

Annual Report

2012

Bank of Cyprus UK

Contents **Page**

Directors, other senior executives, independent auditor and locations	2
Chairman's statement	3
Chief Executive's review	4
Directors' report	5
Directors' responsibilities in respect of the financial statements	7
Independent auditors' report	8
Financial statements	9

Definitions

"BOCFS"	Bank of Cyprus Financial Services Limited
The "Company"	Bank of Cyprus UK Limited (formerly Bank of Cyprus Advances Limited)
"FCA"	Financial Conduct Authority
"FSA"	Financial Services Authority
"FSCS"	Financial Services Compensation Scheme
"IAS"	International Accounting Standards
"IASB"	International Accounting Standards Board
"IFRS"	International Financial Reporting Standards
The "Group"	The Parent together with its subsidiary undertakings
"Laiki"	Cyprus Popular Bank Public Company Limited
"Laiki UK"	The UK branch of Cyprus Popular Bank Public Company Limited
The "Parent"	Bank of Cyprus Public Company Limited
"PRA"	Prudential Regulation Authority

Directors, other senior executives, independent auditor and locations

Directors
Philip Nunnerley* - *Acting Chairman, Chairman of the Audit & Risk Committee and senior independent non-executive director*
Soteris Antoniades† - *Assistant Chief Executive*
David Green* - *Independent non-executive director*
Iacovos Koumi† - *Chief Executive*
Kypros Kyprianou† - *Assistant Chief Executive*
Spyros Neophytou* - *Non-executive director*

Other senior executives
Stephen Byrne† - *Head of Legal & Compliance and Company Secretary*
Andrew Michaelides† - *Chief Financial & Risk Officer*
Tony Leahy† - *Head of Human Resources & Communications*
Emmanuel Theocharopoulos - *Head of Internal Audit*
Christian Kreps - *Compliance Manager*

* Member of the Audit & Risk Committee
† Member of the Management Committee

Independent auditor
Ernst & Young LLP

Registered office
27-31 Charlotte Street, London W1T 1RP

Locations
Central London
27-31 Charlotte Street, London W1T 1RP

North London
PO Box 17484, 87 Chase Side, London N14 5WH

South London
18-24 Brighton Road, South Croydon CR2 6AA

Birmingham
123 Parade, Sutton Coldfield B72 1PU

Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority

Registered in England and Wales under company number 04728421

www.bankofcyprus.co.uk

Chairman's statement

The principal achievement of 2012 was the incorporation of the UK operations of our Parent into a separate subsidiary, Bank of Cyprus UK Limited. Incorporation will bring long-term benefits to the customers and staff of the Company and to the Parent.

The bailout of Cyprus and its banking system has demonstrated the value of incorporation in protecting our UK customers from the direct impact of these events. As a result of its incorporated status, the Company was also able to assist in mitigating the effects of the resolution of Laiki on that bank's UK savers by taking over the deposits and current accounts in credit of Laiki UK.

As part of the Cypriot bailout, the Parent is being significantly restructured and recapitalised so as to satisfy capital adequacy requirements under an adverse stress scenario.

Whilst these continue to be challenging times, I am confident that the Company has a great deal to offer its customers. For individuals and businesses we have for many years offered an attractive home for savings. For our entrepreneurial borrowers, the Company can offer a level of service and flexibility that the larger banks simply do not provide.

Our business has operated in the UK market since 1955, and we have shown that we can respond successfully to difficult economic conditions. We have a strong and focused management team, and hard working and committed employees. They are more than capable of facing the challenges that lie ahead.

I would like to thank my fellow directors, past and present, both for their valuable contribution throughout 2012 and the role they have played in helping to position our business for a successful future.

Philip Nunnerley
Acting Chairman

Chief Executive's review

The Company's business model is straightforward: accepting retail deposits, mainly from UK savers, to fund lending to UK-based small and owner-managed businesses, including property entrepreneurs.

In recent years our business operated as a branch of our Parent until, on 25 June 2012, the business was incorporated within a separate UK legal entity. On that date, following regulatory and court approval, substantially all the assets and liabilities of the UK branch of the Parent (mainly cash, customer loans and customer deposits) were transferred to the Company. Since incorporation we have operated as an authorised UK bank with our own capital and liquid assets, and ring-fenced from our Parent.

As part of our preparation for incorporation we needed to reduce significantly the total amount of customer advances, to minimise the capital and funding burden that would be placed on the Parent. We took the opportunity to reduce the level of concentration in our loan book by bringing down some of the largest exposures to levels that are more appropriate for a separately capitalised UK subsidiary.

For savers, our incorporation gives them the comfort that their eligible deposits are now protected by the UK Financial Services Compensation Scheme. For borrowers, there is the confidence that the Company has dedicated financial resources to support their business and their plans. We are not dependent on the Parent for liquidity and we plan to generate enough capital internally to support our requirements for the foreseeable future.

As a UK bank we were well positioned to assist in mitigating the effects of the resolution of Laiki on its UK savers by taking over the deposits and current accounts in credit at Laiki UK in April 2013; this further strengthened our Company's liquidity. The loans of Laiki UK were transferred to our Parent.

The audited financial statements set out on pages 9 to 36 relate to the legal entity Bank of Cyprus UK Limited and cover the results of our UK banking business from 25 June 2012, when that business was transferred to the Company.

Following the transfer, the Company decided to take a conservative approach to providing for loan impairments in light of the continuing difficult economic conditions in the UK. As a result it has increased its collective provision by £2.4m and its specific provisions by £4.7m. These increases, accounting for £7.1m out of the total impairments charge of £8.4m, relate to loans transferred from the Parent's UK branch and do not arise from events that took place after incorporation.

I would like to give special thanks to our customers for their continued loyalty and to our employees for their hard work and dedication.

Iacovos Koumi
Chief Executive

Directors' report

The directors present their report and financial statements for the year ended 31 December 2012.

Principal activity
The principal activity of the Company is business and personal banking.

Financial results
The results of the Company for the year ended 31 December 2012 are set out in the income statement on page 9. The directors endorse the information and views set out in the Chairman's statement and Chief Executive's review.

The directors are satisfied that the capital and liquidity positions of the Company more than meet regulatory requirements and are adequate for the foreseeable future.

Going concern
The directors believe that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements. A statement of responsibilities of the directors in relation to the financial statements is shown on page 7.

The Company has its own capital and liquidity and is not dependent on the Parent for support. Nevertheless, the directors note the recapitalisation of the Parent which is taking place as part of the Cypriot bailout. Details of the recapitalisation are set out in note 30.

Dividends
The Company did not declare or pay a dividend in 2012 (2011: nil).

Hedging policy
The Company uses appropriate interest rate swaps to hedge against interest rate risk where appropriate. Hedging is covered in more detail in note 15 of the financial statements.

Additional capital
Until shortly before the Company became an authorised UK bank on 25 June 2012, it operated with £1 of issued share capital. To provide adequate capital for the business and in order to meet regulatory requirements with regard to capital, the following ordinary shares of £1 each were issued at par for cash to the Parent:

4,999,999 on 7 June 2012
60,000,000 on 22 June 2012

Tier 2 regulatory capital was injected into the Company by way of a subordinated loan of £30,000,000 from the Parent on 20 June 2012. The current regulatory capital is shown in note 28 of the financial statements.

Regulatory developments
The Company's authorisation in June 2012 as a UK bank has meant it has had to comply with the demanding regime of the PRA, which among other things sets minimum requirements for the level of capital and liquid assets that must be held. The Company remains a member of the British Bankers' Association, which requires it to comply with a number of codes of practice, and remains a signatory to the voluntary Lending Code. Far from seeing these as restrictions on the business, the directors welcome working to the highest standards that ensure customers are treated fairly and remain loyal.

Human resources
The Company had 157 permanent employees at 31 December 2012. During the year, the Company invested £99,000 on staff development.

Board of directors
Full details of the board of directors are shown on page 2. Since 1 January 2012 the following appointments and resignations have taken place:

Name of director	*Date of appointment*	*Date of resignation*
Soteris Antoniades	21 June 2012	
Andreas Artemis	21 June 2012	26 March 2013
John Buddle	21 June 2012	26 July 2012
Stephen Byrne		21 June 2012
David Green	20 July 2012	
Christis Hadjimitsis	21 June 2012	12 April 2013
Kypros Kyprianou	21 June 2012	
Spyros Neophytou	21 June 2012	
Philip Nunnerley	21 June 2012	
Vassilis Rologis	21 June 2012	30 March 2013
Costas Severis	21 June 2012	2 April 2013

No director who resigned in 2012 received any compensation for ceasing to be a director.

Directors and their interests
None of the directors had any beneficial interest in the share capital of the Company or any other group company within the UK at any time during the year. No option to purchase shares in the Company has been granted to any director.

Change of company name
On 25 June 2012 the Company changed its name from Bank of Cyprus Advances Limited to Bank of Cyprus UK Limited. This coincided with the Company starting to operate as a UK bank.

Suppliers
It is the Company's policy to pay its suppliers within the agreed period from the date of their invoice.

Disclosure of information to the auditors
So far as each person who was a director at the date of this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Company's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors
Ernst & Young LLP continue as auditors of the Company. The Company is a private limited company and under the Companies Act 2006 is not required to appoint auditors annually.

Future developments and events after the balance sheet date
The Company plans to continue with its current business model of raising retail deposits, mainly in the UK market, and lending those deposits to UK business customers and property entrepreneurs. It intends to grow its lending business sustainably throughout 2013, raising additional deposits where necessary to fund such lending growth.

As mentioned in note 30, on 1 April 2013 the customer deposits of Laiki UK totalling £274m were transferred to the Company together with an equivalent amount of cash on deposit at the Bank of England.

Corporate governance and risk management
The board is collectively responsible for governance and risk management. It meets as and when required and at least quarterly. It sets the overall risk appetite of the Company and ensures that acceptable risks are carefully managed and controlled. The following are in place to ensure that this happens.

At board level, the Audit & Risk Committee has within its terms of reference the oversight of all risks inherent in the business. This committee meets as and when required and at least quarterly.

The main risk is credit risk which is the risk that customers will be unable to repay their loans and advances and will fail to perform under their contractual commitments. Credit risk is managed by credit policies which include credit approval procedures and controls and analysis in relation to quality, sector and geographical area. Credit risk is overseen at executive level by the Advances Committee, which meets monthly.

Liquidity, cash flow and market risks are monitored at executive level by the Asset & Liability Committee, which meets monthly. Systems risk, including risk relating to IT security, is monitored at executive level by the Systems Committee, which meets quarterly. Resources risk in terms of our people and succession planning is monitored at executive level by the Human Resources Committee, which meets quarterly.

At executive level all relevant risks are reviewed and managed by the Risk Committee, an executive committee which meets quarterly. In addition to the risks covered by the above mentioned executive committees, the Risk Committee oversees the management of operational, legal, regulatory, conduct, compliance and reputational risk.

Matters which in larger companies would be overseen by separate board committees, such as remuneration and board appointments, are overseen by the board as a whole.

More information on risk management is set out in note 26 of the financial statements.

Subsidiary
Prior to incorporation of the UK banking business, the Company's Parent was the sole shareholder of a UK company, Bank of Cyprus Financial Services Limited (BOCFS), an appointed representative of Legal & General Partnership Services Limited. BOCFS sells insurance and protection products of Legal & General. The Court order referred to in note 1 in the financial statement transferred the Parent's UK banking business and all the shares of BOCFS to the Company. Consequently, the Company is now the immediate shareholder of BOCFS.

Charitable donations
During 2012 the Company made charitable donations totalling £6,000 (2011: nil).

Third party indemnity provisions for the benefit of directors
Until 15 March 2013, the Parent arranged directors' and officers' liability insurance for all companies in the Group, including the Company. Such arrangements have now ceased and the Company is in the process of arranging its own insurance.

By order of the board

Stephen Byrne
Secretary

Directors' responsibilities in respect of the financial statements

The directors are responsible for preparing 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 the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) 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 Company and of the profit or loss of the Company for that period. In preparing these financial statements the directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8 'Accounting Policies, Changes in Accounting Estimates and Errors' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report

To the members of Bank of Cyprus UK Limited

We have audited the financial statements of Bank of Cyprus UK Limited for the year ended 31 December 2012 which comprise the income statement, statement of comprehensive income, balance sheet, statement of changes in equity, statement of cash flows and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective responsibilities of directors and auditor
As explained more fully in the directors' responsibilities statement set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Opinion on financial statements
In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Peter Wallace
Senior Statutory Auditor
For and on behalf of Ernst & Young LLP, London

Notes:
The maintenance and integrity of the Bank of Cyprus UK Limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Income statement and statement of comprehensive income

For the year ended 31 December 2012

	Notes	***2012*** ***£000***	*2011* *£000*
Interest income	4	**21,129**	445
Interest expense	5	**(14,492)**	(445)
Net interest income		**6,637**	-
Fee and commission income	6	**1,502**	-
Foreign exchange gains	7	**161**	-
Net gains on financial instrument transactions	8	**61**	-
Total operating income		**8,361**	-
Staff costs	9	**(3,272)**	-
Depreciation and amortisation	10	**(774)**	-
Other operating expenses	11	**(2,461)**	-
Profit before provisions for impairment of loans and advances		**1,854**	-
Provisions for impairment of loans and advances	12	**(8,371)**	-
Loss before tax		**(6,517)**	-
Taxation	13	**1,612**	-
Loss after tax		**(4,905)**	-
Other comprehensive income		**-**	-
Total comprehensive loss for the year attributable to the equity holders		**(4,905)**	-

The notes on page 13 to 36 form an integral part of these financial statements.

Balance sheet

At 31 December 2012

	Notes	2012 £000	2011 £000	1 January 2011 £000
Assets				
Cash and balances with central banks	14	**334,725**	-	-
Placements with related entities	14, 29	**11,532**	-	-
Placements with banks	14	**48,126**	-	-
Investment in subsidiary	27	**400**	-	-
Loans and advances to customers	16	**621,329**	7,506	11,844
Property and equipment	17	**10,245**	-	-
Intangible assets	18	**426**	-	-
Other assets	19	**2,236**	-	-
Total assets		**1,029,019**	7,506	11,844
Liabilities				
Placements by related entities	29	**19,866**	7,506	11,844
Amounts due to banks		**11**	-	-
Customer deposits	20	**911,695**	-	-
Other liabilities	21	**7,352**	-	-
Subordinated loan	22	**30,000**	-	-
Total liabilities		**968,924**	7,506	11,844
Equity				
Share capital	23	**65,000**	-	-
Accumulated losses		**(4,905)**	-	-
Total equity		**60,095**	-	-
Total liabilities and equity		**1,029,019**	7,506	11,844

The notes on pages 13 to 36 form an integral part of these financial statements.

The opening balance sheet for 2011 is shown in accordance with the requirements of IFRS 1 on first time adoption of IFRSs.

These financial statements were approved by the board of directors on 25 April 2013 and were signed on its behalf by:

Philip Nunnerley
Acting Chairman

Iacovos Koumi
Chief Executive

Statement of changes in equity

For the year ended 31 December 2012

	2012			2011
	Share capital	**Accumulated losses**	**Total**	Total
	£000	**£000**	**£000**	£000
1 January	**-**	**-**	**-**	-
Issue of equity shares	**65,000**	**-**	**65,000**	-
Total comprehensive loss for the year attributable to the equity holders	**-**	**(4,905)**	**(4,905)**	-
31 December	**65,000**	**(4,905)**	**60,095**	-

The notes on pages 13 to 36 form an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2012

	Notes	***2012***	*2011*
		£000	*£000*
Loss before tax		**(6,517)**	-
Adjustments for:			
Provisions for impairment of loans and advances		**8,371**	-
Depreciation of property and equipment		**598**	-
Amortisation of intangible assets		**176**	-
Interest on subordinated loan		**1,223**	-
Tax paid		**(667)**	-
Changes in operating assets and liabilities			
Decrease in amounts due to banks		**(1,376)**	-
Increase/(decrease) in amounts due to related entities		**9,022**	(4,339)
Increase in customer deposits		**8,480**	-
Decrease in loans and advances to customers		**75,210**	4,339
Increase in other assets		**(664)**	-
Decrease in accrued income and prepaid expenses		**1,750**	-
Decrease in other liabilities		**(3,907)**	-
Increase in accrued expenses		**1,372**	-
Net cash flow from operating activities		**93,071**	-
Cash flows from investing activities			
Consideration received for assumption of net liabilities on transfer	1	**4,902**	-
Purchase of property and equipment		**(59)**	-
Purchase of intangible assets		**(90)**	-
Net cash flow from investing activities		**4,753**	-
Cash flows from financing activities			-
Issue of share capital	23	**65,000**	-
Issue of subordinated loan	22	**30,000**	-
Net cash flow used in financing activities		**95,000**	-
Net increase in cash and cash equivalents for the year		**192,824**	-
Cash and cash equivalents			
1 January		**-**	-
Cash and cash equivalents received on transfer		**201,559**	-
Net increase in cash and cash equivalents for the year		**192,824**	-
31 December	14	**394,383**	-

The notes on pages 13 to 36 form an integral part of these financial statements.

Notes to the financial statements

1 Corporate information

The Company was incorporated in England and Wales as a private company with limited liability on 9 April 2003 under its previous name of Bank of Cyprus Advances Limited. On 25 June 2012 the Company changed its name to Bank of Cyprus UK Limited. The Company is authorised by the PRA and regulated by the FCA and the PRA.

The Company is wholly owned by Bank of Cyprus Public Company Limited, the Parent in which the financial statements of the Company are consolidated. The Parent is incorporated in Cyprus and its consolidated financial statements may be obtained from www.bankofcyprus.com.

The Company has taken advantage of the exemption from preparing consolidated financial statements afforded by Section 400 of the Companies Act 2006 because the Company and its subsidiary are included in the consolidated financial statements of the ultimate parent company, Bank of Cyprus Public Company Limited, which are publicly available. These financial statements have been prepared on a standalone basis. The accounting policies used by the Company that are relevant to an understanding of the financial statements are stated in note 2.

Transfer of business
On 19 June 2012 the Company was authorised as a bank by the FSA.

On 25 June 2012, substantially all the assets and liabilities of the UK branch of the Parent were transferred to the Company in accordance with an order by the High Court under Part VII of the Financial Services and Markets Act 2000. The obligations of the UK branch of the Parent under a defined benefit pension scheme which had closed to further accrual in 2008 did not form part of the transfer. The Parent continues to be the sponsoring employer of that scheme.

The assets and liabilities transferred from the UK branch of the Parent to the Company were as follows:

	£000
Assets transferred	
Cash and balances with central banks	**201,559**
Loans and advances to customers	**697,405**
Property and equipment	**11,297**
Investment in subsidiary	**400**
Other assets	**1,043**
Total assets transferred	**911,704**
Liabilities transferred	
Placements by related entities	**1,387**
Amounts due to banks	**3,337**
Customer deposits	**903,215**
Other liabilities	**8,667**
Total liabilities transferred	**916,606**
Net liabilities transferred	**4,902**

The business combination is exempt from acquisition accounting under IFRS 3 since it is a combination involving businesses under common control. The Company received payment for the net liabilities assumed through an adjustment to inter-company balances.

2 Accounting policies

Basis of preparation

These standalone financial statements have been prepared on a historical cost basis, except for revaluation of land and buildings and derivative financial instruments that have been measured at fair value through profit and loss. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at cost, are adjusted to record changes in fair value attributable to the risks that are being hedged.

Statement of compliance

The standalone financial statements have been prepared in accordance with the IFRSs as adopted by the EU and the requirements of the Companies Act 2006.

First-time adoption of IFRS

The Company has changed the basis of its accounting from UK Generally Accepted Accounting Principles to IFRS. The revised accounting framework has been applied with effect from 1 January 2011. The Company applied IFRS 1 First-time Adoption of International Financial Reporting Standards in preparing these financial statements. There is no material effect of the transition to IFRS on equity, total comprehensive income and cash flows.

Presentation of financial statements

The financial statements are presented in sterling, which is the Company's functional and presentation currency. All values are rounded to the nearest thousand, except where otherwise indicated.

The Company presents its balance sheet broadly in order of decreasing liquidity. An analysis regarding expected recovery or settlement of financial assets and liabilities within twelve months after the balance sheet date and more than twelve months after the balance sheet date is presented in note 26.

Financial assets and financial liabilities are offset, and the net amount reported in the balance sheet, only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Company.

Foreign currency translation

Transactions in foreign currencies are recorded using the functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated at the reporting currency rate of exchange ruling at the balance sheet date. All differences are taken to ‘Foreign exchange gains’ in the income statement.

Non-monetary items that are measured at historic cost in a foreign currency are translated using the exchange rates ruling as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates ruling at the date when the fair value was determined.

Standards and interpretations that are issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Company’s financial statements are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

Standards and interpretations issued by the IASB and adopted by the EU

IAS 32 ‘Financial Instruments: Presentation’ (Amended) - Offsetting Financial Assets and Financial Liabilities:
The amendment is effective for accounting periods beginning on or after 1 January 2014. This amendment clarifies the meaning of ‘currently has a legally enforceable right to set off’ and also clarifies the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The Company’s management does not expect that this amendment will have a significant impact on the Company’s financial position.

IFRS 7 ‘Financial Instruments: Disclosures’ (Amended) - Offsetting Financial Assets and Financial Liabilities:
The amendment is effective for accounting periods beginning on or after 1 January 2013. The amendment introduces common disclosure requirements on rights of set off and related arrangements. These disclosures will provide users with information that is useful in evaluating the effect or potential effect of netting arrangements on an entity’s financial position. The amendments to IFRS 7 are to be retrospectively applied. The Company’s management does not expect that this amendment will have a significant impact on its financial position.

IFRS 13 ‘Fair Value Measurement’:
The new standard is effective for accounting periods beginning on or after 1 January 2013. IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. This standard is to be applied prospectively and early adoption is permitted. Based on the current portfolio of assets and liabilities, the Company’s management does not expect that this amendment will have a material impact on its financial position.

IFRS 12 ‘Disclosures of Involvement with Other Entities’:
The new standard is effective for accounting periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 and related to financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity’s interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. The Company’s management does not expect that this amendment will have a material impact on the financial position.

Standards and interpretations issued by the IASB but not yet adopted by the EU

IFRS 9 ‘Financial Instruments - Classification and Measurement’:
The new standard is effective for accounting periods beginning on or after 1 January 2015. IFRS 9 as issued reflects the first phase of the IASB’s work on the replacement of IAS 39 and applies to the classification and measurement of financial assets and financial liabilities as defined in IAS 39. The first phase of IFRS 9 will have a significant impact on the classification and measurement of financial assets and reporting for those entities that have designated financial liabilities using the fair value option. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The Company will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued. However, the impact of adoption depends on the assets and liabilities of the Company at the date of adoption.

Segmental information

The Company operates in the United Kingdom in one principal activity, namely business and personal banking.

Revenue recognition

Revenue is recognised when it is probable that economic benefits will flow to the Company and the revenue can be reliably measured.

Interest income

For all financial assets measured at amortised cost and interest-bearing financial assets classified as available-for-sale investments, interest income is recognised using the effective interest rate method. The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the financial asset or liability, where appropriate, to the net carrying amount of that financial asset or liability. The calculation takes into account contractual terms of the financial asset and liability (eg prepayment options) excluding future credit losses.

Fee and commission income

Fees and commissions are recognised on an accruals basis to match the cost of providing the services except for advances arrangement fees which are amortised over the life of the advances in accordance with the effective interest rate method.

Retirement benefits

The cost of providing retirement pensions is charged to the profit and loss account at the amount of the defined contributions payable for each year. Differences between contributions payable and those actually paid are shown as accruals or prepayments.

Taxation

Taxation on income is provided in accordance with fiscal regulations and is recognised as an expense in the period in which the income arises. Deferred tax is provided using the liability method.

Deferred tax liabilities are recognised for all taxable temporary differences between the tax basis of assets and liabilities and their carrying amounts at the balance sheet date which will give rise to taxable amounts in future periods.

Deferred tax assets are recognised for all deductible temporary differences and carry-forward of unutilised tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carry-forward of unutilised tax losses can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to utilise all or part of the deductible temporary differences or tax losses.

Deferred tax assets and liabilities are measured at the amount that is expected to be paid to or recovered from the tax authorities, after taking into account the tax rates and legislation that have been enacted or substantially enacted by the balance sheet date.

Financial instruments

Date of recognition

The Company initially recognises advances and deposits on the date that they are originated. All other financial assets and liabilities are initially recognised on the trade date at which the Company becomes party to the contractual provisions of the instruments.

Initial recognition and measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus any directly attributable incremental costs of acquisition or issue except in the case of loans and receivables and subordinated loan stock not measured at fair value through profit or loss.

Derivative financial instruments

The Company uses derivatives such as interest rate swaps and exchange rate contracts to manage market risk. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in 'Net gains on financial instrument transactions'.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value in the trading portfolio with changes in fair value recognised in the income statement.

Financial assets or financial liabilities designated at fair value through the profit and loss account

Financial assets and financial liabilities classified in this category are designated as such by management on initial recognition when any of the following criteria are met: (a) the designation eliminates or significantly reduces the inconsistency that would otherwise arise from the measurement of the assets or liabilities or the recognition of gains or losses on them on a different basis, or (b) the assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and whose performance is evaluated on a fair value basis, in accordance with a documented risk management framework, or (c) the financial instrument contains one or more embedded derivatives, which significantly modify the cash flows that would otherwise be required by the contract.

Financial assets and financial liabilities designated at fair value through the profit and loss are recognised in the balance sheet at fair value. Changes in fair value are recognised in 'Net gains or losses on financial instrument transactions' in the income statement. Interest income and expense are included in the corresponding captions in the income statement according to the terms of the relevant contract using the effective interest rate method.

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as 'Trading investments', 'Investments available for sale' or 'Investments at fair value through profit or loss'. After their initial recognition, loans and receivables are subsequently measured at amortised cost, less any provision for impairment. The losses arising from impairment are recognised in the income statement in 'Provisions for impairment of loans and advances' in the case of loans and advances to customers**.**

Subordinated loan

The subordinated loan in issue is initially measured at the fair value of the consideration received, net of any issue costs. It is subsequently measured at amortised cost using the effective interest rate method, in order to amortise the difference between the cost at inception and the redemption value, over the period to the earliest date at which the Company has the right to redeem the subordinated loan stock. Interest on subordinated loan stock in issue is included in 'Interest expense' in the income statement.

Derecognition of financial assets and financial liabilities

Financial assets

A financial asset or where applicable a part of a financial asset or part of a group of similar financial assets is derecognised when: (a) the contractual rights to receive cash flows from the asset have expired, or (b) the Company has transferred its contractual rights to receive cash flows from the asset or (c) the Company has assumed an obligation to pay the received cash flows in full to a third party and: either (i) has transferred substantially all the risks and rewards of the asset, or (ii) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event or events have an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Individual impairment

For loans and advances to customers carried at amortised cost, the Company first assesses individually whether objective evidence of impairment exists.

The collectability of individually significant loans and advances is evaluated based on the customer's overall financial condition, resources and payment record, the prospect of support from creditworthy guarantors and the realisable value of any collateral. There is objective evidence that a loan is impaired when it is probable that the Company will not be able to collect all amounts due according to the original contract terms.

Objective evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that the borrower might be declared bankrupt or proceed with a financial restructuring and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or the economic conditions that correlate with defaults or a decline in the value of collateral.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan and the present value of the estimated future cash flows (excluding future credit losses not yet incurred) including the cash flows which may arise from guarantees and tangible collateral, irrespective of the outcome of foreclosure. To assess the future cash flows from tangible collateral in the form of land and buildings the Company obtains up to date professional advice on the sale value.

Future cash flows are based upon prudent assumptions about the value of the property representing the underlying security, costs that might be incurred in realising the value in the property, and the time it takes to repossess and sell properties. The property value is updated at regular intervals to ensure the Company has a good understanding of the change in the market value of the property held as collateral.

The carrying amount of the loan is reduced through the use of a provision account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of 'Interest and similar income'.
The present value of the estimated future cash flows is calculated using the loan's original effective interest rate. If a loan bears a variable interest rate, the discount rate used for measuring any impairment loss is the current reference rate plus the margin specified in the initial contract.

Collective impairment

If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

For the purposes of a collective evaluation of impairment, loans are grouped based on similar credit risk characteristics taking into account the type of the loan, past-due days and other relevant factors. Future cash flows for a group of loans and advances that are collectively evaluated for impairment are estimated on the basis of historical loss experience for loans with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the impact of current conditions that did not affect the period on which the historical loss experience is based and to remove the impact of conditions in the historical period that do not currently exist. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Loan renegotiations and forbearance

In certain circumstances, the Company will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. There are a number of different types of loan renegotiation, including the capitalisation of arrears, payment holidays, temporary transfer to interest-only terms and extensions of the due date of payment. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with the revised terms and are expected to continue to be paid in accordance with the revised terms.

Renegotiation may lead to the loan and associated provision being derecognised and a new loan being recognised initially at fair value.

Write-offs

Loans together with the associated provisions are written off when there is no realistic prospect of recovery. If a previously written off loan is subsequently recovered, any amounts previously charged are credited to 'Provisions for impairment of loans and advances' in the income statement.

Changes after recognition of impairment

Loans are monitored continuously and are reviewed for impairment at each reporting period. If, in a subsequent period, the amount of the estimated impairment loss decreases and the decrease is due to an event occurring after the impairment was recognised, when the creditworthiness of the customer has improved to such an extent that there is reasonable assurance that all or part of the principal and interest according to the original contract terms of the loan will be collected on timely basis, the previously recognised impairment loss is reduced by adjusting the impairment provision account.

Hedge accounting

The Company uses derivative financial instruments to hedge exposures to interest rate and foreign exchange risks. The Company applies hedge accounting for transactions which meet the specified criteria.

At inception of the hedging relationship, the Company formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk and the objective and strategy for undertaking the hedge. The method that will be used to assess the effectiveness of the hedging relationship also forms part of the Company's documentation.

At each hedge effectiveness assessment date, a hedge relationship must be expected to be highly effective on a prospective basis and demonstrate that it was effective retrospectively for the designated period in order to qualify for hedge accounting. A formal assessment is undertaken to ensure that the hedging relationship is highly effective in offsetting the changes in fair value or the cash flows attributable to the hedged risk. A hedge is regarded as highly effective if the changes in fair value or cash flows attributable to the hedged risk of the hedging instrument and the hedged item during the period for which the hedge is designated, are expected to offset in a range of 80% to 125%.

Fair value hedges

In the case of fair value hedges that meet the criteria for hedge accounting, the change in the fair value of a hedging instrument is recognised in the income statement in 'Net gains on financial instrument transactions'. The change in the fair value of the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged item and is also recognised in the income statement in 'Net gains on financial instrument transactions'.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedging relationship is terminated.

For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the income statement.

Cash flow hedges

In the case of cash flow hedges that meet the criteria for hedge accounting, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity in the 'Cash flow hedge reserve'. The ineffective portion of the gain or loss on the hedging instrument is recognised in 'Net gains on financial instrument transactions' in the income statement.

When the hedged cash flows affect the income statement, the gain or loss previously recognised in the 'Cash flow hedge reserve' is transferred to the income statement. When a hedging instrument expires, or is sold, terminated or exercised, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss that has been recognised in other comprehensive income at that time remains in other comprehensive income and is recognised when the hedged forecast transaction is ultimately recognised in the income statement.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents

Cash and cash equivalents for the purposes of the statement of cash flows consist of cash, non-obligatory balances with central banks, placements with banks and other securities that are readily convertible into known amounts of cash or are repayable within three months of the date of their acquisition.

Property and equipment

Property is originally measured at cost and subsequently measured at fair value less accumulated depreciation. Valuations are carried out on a three year cycle by independent qualified valuers on the basis of current market values. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

Computer hardware and furniture and equipment are carried at cost, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to acquisition.

Property and equipment carrying amounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of (i) the asset's fair value less costs to sell and (ii) the asset's value in use.

Depreciation of buildings and equipment is calculated on a straight line basis over its estimated useful life, as follows: buildings 30 years, computer equipment 5 years, furniture and fixtures 10 years.

Asset residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. Gains or losses on the disposal of property and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale, are included in the income statement. Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings.

Intangible assets

Software acquired is measured on initial recognition at cost when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Company. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight line basis over the estimated useful life of the assets which is three years.

Intangible assets are reviewed for impairment when changes in circumstances indicate that the carrying value may not be recoverable. If the carrying amount exceeds the recoverable amount then the intangible assets are written down to their recoverable amount.

Provisions for pending litigation or claims

Provisions for pending litigation or claims against the Company are made when: (a) there is a present obligation (legal or constructive) arising from past events, (b) the settlement of the obligation is expected to result in an outflow of resources embodying economic benefits, and (c) a reliable estimate of the amount of the obligation can be made.

3 Significant accounting judgements, estimates and assumptions

The preparation of the financial statements requires the Company's management to make judgements, estimates and assumptions that can have a material impact on the amounts recognised in the financial statements. The accounting policies that are critical to the Company's results and financial position in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgement including the use of estimates and assumptions are set out below.

Going concern

The Company's directors have made an assessment of its ability to continue as a going concern and are satisfied that it has the resources to continue in business for the foreseeable future.

The Company's capital position remains strong. Stress tests carried out in January 2013 demonstrate that the Company holds sufficient capital to continue in business, even if subjected to a severe stress scenario which includes substantial reductions in the value of property held as security for advances.

The Company's liquidity position has been strengthened by the transfer of £274m of deposits from Laiki UK as explained in note 30. Since the initial Eurogroup agreement for the Cypriot bailout on 15 March 2013 there has been an inevitable spike in the outflow of deposits, but even following this outflow there is sufficient liquidity for the Company's requirements for the foreseeable future.

The assessment of the Company's ability to continue as a going concern does not rely on the availability of parental support. The directors are not aware of any material uncertainties that may cast significant doubt upon the Company's ability to continue as a going concern.

Accordingly, the financial statements for the year ended 31 December 2012 have been prepared on a going concern basis.

Provision for impairment of loans and advances to customers

The Company reviews its loans and advances to customers to assess whether a provision for impairment should be recorded in the income statement. In particular, management is required to estimate the amount and timing of future cash flows in order to determine the amount of provision required.

The amount of provision is affected by the value of collateral held which mainly comprises land and buildings. Any decreases in the fair value of this collateral will translate to increases in the required provisions for impairment of loans and advances. For example, a 5% decrease in the value of collateral for impaired advances would lead to an increase in the provision for impairment by £1,562,000.

In addition to provisions for impairment on an individual basis, the Company also makes collective impairment provisions. The Company bases its calculation of collective provisions on loss rates arising from historical experience. This methodology is subject to estimation uncertainty, partly because it is not practicable to identify losses on an individual loan basis because of the large number of loans in the portfolio. In addition, the use of historical information is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of incurred losses is likely to be greater or less than that suggested by historical experience.

In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio. In certain circumstances, historical loss experience provides less relevant information about the incurred loss in a given portfolio at the balance sheet date, for example, where there have been changes in economic, regulatory or behavioural conditions such that the most recent trends in the portfolio risk factors are not an accurate indicator of likely future trends.

In these circumstances, such risk factors are taken into account when calculating the appropriate levels of impairment allowances, by adjusting the provision for impairment derived solely from historical loss experience. The assumptions underlying this judgement are highly subjective. The methodology and the assumptions used in calculating impairment losses are reviewed regularly.

Taxation

The Company operates in the United Kingdom and is therefore subject to United Kingdom corporation tax. Estimates are required in determining the provision for taxes at the balance sheet date. The Company recognises tax liabilities for transactions whose tax treatment is uncertain. Where the final tax is different from the amounts initially recognised in the income statement, such differences will impact the income tax expense, the tax liabilities and deferred tax assets or liabilities of the period in which the final tax is agreed with the relevant tax authorities. In relation to current year tax there are no assumptions or estimates that significantly affect the tax provision.

Deferred tax assets are recognised by the Company in respect of tax losses to the extent that it is probable that future taxable profits will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax-planning strategies. These variables have been established on the basis of significant management judgement and are subject to uncertainty.

4 Interest income	2012 £000	2011 £000
Loans and advances to customers	**20,205**	445
Placements with banks and central banks	**611**	-
Placements with related entities	**313**	-
	21,129	445

Interest income from loans and advances to customers includes interest from impaired loans and advances amounting to £385,000 (2011: nil).

5 Interest expense

Customer deposits	**12,339**	-
Amounts due to related entities	**440**	445
Subordinated loan	**1,223**	-
	14,002	445
Derivative financial instruments	**490**	-
	14,492	445

6 Fee and commission income

Credit-related fees and commissions	**307**	-
Other banking fees and commissions	**1,195**	-
	1,502	-

7 Foreign exchange gains

Foreign exchange gains arise from the re-translation of monetary assets in foreign currency at the balance sheet date, realised exchange gains from transactions in foreign currency which have been settled during the year, and the revaluation of foreign exchange derivatives.

8 Net gains on financial instrument transactions

Net gains arising from fair value hedges	**61**	-

9 Staff costs

Salaries	**2,478**	-
Social security costs	**273**	-
Retirement benefit costs - defined contribution scheme	**521**	-
	3,272	-

The number of staff employed (including three executive directors) by the Company as at 31 December 2012 was 157 (2011: nil).

10 Depreciation and amortisation	2012 £000	2011 £000
Depreciation	598	-
Amortisation of intangible assets	176	-
	774	-

11 Other operating expenses

Information technology	892	-
Professional fees	408	-
Communication	227	-
Other operating expenses	934	-
	2,461	-

Professional fees include fees (including taxes) to the independent auditors of the Company, for audit and other professional services provided to the Company as follows:

Fees for the audit of the financial statements	198	-
Fees for tax compliance services	39	-
	237	-

12 Provisions for impairment of loans and advances

The movement of provisions for impairment of loans and advances to customers is as follows:

	2012			2011
	£000	£000	£000	£000
	Individual impairment	Collective impairment	Total	Total
1 January	-	-	-	-
Assumed on transfer of business	11,845	1,077	12,922	-
Applied in writing off impaired loans and advances	(313)	-	(313)	-
Interest accrued on impaired loans and advances	1,921	-	1,921	-
Charge for the period	5,948	2,423	8,371	-
31 December	19,401	3,500	22,901	-

13 Taxation

	2012 £000	2011 £000
UK corporation tax		
Charge for the year	-	-
Adjustments in respect of prior years	67	-
	67	-
Deferred tax		
Credit for the year	(1,618)	-
Adjustments in respect of prior years	(61)	-
	(1,679)	-
Tax credit for the year	(1,612)	-

The tax credit in the income statement for the year differs from the standard rate of corporation tax in the United Kingdom of 24.5% (2011: 26.5%). The differences are reconciled below:

	2012	*2011*
	£000	*£000*
Loss before tax	**(6,517)**	-
Tax calculated at 24.5% (2011: 26.5%)	**(1,596)**	-
Tax effect of:		
Expenses not deductible for tax purposes	**42**	-
Non-taxable income	**(169)**	-
Tax rate change	**105**	-
Adjustment in respect of prior years – current tax	**67**	-
Adjustment in respect of prior years – deferred tax	**(61)**	-
	(1,612)	-

The net deferred tax asset arises from:

Difference between capital allowances and depreciation	**105**	-
Property revaluation	**(121)**	-
Tax losses carried forward	**1,607**	-
Net deferred tax asset	**1,591**	-

Business projections indicate that there will be sufficient taxable profits against which to offset the deferred tax asset on losses within the next three years.

The movement in the net deferred tax asset is set out below:

1 January	**-**	-
Assumed on transfer of business	**(88)**	-
Deferred tax recognised in the income statement	**1,679**	-
31 December	**1,591**	-

The analysis of the net deferred tax credit recognised in the income statement is set out below:

Difference between capital allowances and depreciation	**58**	-
Tax loss carried forward	**1,712**	-
Other temporary differences	**(47)**	-
Change in tax rates	**(105)**	-
Adjustment in respect of prior years	**61**	-
	1,679	-

Deferred tax assets have been stated at the corporation tax rate of 23% (2011: 25%) reflecting the reduction in the UK corporation tax rate which took effect from 1 April 2013 and which was substantially enacted on 3 July 2012, on the basis that the Company's deferred tax assets will unwind after 1 April 2013.

In the Budget of 20 March 2013, the Government announced that the UK rate of corporation tax will reduce to 20% from 1 April 2015. As the further reduction was not substantially enacted as at 31 December 2012, the corporation tax rate of 20% has not been applied in calculating the deferred tax asset. The aggregate impact of the proposed reduction in corporation tax rate from 23% to 20% on the closing recognised deferred tax asset is a reduction of £219,000 which could reduce the closing recognised deferred tax asset to £1,460,000.

14 Cash, balances with central banks and placements with banks

	2012	*2011*
	£000	*£000*
Cash	**405**	-
Balances with the Bank of England	**334,320**	-
	334,725	-
Placements with related entities	**11,532**	-
Placements with banks	**48,126**	-
Cash and cash equivalents	**394,383**	-

Placements with banks earn interest based on the inter-bank rate for the relevant term and currency.

Balances with central banks include mandatory deposits of £224,000 (2011: nil) which are not available for use in the Company's day to day business. These comprise cash ratio deposits which are non-interest bearing deposits placed with the Bank of England under the provisions of the Bank of England Act 1998. The balances at related entities were not affected by the provisions of the Cyprus bailout agreement referred to in note 30.

15 Derivative financial instruments

The use of derivatives is an integral part of the Company's activities. Derivatives are used to manage the Company's own exposure to fluctuations in interest rates and exchange rates.

Forward exchange rate contracts are irrevocable agreements to buy or sell a specified quantity of foreign currency on a specified future date at an agreed rate.

Interest rate swaps are contractual agreements between two parties to exchange fixed rate and floating rate interest by means of periodic payments based upon a notional principal amount and the interest rates defined in the contract.

Interest rate caps and floors protect the holder from fluctuations of interest rates above or below a specified interest rate for a specified period of time.

The fair value of derivative financial instruments represents the cost of replacement of these contracts at the balance sheet date. The credit exposure arising from these transactions is managed as part of the Company's market risk management.

The fair value of the derivatives can be either positive (an asset) or negative (a liability) as a result of fluctuations in market interest rates or foreign exchange rates in accordance with the terms of the relevant contract. The aggregate net fair value of derivatives may fluctuate significantly over time.

The Company applies fair value hedge accounting using derivatives when the required criteria for hedge accounting are met. The Company also uses derivatives to hedge the changes in interest rates or exchange rates which do not meet the criteria for hedge accounting. As a result, these derivatives are accounted for as trading derivatives and the gains or losses arising from revaluation are recognised in the income statement.

Changes in the fair value of derivatives designated as fair value hedges are recognised in the income statement. The Company's fair value hedge relationships are principally interest rate swaps used to hedge the interest rate risk of fixed rate loans to customers.

Gains or losses due to changes on fair value hedges for the year are as follows:

	2012	*2011*
	£000	*£000*
Gains from change in fair value of trading derivatives	**32**	-
Gains from change in fair value of hedging instruments	**363**	-
Losses from change in fair value of hedged items	**(334)**	-
	61	-

The table below shows the fair values of derivative financial instruments recorded as assets or liabilities together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

	2012			2011		
	Contract amount	**Fair value**		Contract amount	Fair value	
		Assets	**Liabilities**		Assets	Liabilities
	£000	**£000**	**£000**	£000	£000	£000
Interest rate related contracts						
Swaps	**37,582**	**-**	**(1,472)**	-	-	-
Collar	**2,896**	**2**	**(332)**	-	-	-
Spot foreign exchange rate contracts	**625**	**3**	**-**	-	-	-
Total derivative contracts	**41,103**	**5**	**(1,804)**	-	-	-

16 Loans and advances to customers

	2012			2011		
	Loans	**Overdrafts**	**Total**	Loans	Overdrafts	Total
	£000	**£000**	**£000**	£000	£000	£000
Gross loans and advances	**622,169**	**22,061**	**644,230**	7,506	-	7,506
Provisions for impairment of loans and advances	**(21,847)**	**(1,054)**	**(22,901)**	-	-	-
	600,322	**21,007**	**621,329**	7,506	-	7,506

The credit quality of gross loans and advances to customers is as follows:

Neither past due nor impaired	**510,014**	**17,178**	**527,192**	7,506	-	7,506
Past due but not impaired	**65,317**	**1,936**	**67,253**	-	-	-
Impaired	**46,838**	**2,947**	**49,785**	-	-	-
	622,169	**22,061**	**644,230**	7,506	-	7,506

The length of arrears of past due but not impaired loans and advances to customers is as follows:

Up to 30 days	**23,673**	**334**	**24,007**	-	-	-
31 to 90 days	**15,065**	**256**	**15,321**	-	-	-
91 to 180 days	**8,285**	**97**	**8,382**	-	-	-
181 to 365 days	**8,280**	**1,042**	**9,322**	-	-	-
Over one year	**10,014**	**207**	**10,221**	-	-	-
	65,317	**1,936**	**67,253**	-	-	-

Loans in arrears over 90 days are not considered impaired if there is sufficient collateral to give reasonable certainty that the loan will be recovered in full.

17 Property and equipment

	2012					2011
	Freehold property	Leasehold property	Computer equipment	Furniture & equipment	Total	Total
	£000	£000	£000	£000	£000	£000
Cost or valuation at 1 January	-	-	-	-	-	-
Assumed on transfer of business	5,801	290	2,703	7,628	16,422	-
Additions or valuation	-	-	35	23	58	-
Cost or valuation at 31 December	5,801	290	2,738	7,651	16,480	-
Accumulated depreciation assumed on transfer of business	(65)	(5)	(1,986)	(3,585)	(5,641)	-
Depreciation charge for the year	(60)	(5)	(147)	(382)	(594)	-
Accumulated depreciation at 31 December	(125)	(10)	(2,133)	(3,967)	(6,235)	-
Net book value at 31 December	5,676	280	605	3,684	10,245	-

Property includes land amounting to £2,045,000, of which £1,950,000 relates to freehold property and £95,000 relates to leasehold property. No depreciation is charged for land. The property of the Company was acquired under the business transfer during the year and it was last revalued at 31 December 2011. The valuations were carried out by independent qualified valuers, on the basis of market value using observable prices and recent market transactions in accordance with guidance published by the Royal Institution of Chartered Surveyors. The carrying value of the property on the historical cost basis and on the revaluation basis are deemed to be the same as all property was acquired on the transfer of business during the year and no material change has been noted in the value of property post acquisition.

18 Intangible assets

	2012	2011
Computer software	£000	£000
Cost at 1 January	-	-
Assumed on transfer of business	512	-
Additions	90	-
Cost at 31 December	602	-
Amortisation charge for the year	(176)	-
Net book value at 31 December	426	-

19 Other assets

Debtors	104	-
Prepaid expenses	529	-
Deferred tax asset	1,591	-
Other assets	12	-
	2,236	-

20 Customer deposits

	2012	2011
	£000	£000
Customer deposits by category		
Demand	**169,562**	-
Notice	**122,980**	-
Term	**619,153**	-
	911,695	-
Customer deposits by geographical area		
United Kingdom	**522,614**	-
Cyprus	**272,229**	-
Greece	**85,467**	-
Other countries	**31,385**	-
	911,695	-

Customer deposits include cash collateral of £1,861,000 against advances as at 31 December 2012 (2011: nil).

21 Other liabilities

Trade creditors	**1,371**	-
Financial Services Compensation Scheme levy	**808**	-
Accrued subordinated loan interest	**1,223**	-
Interest rate swaps (held for trading)	**753**	-
Interest rate swaps (designated as fair value hedges)	**1,051**	-
Taxes payable	**296**	-
Items in the course of settlement	**1,388**	-
Other liabilities	**462**	-
	7,352	-

The movement for the year in the provision for pending litigation or claims is as follows:

1 January	**-**	-
Assumed on transfer of business	**81**	-
31 December	**81**	-

22 Subordinated loan

Unsecured subordinated loan	**30,000**	-

The unsecured subordinated loan is due to the Parent. Interest on the loan is payable at 7% above the London Interbank Offered Rate. The loan has no maturity date, and is repayable at the option of the Company at any time after 22 June 2017, subject to the prior consent of the PRA. The loan is subordinated to the claims of other creditors and is unsecured.

23 Share capital

	2012		2011	
	Number of shares	**£000**	Number of shares	£000
Issued and fully paid				
Ordinary shares of £1 each	**65,000,000**	**65,000**	1	-

The Company issued 4,999,999 ordinary shares at £1 each on 7 June 2012 and 60,000,000 ordinary shares at £1 each on 22 June 2012.

24 Contingent liabilities and commitments

As part of the services provided to its customers, the Company enters into various revocable commitments and contingent liabilities. These consist of financial guarantees and undrawn commitments to lend.

Guarantees include those given on behalf of a customer to stand behind the current obligations of the customer and to carry out those obligations should the customer fail to do so.

Where guarantees are issued on behalf of customers, the Company usually holds collateral against the exposure and has a right of recourse to the customer.

In relation to acceptances and guarantees, the table below shows the Company's maximum exposure should contracts be fully drawn upon and customers default without taking account of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held:

	2012	2011
	£000	£000
Acceptances and guarantees	**1,248**	-
Commitments to advance	**15,266**	-
	16,514	-

Contingent obligations and commitments are managed in accordance with the Company's credit risk management policies. Even though these obligations may not be recognised on the balance sheet, they do contain credit risk and are therefore part of the overall risk of the Company.

Capital commitments

Capital commitments for the acquisition of property, equipment and intangible assets as at 31 December 2012 amount to £233,000 (2011: nil).

Litigation

The Company's provision for pending litigation or claims is set out in note 21. There are no other significant pending litigation claims or assessments against the Company the outcome of which would have a material effect on the Company's financial position or operations.

25 Financial Services Compensation Scheme levy

The FSCS provides compensation to eligible depositors up to £85,000 in the event that a financial institution is unable to repay amounts due. Following the failure of a number of financial institutions in 2008, the FSCS raised borrowings from the UK government to cover compensation in relation to protected deposits. These borrowings are expected to be repaid from the realisation of the assets of the institutions. Under the FSCS levy rules, all deposit takers will be required to pay a proportion of any irrecoverable losses. Deposit takers are also obligated to share the interest costs of the loans and the management expenses of the FSCS. The proportion of the total levy charged to each bank is determined by the Company's market share of deposits protected under the FSCS at the time of crisis.

The Company accrued £808,000 at 31 December 2012 in respect of its estimated share of the management expenses and interest cost for 2012 and its estimated share of the expected irrecoverable losses.

The ultimate cost of the FSCS levy to the industry as a result of the banking collapses in 2008 is dependent upon various still uncertain factors, including the value of potential recoveries of assets by the FSCS, the level of protected deposits and the population of FSCS members at the time.

26 Risk management

Through its normal operations the Company is exposed to a number of risks, the most significant of which are liquidity risk, credit risk, operational risk and market risk. To manage these risks the Company has established clear risk policies, including limits, reporting lines and control procedures. Adherence to these policies and procedures is independently monitored by the Company's credit risk, market risk, operational risk, compliance and internal audit functions. The Company's risk management processes and internal controls are subject to regular review by the appropriate executive and board committees, including the Advances, Risk, Asset & Liability and Audit & Risk committees.

Fair value of financial assets and liabilities

The following tables analyse the Company's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. For the purposes of this note, carrying value refers to amounts reflected in the balance sheet.

		2012		*2011*	
	Notes	***Carrying value***	***Fair value***	*Carrying value*	*Fair value*
		£000	***£000***	*£000*	*£000*
Financial assets					
Cash and balances with central banks	(a)	**334,725**	**334,725**	**-**	**-**
Placements with banks	(b)	**48,126**	**48,126**	**-**	**-**
Placements with related entities	(b)	**11,532**	**11,532**	**-**	**-**
Loans and advances to customers	(c)	**621,329**	**621,329**	7,506	7,506
Financial liabilities					
Amounts due to banks	(b)	**11**	**11**	-	-
Amounts due related entities	(b)	**19,866**	**19,866**	7,506	7,506
Customer deposits	(d)	**911,695**	**911,695**	**-**	**-**
Derivative financial liabilities	(e)	**1,805**	**1,805**	**-**	**-**
Subordinated loan	(f)	**30,000**	**30,000**	**-**	**-**

The fair value estimates are based on the following methodologies and assumptions:

(a) The carrying amounts of these financial assets and financial liabilities approximate fair value.
(b) The carrying value of placements with banks and amounts due to banks is considered to approximate fair value. Placements with banks are repayable on demand or within twelve months. Amounts due to banks are re-priced every three months relative to market rates. As a result, the carrying value approximates the fair value.
(c) The carrying value of loans and advances to customers is net of allowance for impairment losses and unearned income. The majority of loans are variable rate and re-price in response to changes in market rates and hence the fair value has been estimated as the carrying value.
(d) The carrying value of customer deposits is considered to approximate fair value. The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.
(e) The fair value of derivatives (including foreign exchange contracts and interest rate swaps) designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based on observable market data as appropriate to the nature and type of the underlying instrument.
(f) The subordinated loan is non-traded and re-prices in response to changes in market rates, hence the fair value has been estimated as the carrying value.

The following table shows an analysis of derivative financial instruments recorded at fair value by level of the fair value hierarchy:

	2012				*2011*
	Level 1	***Level 2***	***Level 3***	***Total fair value***	
	£000	***£000***	***£000***	***£000***	*£000*
Derivative financial assets	**-**	**5**	**-**	**5**	-
Derivative financial liabilities	**-**	**(1,805)**	**-**	**(1,805)**	-

Level 1 inputs are those with quoted prices for similar instruments, level 2 inputs have directly observable market inputs other than level 1 inputs, and level 3 inputs are not based on observable market data.

Liquidity risk

Liquidity risk is the risk of failure to realise assets or raise funds to meet current and future commitments. To manage liquidity risk the Company maintains a portfolio of high quality liquid and marketable assets sufficient to meet liquidity ratios stipulated by the PRA and the Company's internal policies. Actual and projected cash flows of the Company are monitored on a continuing basis to ensure that the Company preserves a satisfactory liquidity position at all times.

Analysis of assets and liabilities by expected maturity

31 December 2012	***Carrying value***	***Demand***	***Up to 3 months***	***3 months to 1 year***	***1 year to 5 years***	***Over 5 years***
	£000	***£000***	***£000***	***£000***	***£000***	***£000***
Assets:						
Cash and balances with central banks	**334,725**	**307,643**	**27,082**	**-**	**-**	**-**
Placements with banks	**48,126**	**32,848**	**15,278**	**-**	**-**	**-**
Placements with related entities	**11,532**	**128**	**11,404**	**-**	**-**	**-**
Investment in subsidiary	**400**	**-**	**-**	**-**	**-**	**400**
Loans and advances to customers	**621,329**	**38,120**	**47,587**	**88,759**	**253,620**	**193,243**
Property and equipment	**10,245**	**-**	**-**	**-**	**-**	**10,245**
Intangible assets	**426**	**-**	**-**	**-**	**-**	**426**
Other assets	**2,236**	**-**	**-**	**2,236**	**-**	**-**
Total assets	**1,029,019**	**378,739**	**101,351**	**90,995**	**253,620**	**204,314**
Liabilities and equity:						
Amounts due to banks	**11**	**11**	**-**	**-**	**-**	**-**
Amounts due to related entities	**19,866**	**8,571**	**-**	**11,295**	**-**	**-**
Customer deposits	**911,695**	**169,562**	**251,960**	**335,433**	**154,740**	**-**
Other liabilities	**7,352**	**-**	**-**	**7,352**	**-**	**-**
Subordinated loan	**30,000**	**-**	**-**	**-**	**-**	**30,000**
Total liabilities	**968,924**	**178,144**	**251,960**	**354,080**	**154,740**	**30,000**
Total equity	**60,095**	**-**	**-**	**-**	**-**	**60,095**
Total liabilities and equity	**1,029,019**	**178,144**	**251,960**	**354,080**	**154,740**	**90,095**
Acceptances and guarantees	**1,248**	**1,248**	**-**	**-**	**-**	**-**
31 December 2011						
Assets:						
Loans and advances to customers	7,506	-	627	951	3,479	2,449
Total assets	7,506	-	627	951	3,479	2,449
Liabilities and equity:						
Amounts due to related entities	7,506	**-**	627	951	3,479	2,449
Total liabilities	7,506	-	627	951	3,479	2,449
Total equity	-	**-**	-	-	-	-
Total liabilities and equity	7,506	-	627	951	3,479	2,449
Acceptances and guarantees	-	-	-	-	-	-

The tables below have been drawn up based on the undiscounted contractual maturities of the financial liabilities including interest that will accrue to those liabilities except where the Company is entitled and intends to repay the liability before its maturity.

The following table details the Company's remaining contractual maturity for its non-derivative financial liabilities:

Non-derivative financial liabilities

	2012					2011				
	Demand	**Up to 3 months**	**3 months to 1 year**	**1 year to 5 years**	**Over 5 years**	Demand	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years
	£000	**£000**	**£000**	**£000**	**£000**	£000	£000	£000	£000	£000
Amounts due to banks	**11**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Amounts due to related entities	**8,571**	**-**	**11,320**	**-**	**-**	-	627	957	3,479	2,449
Customer deposits	**169,562**	**252,438**	**342,294**	**163,798**	**-**	**-**	**-**	**-**	**-**	**-**
Subordinated loan	**-**	**-**	**-**	**2,259**	**38,540**	**-**	**-**	**-**	**-**	**-**

The following table details the Company's contractual maturity for its derivative financial instruments. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the projected interest rates as determined by the yield curves existing at the reporting date.

Derivative financial liabilities

	2012				2011			
	Up to 3 months	**3 months to 1 year**	**1 year to 5 years**	**Over 5 years**	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years
	£000	**£000**	**£000**	**£000**	£000	£000	£000	£000
Interest rate swaps	**231**	**659**	**931**	**-**	-	-	-	-

The balances in the cash flow tables above will not agree directly to the balances in the balance sheet as the table incorporates all cash flows, on an undiscounted basis, related to both principal and future interest payments.

Credit risk

Credit risk arises principally from lending activities, but also from other on and off balance sheet transactions where there is a risk that the counterparty may not meet its obligations to the Company. Credit risk occurs mainly in customer advances. To control credit risk, the Company establishes exposure limits by various categories including counterparty, sector and country, which are reviewed on a continuing basis.

Credit policies are approved by the board of directors on recommendation from the executive Advances Committee, which has management oversight of credit risk. The Company maintains a dedicated credit risk function with responsibility for reviewing credit proposals and monitoring management of advances by the Company's business units.

The Advances Committee meets monthly and reviews reports on credit concentration, portfolio performance and provisions. The Advances Committee approves credit facilities within its authority or makes recommendations to the board of directors for approval.

An analysis of impairments and watch list customer advances is shown below:

	2012			2011		
	Loans	**Overdrafts**	**Total**	Loans	Overdrafts	Total
	£000	**£000**	**£000**	£000	£000	£000
Individually impaired	**46,836**	**2,949**	**49,785**	-	-	-
Allowance for impairment	**(18,458)**	**(943)**	**(19,401)**	-	-	-
	28,378	**2,006**	**30,384**	-	-	-
Watch list advances						
High risk	**26,580**	**1,345**	**27,925**	-	-	-
Medium risk	**38,737**	**591**	**39,328**	-	-	-
	65,317	**1,936**	**67,253**	-	-	-
Not subject to impairment nor on watch list	**510,014**	**17,178**	**527,192**	7,506	-	7,506
Allowance for collective impairment	**(3,387)**	**(113)**	**(3,500)**	-	-	-
Carrying amount	**600,322**	**21,007**	**621,329**	7,506	-	7,506

The following table shows the risk concentration by sector for customer advances:

	2012	2011
	£000	£000
Business sector		
Property investment	**396,918**	6,758
Property development	**31,198**	-
Hotel, catering and leisure	**92,143**	-
Manufacturing	**11,708**	-
Retail and wholesale	**27,611**	-
Other business sectors	**41,228**	269
Personal sector	**43,424**	479
	644,230	7,506
Allowance for impairment	**(22,901)**	-
Carrying amount	**621,329**	7,506

The amount of loans and advances subject to forbearance is analysed below:

	2012				2011
	Total	**Neither past due nor impaired**	**Past due but not impaired**	**Impaired**	
	£000	**£000**	**£000**	**£000**	£000
Interest-only conversions	**804**	**157**	**405**	**242**	-
Extension of bridging period	**3,044**	**1,162**	**1,219**	**663**	-
Term extensions – capital repayment and interest only	**61**	**61**	**-**	**-**	-
Payment holidays	**1,430**	**544**	**886**	**-**	-
Capitalisation of arrears	**616**	**476**	**140**	**-**	-
	5,955	**2,400**	**2,650**	**905**	-

Operational risk

Operational risk is the risk of loss or reputational damage arising from inadequate systems, errors, poor management, internal control breaches, fraud and external events. Procedures and controls are in place to manage these risks throughout the Company and are supplemented by contingency planning to ensure business continuity, as well as the maintenance of insurance cover where appropriate.

Market risk

Market risk is the risk that changes in the level of interest rates, exchange rates and other financial contracts, including derivatives, will have an adverse financial impact.

The Company is exposed to interest rate risk as a result of mismatches in its balance sheet between the dates on which interest receivable on assets and interest payable on liabilities next reset to market rates or the dates on which the assets and liabilities mature. The Company aims to manage this risk through controlling such mismatches within limits set by reference to the maximum potential loss of earnings under given changes of interest rates. In managing these mismatches the Company makes use of appropriate interest rate derivative contracts including interest rate swaps.

A summary of the Company's interest rate gap position is as follows:

31 December 2012	***Carrying value***	***Non-interest bearing***	***Up to 3 months***	***3 months to 1 year***	***1 year to 5 years***	***Over 5 years***
	£000	***£000***	***£000***	***£000***	***£000***	***£000***
Assets:						
Cash and bank advances	**382,851**	**27,583**	**355,044**	**224**	**-**	**-**
Placements with related entities	**11,532**	**23**	**11,509**	**-**	**-**	**-**
Investment in subsidiary	**400**	**400**	**-**	**-**	**-**	**-**
Loans and advances to customers	**621,329**	**2,258**	**558,239**	**22,918**	**37,914**	**-**
Fixed assets	**10,671**	**10,671**	**-**	**-**	**-**	**-**
Other assets	**2,236**	**2,236**	**-**	**-**	**-**	**-**
Total assets	**1,029,019**	**43,171**	**924,792**	**23,142**	**37,914**	**-**
Liabilities:						
Amounts due to banks	**11**	**-**	**11**	**-**	**-**	**-**
Amounts due to related entities	**19,866**	**36**	**19,830**	**-**	**-**	**-**
Customer deposits	**911,695**	**70,875**	**354,265**	**334,673**	**151,882**	**-**
Other liabilities	**7,352**	**6,682**	**670**	**-**	**-**	**-**
Subordinated loan	**30,000**	**-**	**30,000**	**-**	**-**	**-**
Total liabilities	**968,924**	**77,593**	**404,776**	**334,673**	**151,882**	**-**
Derivatives	**-**	**(3)**	**34,985**	**(3,540)**	**(31,442)**	**-**
Interest rate gap	**60,095**	**(34,425)**	**555,001**	**(315,071)**	**(145,410)**	**-**

31 December 2011						
Assets:						
Loans and advances to customers	7,506	-	7,506	-	-	-
Total assets	7,506	-	7,506	-	-	-
Liabilities:						
Amounts due to related entities	7,506	-	7,506	-	-	-
Total liabilities	7,506	-	7,506	-	-	-
Derivatives	-	-	-	-	-	-
Interest rate gap	-	-	-	-	-	-

The Company monitors its exposure to interest rate risk. The impact of a potential 1% change, both increase and decrease, in the interest rates against the Company's interest bearing assets and liabilities is as follows:

	2012	*2011*
	£000	*£000*
Increase of 1%	**2,868**	-
Decrease of 1%	**(1,416)**	-

The interest rate sensitivities set out above are illustrative only and are based on simplified scenarios. The figures represent the effect on net interest income arising from a parallel rise or fall in all market interest rates and do not take into account the effect of any further actions to mitigate the effect.

Exchange rate risk

Foreign currency risk arises from mismatches between assets and liabilities in foreign currencies arising from the Company's lending, deposit taking and currency dealing activities. The majority of currency dealings are carried out for the purpose of facilitating customer transactions. The Company's treasury department is responsible for managing currency risk within intra-day and overnight limits. The Company's currency net exposures remain low at the balance sheet date.

27 Investment in subsidiary

Bank of Cyprus Financial Services Limited is a wholly owned subsidiary of the Company. BOCFS is a representative of Legal & General Partnership Services Limited, which is authorised and regulated by the FCA for the purposes of recommending, advising on and selling life assurance and other insurance products bearing the Legal & General name.

28 Capital management

Pillar 3 of the Basel 2 accord covers the external communication of risk and capital information by banks as specified in the Basel rules. The Pillar 3 disclosures for the Company are set out below.

Capital adequacy

The Company is supervised by the PRA, as a UK authorised bank, and is required to satisfy the liquidity and capital requirements of the PRA on a standalone basis. It is required to demonstrate to the PRA that it can withstand liquidity and capital stress tests without parental support.

The Company carries out a full annual review of the adequacy of its capital to support its current and future activities, including during periods of stress, using the standardised approach for credit risk. The review is documented in the Internal Capital Adequacy Assessment Process document, which is approved by the board of directors and submitted to the PRA (before April 2013 the FSA). The FSA reviewed the Internal Capital Adequacy Assessment Process document that was produced in preparation for the authorisation of the Company and issued Individual Capital Guidance (ICG) setting out the minimum capital requirements for the Company.

The Company manages its capital so as to ensure that it will have adequate capital resources to support its plans and to meet the regulatory requirements as set out in the ICG, including during periods of stress. For this purpose it maintains its own buffer in excess of the regulatory requirements. The preparation of annual plans, budgets and forecasts includes a projection of the capital position and capital requirements to ensure that capital resources will continue to be adequate. At 31 December 2011 there were no capital requirements as the Company became a regulated bank on 25 June 2012.

Composition of regulatory capital and ratios

31 December 2012

	£000
Core Tier 1	
Shareholders' equity	**60,095**
Core Tier 1 deduction: Intangible assets	**(426)**
Core Tier 1 capital	**59,669**
Qualifying Tier 2 capital	
Undated subordinated debt	**30,000**
Collective provisions	**3,500**
	93,169
Deductions from the totals of Tier 1 and Tier 2	
Investment in subsidiary	**(400)**
Total regulatory capital	**92,769**
Tier 1 ratio %	**15.8%**
Total capital ratio %	**24.5%**

The Parent, Bank of Cyprus Public Company Limited, is supervised by the Central Bank of Cyprus on a consolidated basis.

The risk weighted assets by category are as follows:

31 December 2012	*Balances*	*Risk weighted assets*	*Capital requirement*
	£000	*£000*	*£000*
Central governments and central banks	**334,725**	**-**	**-**
Institutions	**48,126**	**9,625**	**770**
Related entities	**11,532**	**-**	**-**
Corporate	**93,028**	**86,815**	**6,945**
Retail exposures:			
Exposures to small and medium size enterprises	**108,883**	**67,837**	**5,427**
Retail exposures secured by residential real estate collateral	**281,630**	**98,217**	**7,857**
Other retail exposures	**34,622**	**20,206**	**1,617**
Exposures secured on residential real estate	**49,948**	**17,482**	**1,399**
Past due exposures	**56,718**	**65,068**	**5,205**
Other assets	**9,807**	**12,879**	**1,030**
	1,029,019	**378,129**	**30,250**
Off balance sheet exposures	**16,715**	**424**	**34**
Credit risk totals	**1,045,734**	**378,553**	**30,284**
Operational risk capital requirement			**3,439**
Total minimum capital requirement			**33,723**

Operational risk business lines and capital requirements are as follows:

	Average income	*Capital requirement*
	£000	**£000**
Commercial banking	**8,662**	**1,299**
Retail banking	**16,707**	**2,005**
Payment and settlement	**750**	**135**
Total average income and capital requirement	**26,119**	**3,439**

29 Related party transactions

The Company is a wholly-owned subsidiary of Bank of Cyprus Public Company Limited, which is incorporated in Cyprus. The Parent is the immediate and ultimate parent and the controlling party. The smallest and largest group into which the results of the Company are consolidated is the Parent's group, whose annual report is available at www.bankofcyprus.com.

The Company has one wholly-owned subsidiary company, BOCFS, which advises on and sells life assurance and other protection products.

During 2012, the Company entered into the following transactions with the Parent:

- The purchase of the assets and business of the UK branch of the Parent on 25 June 2012 as set out in note 1.
- An unsecured subordinated loan agreement dated 20 June 2012 for £30m. The interest rate under this agreement is set at rates related to the London Interbank Offered Rate, and interest is payable annually. At 31 December 2012 the outstanding balance was £30m and there was accrued interest of £1,223,000. The loan has no maturity date, and is repayable at the option of the Company at any time after 22 June 2017.
- A deposit agreement dated 4 July 2012 under which either party may deposit an amount with the other party up to a maximum of £45m. The total deposits of each party are to equal the total deposits of the other party within a tolerance of 2%. The deposits of the Parent with the Company are subject to a withdrawal notice of 100 days. At 31 December 2012 the Company's deposits with the Parent totalled £11,381,000 and there was accrued interest on them of £23,000. The Parent's deposits with the Company at the same date totalled £11,260,000 and there was accrued interest of £35,000. Under the deposit agreement there is a right of set-off for each party in case of default or insolvency by the other party.
- Nostro accounts held by the Company with the Parent with a total credit balance of £128,000 at 31 December 2012.
- Vostro accounts held by the Parent with the Company with a total credit balance of £3,860,000 at 31 December 2012.
- Service level agreements for the provision of services by the Parent in connection with online banking, Swift payments and the Company's website. By the balance sheet date the Service Level Agreements in connection with Swift and the website had been terminated. There was no charge for these services.

- Up to 25 June 2012, the Parent, acting through its UK branch, administered the loan portfolio of the Company at no charge.

- Up to 25 June 2012, the Parent, acting through its UK branch, provided funding to the Company at the same maturity and interest rate and in the same currency as the loans made by the Company to its customers. The total interest paid by Bank to the Parent was £181,000.

During 2011, the Company entered into the following transactions with the Parent:

- The Parent, acting through its UK branch, administered the loan portfolio of the Company at no charge.

- The Parent, acting through its UK branch, provided funding to the Company at the same maturity and interest rate and in the same currency as the loans made by the Company to its customers. At 31 December 2011 the outstanding balance was £7,506,000 and the total interest paid was £445,000.

During 2012, the Company levied a management charge of £9,000 on its subsidiary, BOCFS, for the provision of staff and other support services. At 31 December 2012 there was an interest-free debt of £400,000 to BOCFS.

During 2012, the Company entered into the following transactions with fellow subsidiaries of the Parent (2011: none):

- Vostro accounts held by Bank of Cyprus Channel Islands Limited, a wholly owned subsidiary of the Parent, with a total balance of £3,142,000 at 31 December 2012.

- Vostro accounts held by Tefkros Investments (CI) Limited, a wholly owned subsidiary of the Parent, with a total balance of £1,169,000 at 31 December 2012.

Placements with and by related entities were as follows:

	2012	*2011*
	£000	*£000*
Placements with related entities		-
Balance under deposit agreement of 4 July 2012 including accrued interest	**11,404**	-
Credit balances on nostro accounts	**128**	-
	11,532	-

Placements by related entities		
Balance under deposit agreement of 4 July 2012 including accrued interest	**11,295**	-
Credit balances on vostro accounts held by Parent	**3,860**	-
Credit balance on Bank of Cyprus Channel Islands Limited vostro account	**3,142**	-
Credit balance on Tefkros Investments (CI) Limited vostro account	**1,169**	-
Balance owed to BOCFS	**400**	-
Funding from Parent for customer loans	**-**	7,506
	19,866	7,506

The Company made contributions to an employee savings plan during the year ended 31 December 2012 totalling £100,000 (2011: nil). The contributions are held as a deposit in the Company.

The total personnel compensation of key management personnel paid by or on behalf of the Company was as set out below. Key management personnel are defined as persons who are or have been members of the board or the Management Committee of the Company or the board of the Parent during 2012.

	2012	*2011*
	£000	*£000*
Directors' emoluments	**307**	-
Short-term employee benefits of key management personnel	**147**	-
Post-employment benefits	**3**	-

The total remuneration of the highest paid director was £118,000 (2011: nil). The amount of pension contributions paid by the Company to the pension scheme on behalf of the highest paid director was £25,000 (2011: nil).

Key management personnel and their connected persons have undertaken the following transactions with the Company in the normal course of business (2011: none).

	Number of key management personnel	***Amounts £000***
Secured loans, unsecured loans and overdrafts		
1 January 2012	**-**	**-**
Net movements in the year	**3**	**17**
31 December 2012	**3**	**17**
Deposit accounts and current account credit balances		
1 January 2012	**-**	**-**
Net movements in the year	**9**	**461**
31 December 2012	**9**	**461**

30 Events after the balance sheet date

On 25 March 2013 the Eurogroup of Finance Ministers of countries in the eurozone reached an agreement with Cyprus to restore the viability of the Cypriot financial sector and to restore sound public finances. The measures included the resolution of Laiki and the restructuring of the Parent. The restructuring of the Parent involves a recapitalisation through a bail-in deposit-to-equity conversion of deposits in excess of €100,000 to ensure that the Group fully satisfies capital adequacy requirements and maintains a Core Tier 1 ratio of 9% under an adverse stress scenario. Customers of Bank of Cyprus UK Limited, which is a UK bank, are not affected.

As part of the resolution of Laiki, the deposits of its UK branch totalling £274m were transferred to the Company on 1 April 2013 pursuant to a decree issued by the Central Bank of Cyprus and an agreement between the Company and Laiki. An equal amount of funds on deposit at the Bank of England was transferred to the Company at the same time.

Published by Bank of Cyprus UK Limited. Registered office 27-31 Charlotte Street, London W1T 1RP

0845 850 5555*
www.bankofcyprus.co.uk

*Calls may be recorded for monitoring and training.

Cover artwork created by Kate O'Leary of Ashmole Academy.