 1 January 2017	1,586	5,450	7,036
Additions	15	282	297
Balance at 31 December 2017	**1,601**	**5,732**	**7,333**
Amortisation			
Balance at 1 January 2017	1,167	4,934	6,101
Amortisation charge for the year	226	290	516
Balance at 31 December 2017	1,393	5,224	6,617
Net book value at 31 December 2017	**208**	**508**	**716**

2016	Computer licences £'000s	Purchased & developed software £'000s	Total £'000s
Cost			
Balance at 1 January 2016	1,261	5,054	6,315
Additions	325	396	721
Balance at 31 December 2016	**1,586**	**5,450**	**7,036**
Amortisation			
Balance at 1 January 2016	1,019	4,673	5,692
Amortisation charge for the year	148	261	409
Balance at 31 December 2016	**1,167**	**4,934**	**6,101**
Net book value at 31 December 2016	**419**	**516**	**935**

18. Deferred tax asset

Deferred tax assets are recognised only to the extent that realisation of the related tax benefit against future taxable profits is probable within the next five years.

The deferred tax asset balances attributable to carried forward losses are expected to be recoverable against future taxable profits (as projected in the latest Strategic Plan). The assumptions surrounding future expected credit losses and increases in the Bank Base Rate represent the most subjective areas of judgment in management's projections of future taxable profits. The deferred tax assets have not been discounted.

The deferred tax asset recognised is £5.5m (2016: £6.1m). The Bank has an unrecognised deferred tax asset that will arise from remaining carried forward losses of £14.5m.

The Bank had accumulated tax losses prior to 2014 of £66.8m, of which £22.9m have been utilised against tax profits in 2014 (£2.0m), 2015 (£5.3m), 2016 (£8.2m) and 2017 (£7.4m).

Deferred tax assets have been calculated based on the rate substantively enacted at the Statement of Financial Position date.

The movement on the deferred tax account is as follows:

Deferred tax account movement

	2017 £'000s	2016 £'000s
Asset at start of period	6,097	4,781
Adjustment in respect of prior years	178	-
Deferred tax (charge) / credit to profit for the period	(730)	1,316
Deferred tax asset as at 31 December 2017	5,545	6,097

19. Other assets

	2017 £'000s	2016 £'000s
Prepayments and other receivables	2,032	1,692
Total other assets	**2,032**	1,692

There are no receivables within other assets that are expected to be recovered in more than 12 months (2016: £nil). In 2016 other assets included accrued income of £2.5m on treasury placements, net investment in Home Purchase Plan, net investment in Commercial Property Finance, and investment securities, which have been reclassified to the aforementioned assets.

20. Deposits from banks

	2017 £'000s	2016 £'000s
Repayable on demand	4,976	776
3 months or less but not repayable on demand	57,243	82,795
Total deposits from banks	**62,219**	83,571
Non profit sharing accounts	4,976	776
Profit sharing/paying accounts	57,243	82,795
Total deposits from banks	**62,219**	83,571

21. Deposits from customers

	2017 £'000s	2016 £'000s
Repayable on demand	923,131	259,166
3 months or less but not repayable on demand	193,079	153,737
1 year or less but over 3 months	300,820	592,970
2 years or less but over 1 year	162,409	166,712
3 years or less but over 2 years	17,217	52,659
Total deposits from customers	**1,596,656**	1,225,244

22. Subordinated financing

	2017 £'000s	2016 £'000s
Subordinated financing	10,000	-
Total	**10,000**	-

Total returns paid on this financing for the year ended 31 Dec 2017 were £620,274 (2016: £0). There were no returns payable on this financing as at 31 December 2017 (2016: £0).

This facility was granted through an agreement dated 24 March 2017 negotiated on an arm's length basis. The contract is based on a Wakala agreement and expected profit is payable every 6 months.

The maturity of the facility is greater than 5 years and qualifies as tier 2 capital. Details can be found in Note 29.

23. Other liabilities

	2017 £'000s	2016 £'000s
Trade payables	170	389
Social security and income tax	279	256
Accruals	4,327	3,131
Other creditors	3,895	(184)
Total	**8,671**	3,592

In 2016, other liabilities included 'returns payable to customers' of £2.4m accrued on deposits from customers, which have been reclassified as deposits from customers.

24. Share capital

Allotted, called up and fully paid	2017 £'000s	2016 £'000s
Issued ordinary share capital (12,121,870,000 ordinary shares of £0.01 each)	121,219	121,219

25. Operating leases

Future minimum lease payments for non-cancellable operating lease rentals are payable as follows:

	2017 £'000s	2016 £'000s
Less than one year	1,034	775
Between one and five years	3,670	2,919
More than five years	1,350	2,055
Total	**6,054**	5,749

During the year, there was £1,103,561 recognised in the statement of comprehensive income in respect of operating leases (2016: £903,903).

As at 31 December 2017 the Bank has capital commitments in the form of non-cancellable operating lease rentals of £6.1m (2016: £5.7m).

26. Related parties

(a) Transactions with key management personnel

At 31 December 2017, Directors of the Bank and their immediate relatives have no shareholding in the Bank (2016: £nil). Key management of the Bank are the Board of Directors and members of the Executive Committee. The compensation of key management personnel is as follows:

Key management compensation	2017 £'000s	2016 £'000s
Key management emoluments including social security costs	1,416	1,114
Bank contributions to pension plans	61	120
Total	**1,477**	1,234

Deposit balances, operated under standard customer terms and conditions, held by key management personnel, including Directors and immediate relatives, totalled £2,005,995 as at 31 December 2017 (2016: £1,604,180). Total returns paid on these accounts during the year were £6,137 (2016: £1,219).

Outstanding consumer finance and Home Purchase Plan balances relating to key management personnel and immediate relatives totalled £534,835 as at 31 December 2017 (2016: £556,560). The amount of the provision relating to these finances is £nil (2016: £nil). Returns recognised during the year for these accounts were £19,925 (2016: £18,408). All consumer finance account facilities taken by key management personnel and staff were offered in line with standard customer terms and conditions.

(b) Transactions with ultimate parent company

Masraf Al Rayan Q.P.S.C (MAR) owns 70% and Qatar Holding LLC incorporated in Doha, Qatar owns 30% of Al Rayan (UK) Ltd which in turn owns 98.34% of Al Rayan Bank PLC. The remaining 1.66% is owned by other minority shareholders. MAR prepares consolidated financial statements and the Bank's results are only reported in their statement. These statements are available to the public.

	Less than 1 month 2017 £'000s	Less than 1 month 2016 £'000s
Placements with MAR	48,447	12,182
Deposits from MAR	1,778	1,712

As at 31 Dec 2017 there was an outstanding subordinated financing balance payable to MAR of £10m (2016: £0). Total returns paid on this liability for the year ended 31 Dec 2017 were £620,274 (2016: £0). There were no returns payable on this liability as at 31 December 2017 (2016: £0).

This facility was granted through an agreement dated 24 March 2017 negotiated on an arm's length basis. The contract is based on a Wakala agreement and expected profit is payable every 6 months.

The maturity of the facility is greater than 5 years.

27. Assets and liabilities denominated in foreign currency

Assets denominated in US Dollars (USD) and Euro (EUR) are included within treasury placements, cash balances with banks, financing assets and investment securities.

Deposits denominated in USD and EUR are included within from banks and customers.

The Bank manages its foreign currency exposure within its set risk appetite. As at year ended 31 December 2017 the Bank's net foreign currency exposure was immaterial.

Assets and liabilities in foreign currency

£'000s equivalent	USD	EUR
2017		
Assets	177,588	5,087
Deposits	179,431	5,186
2016		
Assets	126,485	3,063
Deposits	125,729	5,167

28. Financial instruments

The table below summarises the carrying amounts and fair values of financial assets and liabilities.

Categories of financial instruments, 2016-17

	Financing and receivables £'000s	Available-for-sale financial assets £'000s	Other liabilities at amortised cost £'000s	Total carrying amount £'000s
As at 31 December 2017				
Cash	2,692	-	-	2,692
Treasury Placements and balances with banks	228,822	-	-	228,822
Net investment in Consumer Finance	9	-	-	9
Net investment in Home Purchase Plans	930,386	-	-	930,386
Net investment in Commercial Property Finance	475,787	-	-	475,787
Investment securities	-	154,207	-	154,207
Total	**1,637,696**	**154,207**	**-**	**1,791,903**
Deposits from banks	-	-	62,219	62,219
Deposits from customers		-	1,596,656	1,596,656
Total	**-**	**-**	**1,658,875**	**1,658,875**
As at 31 December 2016				
Cash	2,412	-	-	2,412
Treasury Placements and balances with banks	217,304	-	-	217,304
Net investment in Consumer Finance	43	-	-	43
Net investment in Home Purchase Plans	638,314	-	-	638,314
Net investment in Commercial Property Finance	394,221	-	-	394,221
Investment securities	-	168,242	-	168,242
Total	**1,252,294**	**168,242**	**-**	**1,420,536**
Deposits from banks	-	-	83,571	83,571
Deposits from customers		-	1,225,244	1,225,244
Total	**-**	**-**	**1,308,815**	**1,308,815**

Investment securities are held at fair value and are recognised as available for sale assets.

Fair values of financial assets and financial liabilities are based on quoted market prices. If the market is not active the Bank establishes a fair value by using appropriate valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis. The objective of valuation techniques is to determine the fair value of the financial instrument at the reporting date as the price that would have been agreed between active market participants in an arm's length transaction.

The Bank measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making measurements:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: Inputs for the asset or liability that is not based on observable market data (unobservable inputs).

Fair value of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair values using valuation techniques. For Level 3 assets, the technique used to determine the fair value is by estimating the net present value (NPV) of the future cash flows discounted at a market rate. These are determined with reference to observable inputs, historical observations and analytical techniques.

As at 31 December 2017 the only financial assets or financial liabilities which were subsequently measured at fair value after initial recognition were the investment securities recognised as 'available for sale' financial assets.

The table below analyses financial instruments measured at fair value into a fair value hierarchy:

Financial instruments measured at fair value

	Level 1	Level 2	Level 3	Total
	£'000s	£'000s	£'000s	£'000s
As at 31 December 2017				
Investment securities	154,207	-	-	154,207
Total	154,207	-	-	154,207
As at 31 December 2016				
Investment securities	168,242	-	-	168,242
Total	168,242	-	-	168,242

29. Financial risk management

The Bank has exposure to the following risks arising from its use of financial instruments:

a) Credit risk

b) Liquidity risk

c) Market risk

d) Concentration risk

e) Capital management

This note presents information about the Bank's exposure to each of the above risks, its objectives, policies and processes for measuring and managing these risks, and its management of capital.

The comparatives contained in this note for 2016 are unaudited.

Risk Management Framework (RMF)

The Board of Directors has overall responsibility for the establishment of the Bank's Risk Management Framework with robust oversight provided through the Board Risk Committee (BRC). The Bank has established the Asset & Liability (ALCO), Executive Risk Committee (ERC), supported by other sub-committees such as the Credit Committee, which together are responsible for developing and monitoring risk management policies in their specific areas.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations. Risk management controls and procedures are reviewed by Internal Audit, both as part of the regular audit review programme and through ad-hoc reviews. The results of these reviews are reported to the Audit Committee.

(a) Credit risk

Credit risk is the risk of loss arising from the failure of a customer or counterparty to meet their contractual obligations. The risk arises from the Bank's secured and unsecured finance provided to customers and the investment of surplus funds in Sharia compliant wholesale deposits with bank counterparties.

(i) Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to the Management Credit Committee and the Executive Risk Committee. A separate Credit department and Credit Risk Committee (sub-committee of ERC), reporting to the Chief Risk Officer is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with other business units, covering credit assessments, collateral requirements, risk reporting, legal requirements and compliance with regulatory and statutory requirements.
- Establishing authorisation limits and structures for the approval and renewal of credit exposure limits.
- Reviewing and assessing credit risk prior to agreements being entered into with customers.
- Limiting concentrations of exposure to counterparties, countries or sectors and reviewing these limits.
- Ongoing assessment of exposure and implementation of procedures to reduce this exposure.
- Providing advice, guidance and specialist skills to all business areas to promote best practice throughout the Bank in the management of credit risk.

Adherence to country and counterparty limits, for amounts due from other banks, is monitored on an ongoing basis by the Bank's Treasury department, with a detailed review of all limits at least annually. Senior management receive regular reports on the utilisation of these limits.

(ii) Exposure to credit risk

Credit risk exposure	NOTE	Treasury placements and deposits with banks £'000s	Investment securities £'000s	Net investment in Consumer Finance £'000s	Net investment in Commercial Property Finance £'000s	Net investment in Home Purchase Plans £'000s	Total £'000s
2017							
Investment grade financial assets	13/15	228,822	154,207	-	-	-	383,029
Below investment grade		-	-	-	-	-	-
Unrated financial assets	14	-	-	32	475,946	931,614	1,407,592
Specific allowances for impairment	14	-	-	-	-	-	-
Collective allowances for impairment	14	-	-	(23)	(159)	(1,228)	(1,410)
Carrying amount as at 31 December 2017		**228,822**	**154,207**	**9**	**475,787**	**930,386**	**1,789,211**
2016							
Investment grade financial assets	13/15	217,304	168,242	-	-	-	385,546
Below investment grade		-	-	-	-	-	-
Unrated financial assets	14	-	-	255	394,424	639,138	1,033,817
Specific allowances for impairment	14	-	-	-	-	-	-
Collective allowances for impairment	14	-	-	(212)	(203)	(824)	(1,239)
Carrying amount as at 31 December 2016		**217,304**	**168,242**	**43**	**394,221**	**638,314**	**1,418,124**

Treasury placements and balances with banks (£60,357) were reclassified for 2016 to investment grade financial assets. Investment grade financial assets have a minimum rating of BBB-. As at 31 December 2017, the amount of unimpaired balances stood at £1,789m (2016: £1,417m). The maximum exposure to credit risk is the carrying amount of the financial asset receivable balances.

(iii) Write-off policy

The Bank writes off a balance (and any related allowances for impairment) when the Credit department determines that the balance is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the counterparty's financial position such that the counterparty can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

(iv) Collateral

The Bank holds collateral against secured financing made to businesses and individuals in the form of charges over properties, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of financing and are updated on a periodic basis. The estimated fair value of collateral held against financial assets as at 31 December 2017 is £2,676m (2016: £2,031m). None of this amount was held against impaired assets. There were no non-performing exposures in the secured book as at 31 December 2017.

(v) Concentration of credit risk

The Bank monitors concentration of credit risk by sector and geographical location. An analysis of concentrations of credit risk at the reporting date is shown below.

Concentration by sector

	Individuals £'000s	Corporate £'000s	Bank £'000s	Total £'000s
2017				
Treasury placements and balances with banks	-	-	228,822	228,822
Investment securities	-	138,354	15,853	154,207
Net investment in Consumer finance	9	-	-	9
Net investment in Home Purchase Plans	930,386	-	-	930,386
Net investment in Commercial Property Finance	25,667	450,120	-	475,787
2016				
Treasury placements and balances with banks	-	-	217,304	217,304
Investment securities	-	65,464	102,778	168,242
Net investment in Consumer finance	43	-	-	43
Net investment in Home Purchase Plans	638,314	-	-	638,314
Net investment in Commercial Property Finance	28,883	365,338	-	394,221

Concentration by location

	UK £'000s	Europe £'000s	Asia £'000s	Middle East £'000s	Total £'000s
2017					
Treasury placements and balances with banks	151,980	-	-	76,842	228,822
Investment securities	45,941	-	30,083	78,183	154,207
Net investment in Consumer finance	9	-	-	-	9
Net investment in Home Purchase Plans	930,152	234	-	-	930,386
Net investment in Commercial Property Finance	473,921	1,866	-	-	475,787
2016					
Treasury placements and balances with banks	156,947	-	-	60,357	217,304
Investment securities	68,721	-	-	99,521	168,242
Net investment in Consumer finance	43	-	-	-	43
Net investment in Home Purchase Plans	638,078	236	-	-	638,314
Net investment in Commercial Property Finance	392,159	2,062	-	-	394,221

The asset quality underlying the Commercial Property Finance and Home Purchase Plans portfolios is maintained, with financing decisions based on clear affordability assessments and prudent finance-to-value (FTV) ratios. As at 31 December 2017, 28 of the facilities within the secured finance portfolios were in arrears.

(vi) Financing assets that are past due

The table below sets out information about the credit quality of financial assets and the allowance for impairment/loss held by the Bank against those assets:

Financing assets that are past due	Net investment in consumer finance £'000s	Net investment in Commercial Property Finance £'000s	Net investment in Home Purchase Plans £'000s	Total £'000s
Financial assets that were past due but not impaired				
31-60 days	-	147	22,338	22,485
61-90 days	-	-	976	976
90+ Days	-	-	783	783
Total	-	147	24,097	24,244
Financial assets not past due and not impaired	32	475,799	907,517	1,383,348
Total	32	475,799	907,517	1,383,348
Gross amount	32	475,946	931,614	1,407,592
Collective allowances for impairment	(23)	(159)	(1,228)	(1,410)
Carrying amount	9	475,787	930,386	1,406,182

The above table reflects collective provisioning as at 31 December 2017. The Bank did not hold specific provision against any financing assets (2016: £nil)

Financial assets that are 'past due but not impaired' are those for which contractual profit or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of collateral available.

(b) Liquidity risk

Liquidity risk is the risk that the Bank does not have sufficient financial resources to meet its commitments when they fall due or can secure them only at excessive cost. The Bank's approach to managing liquidity is to ensure that it will aim to have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

The Treasury department is responsible for monitoring the liquidity profile of financial assets and liabilities and preparing details of projected cash flows arising from projected future business. The Treasury department maintains a portfolio of Sukuk and short term liquid assets, made up of cash on demand and

short term Treasury placements, to ensure that sufficient liquidity is maintained. All liquidity policies and procedures are subject to review and sanction at ALCO and approved by the Board.

The key measure used by the Bank for managing liquidity risk is the comparison of the maturity of assets and customer deposits. This analysis is completed and monitored daily, and reports are submitted each month for review by ALCO. A similar calculation of mismatches is submitted to the Prudential Regulation Authority (PRA) as part of the Bank's quarterly regulatory reporting.

Residual contractual maturities of financial liabilities

The following table shows the undiscounted cash flows on the Bank's financial liabilities based on their earliest possible contractual maturity. However, based on behavioural experience demand deposits from customers are expected to maintain an increasing balance.

Undiscounted cash flows on financial liabilities

	Note	Carrying amount	Gross maturity outflow	Less than 1 month	1 - 3 months	3 months - 1 year	1 year – 2 years	2 years – 3 years
		£'000s	£'000s	£'000s	£'000s	1 year	£'000s	£'000s
2017								
Deposits from banks	20	62,219	62,327	62,327	-	-	-	-
Deposits from customers	21	1,596,656	1,619,000	1,017,722	103,220	309,249	170,536	18,274
Total		**1,658,875**	**1,681,327**	**1,080,049**	**103,220**	**309,249**	**170,536**	**18,274**
2016								
Deposits from banks	20	83,571	84,183	1,796	82,387	-	-	-
Deposits from customers	21	1,225,244	1,237,152	836,749	79,129	92,320	172,761	56,193
Total		**1,308,815**	**1,321,335**	**838,545**	**161,516**	**92,320**	**172,761**	**56,193**

A breakdown of the Bank's Treasury placements by maturity date is shown in Note 13.

(c) Market risk

Market risk is the risk of loss of income arising from unfavourable market movements, including foreign exchange rates, profit rates and basis risk. The objective of market risk management is to manage and control exposures within acceptable parameters, whilst optimising returns. The Bank is not exposed to any material foreign currency risk. Given the Bank's current profile of financial instruments, the principal exposure is the risk of loss arising from fluctuations in the future cash flows or fair values of these financial instruments because of a change in achievable rates. This is managed principally through monitoring gaps between effective profit and rental rates and matching fixed or variable rate assets with liabilities of comparable rate basis and reviewing approved rates and bands at regular re-pricing meetings.

Profit rates for Treasury placements are agreed with the counterparty bank at the time of each transaction and the profit (mark-up) and effective profit rate is consequently fixed (for Murabaha) and maintained (for Wakala) for the duration of the contract. Risk exposure is managed by reviewing the maturity profiles of transactions entered into.

Effective rates applied to new consumer finance transactions are agreed on a monthly basis by ALCO and the profit (mark-up) will then be fixed for each individual transaction for the agreed deferred payment term.

Rentals for longer term Commercial Property Financing and Home Purchase Plans are benchmarked against a market measure, in agreement with the Bank's Sharia Supervisory Committee, subject to maximum rent levels.

Profit rates payable on Mudaraba customer deposit accounts are calculated at each month-end in line with the profit allocation model and the customer terms and conditions. Profit rates payable on Treasury placements and deposits are agreed with the customer at the time of each transaction and the profit (mark-up) and effective profit rate is consequently fixed (for Murabaha) and maintained (for Wakala) for the duration of the contract. Risk exposure is managed by reviewing the maturity profiles of transactions entered into.

All profit rates and re-pricings are reviewed and agreed at ALCO, which is principally responsible for monitoring market risk. ALCO will also review sensitivities of the Bank's assets and liabilities to standard and non-standard changes in achievable effective rates.

Standard scenarios that are considered monthly include a 2.00% or 0.50% rise or fall in effective average rates. An analysis of the Bank's statement of comprehensive income sensitivity to an increase or decrease in effective rates (assuming no asymmetrical movement and a constant statement of financial position status) is as follows:

Earnings Based Approach

This looks at the 12-month rolling impact of the Bank's income and expenditure account in the event of a rate shift. The P&L impact is measured by flexing the Bank of England base rate (BBR) and measuring the profits arising from the rate shift.

- 2% increase - Rate rise from 0.25% BBR to 2.25%
- 2% decrease - Rate drop from 0.25% but rate drop is capped to a floor rate of 0% (i.e. a drop of 0.25%)

	2.00% parallel increase £'000s	2.00% parallel decrease £'000s
31 December 2017	7,762	(1,613)
31 December 2016	**8,177**	**(2,260)**

Economic Based Approach

This looks at the net present value (NPV) of the balance sheet impact of the mismatch in each time period arising between assets and liabilities measured up to 10 years.

The profit risk is the result of the most severe impact of a 2% increase and a 2% decrease in rates.

	2.00% parallel increase £'000s	2.00% parallel decrease £'000s
31 December 2017	(6,315)	2,994
31 December 2016	**(4,234)**	**2,486**

Basis risk

Basis risk assesses the impact of a 0.5% widening of profit reference rates (BBR vs LIBOR) used as a basis for asset and liabilities' pricing measured over a 12 month period. The maximum negative impact is shown here:

	0.5% widening £'000s
31 December 2017	322
31 December 2016	**192**

(d) Concentration risk

Concentration risk is the risk of loss arising from inadequate diversification of credit risk across sectors. The risk arises due to exposure to specific geographical locations, industry sectors or particular customers or institutions.

The Board sets counterparty, country and regional limits in respect of treasury assets and adherence to these limits is monitored daily.

Concentrations exist within the Commercial Property Finance and Home Purchase Plans portfolios. Concentration limits are set for customers. As these portfolios grow, such concentrations are expected to reduce.

The Credit Committee monitors both sectoral and geographic concentration for each finance asset class and regularly reviews counterparty, country and regional limits in respect of treasury assets.

(e) Capital management

In accordance with the EU's Capital Requirements Directive (CRD) and the required parameters set out in the EU's Capital Requirements Regulation (CRR), together with local rules and guidance set by the PRA, the Bank's Individual Capital Adequacy Assessment Process (ICAAP) is embedded in the risk management framework of the Bank. The ICAAP is reviewed on an annual basis as part of the Bank's strategic planning process and more frequently if business requirements demand.

Regulatory capital is analysed as below;

- Tier 1 capital, (the Bank's Tier 1 wholly comprises of CET1 capital), includes ordinary share capital, share premium, AFS reserve, deficit earnings and profit stabilisation reserve, less intangible assets and deferred tax.
- Tier 2 capital, includes subordinated financing and collective impairment allowances

The PRA has reviewed and evaluated the ICAAP and has provided the Bank with its Individual Capital Requirement (ICR) to be met. The PRA sets out ICR for all banks operating in the United Kingdom by reference to its Capital Resources

Requirement and monitors the available capital resources in relation to the ICR requirement. The Bank's capital requirements are monitored by the Executive team and the Board.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The Bank has complied with all externally imposed capital requirements throughout the period.

The Bank's regulatory capital position as at 31 December 2017 was as follows:

Regulatory capital

	2017 £'000s	2016 £'000s
Tier 1 capital		
Total equity	128,765	123,284
Less intangible assets	(716)	(934)
Less deferred tax	(5,545)	(6,097)
Total	**122,504**	**116,253**
Tier 2 capital		
Subordinated financing	10,000	-
Collective allowances for impairment	1,411	1,238
Total regulatory capital	**133,915**	**117,491**

30. Events after the reporting period

The following events and transactions occurred subsequent to 31 December 2017:

The Bank received subordinated financing of £5m from its parent, MAR on 1 February 2018. This was under the same terms disclosed under Note 22.

The Bank received funding of £250m from the issuance of an Asset Backed Sukuk on 22 February 2018.

These were non-adjusting events.

31. Ultimate parent company

The Bank's ultimate controlling parent Company is MAR, a Company registered in Doha, Qatar.

NOTES

NOTES

AL RAYAN BANK

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