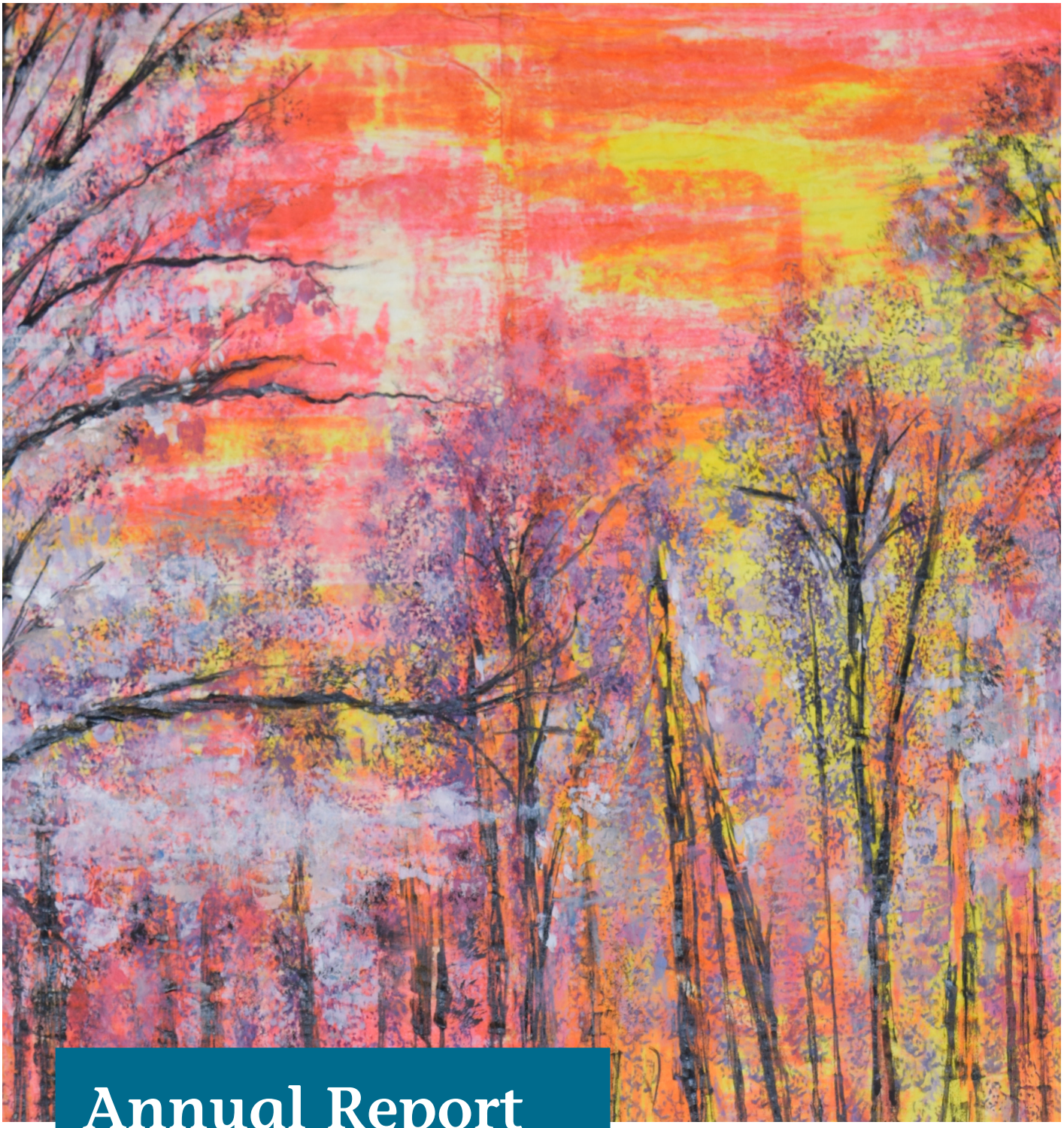


Annual Report 2017

Bank of Cyprus UK

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Definitions

"BOCFS"	Bank of Cyprus Financial Services Limited
The "Company"	Bank of Cyprus UK Limited
"FCA"	Financial Conduct 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
The "Parent"	Bank of Cyprus Public Company Limited
"PRA"	Prudential Regulation Authority

Corporate information

Directors
Philip Nunnerley[3, 4] - *Chairman and Chair of the Nominations and Corporate Governance Committee*
Nick Fahy[5] - *Chief Executive, Executive Director*
David Green[3, 4] – *Independent non-executive director and Chair of the Human Resources and Remuneration Committee*
Jean Stevenson[1, 2, 3] – *Senior independent non-executive director and Chair of the Audit Committee and of the Risk Committee*
Euan Hamilton[1, 2] - *Non-executive director*
Kim Rebecchi[1, 2, 4] – *Independent non–executive director - appointed 11 July 2017*
Francesca Hampton[5] - *Chief Financial Officer, Executive Director - appointed 26 September 2017*

Other senior executives
Soteris Antoniades[5] – *Chief Operating Officer*
Les Cantlay[5] – *Chief Risk Officer*
Greg Jones[5] – *Managing Director, Property and Business Banking*
Andy Hobbins[5] – *Managing Director, Consumer Banking and Chief Customer & Commercial Officer*
Helen Challis[5] – *Chief People Officer*

[1] Member of the Audit Committee
[2] Member of the Risk Committee
[3] Member of the Nominations and Corporate Governance Committee
[4] Member of the Human Resources and Remuneration Committee
[5] Member of the Executive Committee

Company secretary
Paul Jordan – *appointed 25 January 2018*

Independent auditor
Ernst & Young LLP
25 Churchill Place
London E14 5EY

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

Locations
Central London
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&
48 Charlotte Street, London W1T 2NS

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

North
3 Hardman Square, Spinningfields, Manchester M3 3EB

South
Office 4:30, Mocatta House, Trafalgar Place, Brighton BN1 4DU

South West
10 Victoria Street, Bristol BS1 6BN

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

2017 represents year 2 of the challenger bank strategy, delivering c.30% loan growth including draw-downs from the successful launch of our new personal mortgage products. This growth, coupled with improvements seen in our customer net promoter scores, highlights the faith that our customers have in the organisation, and our ability to serve their needs.

We have further supported our customers with our new mortgage product and our new deposit accounts which include our Online Easy Access Account, which is continuously in the top tier of deposit competitor tables and our Business Fixed Rate account, recently nominated for a Moneyfacts award.

In 2017 we started the process of remediating the customers identified as being negatively impacted by the historic conduct issue (2008 to 2012), and we expect to materially conclude this exercise during Q2 2018, allowing us to move forward with our customers, on the right footing.

In December we successfully raised £30m of tier 2 subordinated debt, which leaves us with a strong balance sheet entering 2018 to continue on our strategy of growth and diversifying the bank across our property, personal banking, and business pillars.

We have further strengthened our Executive Committee during the year. We also have increased our Board level experience by welcoming Kim Rebecchi on 11 July 2017.

In summary the bank has performed well against the strategy, whilst recognising the headwinds faced including the economic environment and taking the time to focus on the remediation programme.

I would like to thank my fellow directors, the management and staff for their valuable contribution throughout 2017 and the role they have played in supporting customers and helping to position our business for a successful future.

Philip Nunnerley
Chairman

Chief Executive Officer's review and strategic report

Overview

2017 has proved to be a rewarding yet challenging year for the Company, with the successes of achieving strong lending growth, new product launches and continued improvements in our customer feedback scores against the challenges of a benign economy as a result of Brexit, undertaking a significant remediation programme and continuing the improvement programme.

Further work has been undertaken within the Company's enablement programme, which provides the Company the ability to deliver on its strategic goals, to invest in its people, processes and systems, and to ensure that we remain a safe and secure Company – now and in the future.

During 2017 we have reassessed the size and extent of our remediation programme, which led to a significant provision being set aside for our customers across both the Company's and the Parent Company's financial statements.

Strategic Progress

The Company has a clear strategy "to be a recognised bank for Business Owners and Entrepreneurs supporting our customers, communities and people to prosper and grow". This is based on diversification both geographically and by portfolio type and repositions the Company in the market as a sustainable bank with scale supporting the Owner Managed Business sector.

2017 reflects year 2 of the strategy, and progress includes the following highlights:

- Continued establishment of 3 clear business pillars, with the successful launch of Consumer Mortgage product in August
- Net Lending growth of £323m (30%) continuing on last years' >30% lending growth, demonstrating our ongoing priority to grow and diversify our book
- Continued increase in customer satisfaction scores to 38, evidenced by Net Promotor Scores (NPS), reflecting an increase of over 70% since we commenced the strategy
- Our first online exclusive savings account was launched. Positive response from customers with an NPS of +53, c. 9,000 new accounts opened to date and over £300m in deposits raised
- ISA deposits more than doubled year on year – now c. 13,000 customers are benefitting from a Bank of Cyprus UK ISA
- At the Savings Champion Awards 2018 we were nominated in multiple categories, including finalist for 'Best Savings Provider for Existing Customers', and we won 'Best Short Term Fixed Rate Cash ISA Provider'
- We initiated the full customer roll out of our customer remediation programme, contacting all identified and impacted customers, with an expected material conclusion of the process by Q2 2018
- Successful raising of £30m of Tier 2 subordinated debt to provide the back-drop of further lending growth in 2018
- 14% of our cost base in 2017 reflects operational and strategic investment in the organisation, making it stronger, more secure and building the enablement for future growth
- Delivered 3 new business centres: Bristol, Brighton and North West, out of Manchester, which will help us with our goal to diversify geographically

Conduct

During 2016 it came to light as a result of a compliance review that the Company may have acted unfairly towards customers regarding historic conduct issues (2008 to 2012). This finding was reported to the FCA and it was agreed that the Company would write to potentially affected customers.

An amount of £14.91m was provided in December 2016, which was subsequently increased by £35.46m in 2017 with an updated set of response rate assumptions after the completion of the pilot phase. £4m of the increase in 2017 was booked in the Company and the remaining £31.46m was booked by the Parent Company. The Company has received a £16m injection of equity from the Parent Company to replenish the capital utilised to make the provision.

During Q4 2017 the conduct provision requirements were reassessed to a total value of £50.37m, which is to be funded by the Parent Company, reflecting an increased population size and associated operational costs for completing the remediation programme.

The provision for customer redress is disclosed in note 22 to the Financial Statements.

Overall Company Financial Performance

This year, there has been significant investment in the Company, across functions, systems, people and processes. This is recognition that historically certain areas of the Company have been under invested, which needed to be addressed to ensure that we remain safe and sound for our customers and stakeholders, and that we meet all regulatory and mandatory standards.

Additional investment was made to provide the enablement required to ensure we deliver on our strategy of diversification and growth investing in new products, improved processes and creating capacity. This investment will create future income or cost benefits. Further, we have incurred the costs associated with raising our Tier 2 debt, providing the capital required for scalability.

Our headline figures are also impacted by the additional conduct charge increase, as mentioned above.

The table below provides clarity of the underlying performance of the business, adjusting for these one off in nature investment costs and charges:

Profit Before Tax (PBT):	**2017 Actuals £000**	**2016 Actuals £000**
Reported PBT:	**1,916**	**(8,112)**
- Conduct Provision	4,000	14,910
- Interest Paid on subordinated debt	949	2,264
- Operational Investment		
- Regulatory & Mandatory Costs (e.g. IFRS9)	1,641	173
- Strategic Investment		
- Processes, Systems and People	1,904	108
- New Product Investment	1,120	-
Underlying PBT	**11,530**	**9,343**

Key Ratios	**2017**	**2016**
Underlying Ratios		
Year on Year PBT Growth	23%	36%
Year on Year Asset Growth	30%	32%
Return on Equity	10.5%	11.2%
Cost / Income Ratio	73%	74%
Statutory Ratios		
Return on Equity	1.0%	(13.3%)
Cost / Income Ratio	86.5%	80.1%

Our underlying PBT has increased by £2.2m and the Cost / Income ratio improved 1%. These improvements are primarily due to higher net interest income, which at £37.4m is 38% higher than in 2016.

This has been achieved through an increase in our asset margins whilst controlling our interest expense through issuance of new cost effective products, moving our deposit base away from historically more expensive long term bonds onto cheaper instant access saving accounts.

Interest income has also increased through our ongoing lending book growth, which in 2017 has increased by 30%, with net new loans totaling £323m during the year, including £53m contributed from our new mortgage book.

Alongside the growth in lending, liquidity is strong, with cash and balances with central banks standing at £359m, representing 21.7% of customer deposits (2016: 16.3%). Deposits increased from £1,257m at 31 December 2016 to £1,657m at 31 December 2017, an increase of 32%.

Underlying Return on Equity has decreased on prior year, with higher profits offset by a higher equity base, driven by the conversion of £30m of Tier 2 subordinated debt to equity in May, which reduced our interest expense but increased our equity.

Our capital position remains strong, with total capital standing at 21.4% of risk weighted assets (2016: 18.2%), benefitting from the £30m Tier 2 subordinated debt issuance in December.

Composition of regulatory capital and ratios (Unaudited)

	2017	*2016*
	£000	*£000*
Core Tier 1		
Shareholders' equity	**112,718**	65,857
Core Tier 1 deduction: Intangible assets	**(1,623)**	(840)
	111,095	65,017
Qualifying Tier 2 capital		
Undated subordinated loan	**29,537**	30,061
Collective provisions	**2,451**	2,160
Total regulatory capital	**143,083**	97,238
Core tier 1 ratio %	**16.5%**	12.1%
Total capital ratio %	**21.4%**	18.2%
Leverage ratio	**6.0%**	4.7%

Gender pay gap report 2017

Our gender pay gap as at the reporting date (5 April 2017) is 34.4%. This is the amount by which the male median hourly rate of pay exceeds the female hourly rate. There were no bonus payments made by the Company during the reporting period.

The Company is committed to the principle of equal opportunities and equal treatment for all employees and we have a clear policy of paying our employees fairly for the same or equivalent work regardless of their gender or any other characteristic.

The primary contributor to our gender pay gap is therefore the structure of our workforce where we have a lower representation of women at senior levels within the business coupled with a higher representation at more junior levels.

We believe that continuing to address the gender imbalance amongst our executive and wider manager population will be good for our business, and is an important strategy in addressing our gender pay gap. We are taking a number of actions in this respect, whilst also ensuring we offer an inclusive and flexible working environment that is attractive to all our employees.

A copy of our Gender Pay Gap Report 2017 is available on our website.

Quality

The Board and management continuously assess the performance of the business, including monitoring a key range of indicators, such as the capital ratio; net interest margin; cost and income growth rates; cost to income ratio; return on capital; and liquidity position; as well as non-financial measures, such as headcount and risk related measures.

The quality of the lending book is reflected in the average loan to value ratio of 53% and by a write back in 2017 of £497k (2016: £898k); this standard will be further strengthened by the new diversified business strategy.

The Company's business is to take on risk within limits defined by the Company's Board and therefore implementing efficient risk management is critical to the Company's successful operation.

The underlying objectives of the Company's risk management are:

- to support business that is profitable for the Company whilst ensuring that business written remains within the Company's overall appetite for risk
- to underpin the long term viability of the Company by correctly identifying, measuring and monitoring risk.

The Company achieves this by having a clear risk appetite, appropriate policies for and governance of different types of risk, tools designed to support decision making in relation to risk and a risk aware culture with the tone set by the Board.

In 2017, the Company has deployed new systems designed to better articulate the risks that the Company faces and the controls that limit those risks and to improve the consistency and the effectiveness of its risk control processes. In 2018, the Company will add further tools intended to allow closer and more rapid monitoring of its asset and liability management.

Principal risks and uncertainties

The Board has ultimate responsibility for ensuring that the Company's principal risks are identified and managed. It establishes the Company's risk appetite and oversees the effectiveness of risk management and internal controls through the Risk Committee and Audit Committee. The principal risks are as follows:

Risk	Description	Mitigation
Capital risk	The risk of business failure or regulatory breach arising from inadequate capital	An annual capital adequacy assessment is prepared and approved by the Board. Capital adequacy is reviewed monthly on an actual and projected basis. Capital adequacy is also considered as part of the budget and business plan process.
Cyber risk	The risk of external or internal misuse of computer systems leading to financial loss or reputational damage	The Company has received ISO27001 certification for information security. Firewalls and anti-virus software are in place. Systems are monitored at all times and penetration testing is carried out periodically.
Operational risk, including systems risk	The risk of loss or reputational damage arising from human, process or system failure	An enterprise risk management system has been implemented to catalogue lists and controls, to document control risk self-assessments and to record operational risk incidents. Controls are in place to ensure that errors are prevented or detected.
Human Resources risk	The risk of having insufficient appropriately qualified staff to manage the business soundly	Recruitment is carried out through reputable agencies. Staff turnover is monitored and succession plans are in place for all critical positions. Staff appraisals identify training and development needs and plans are put in place to meet them.
Conduct risk	The loss or reputational damage arising from a failure of the company or its staff to act ethically and treat customers fairly	A strengthened Compliance Unit carries out reviews of high risk areas to identify failures. A new product approval process ensures that new products are fair to customers and comply with regulations.
Data risk	The risk of loss or reputational damage arising from a failure to safeguard, control or process data appropriately	The information security policy and data retention policies set out standards for data integrity, safeguarding and retention.
Political and economic risk	The risk of changes in the political or economic environment which are detrimental to the Company	The Executive Committee reviews economic and risk indicators and a Central Planning Scenario is prepared quarterly with external assistance to update the Company's view of the economy. In relation to Brexit, a Working Party has identified the impacts and a contingency plan has been prepared.
Liquidity and funding risk	The risk of business failure arising from inadequate liquidity or funding	The Company has a liquidity risk appetite which is more conservative than regulatory requirements. Cashflow projections are prepared weekly to confirm adherence to the risk appetite. An annual liquidity adequacy assessment is prepared and approved by the Board.
Strategy implementation risk	The risk of failing to appropriately implement the bank's strategy	A project management unit oversees the implementation of strategy. Performance against objectives and deadlines is monitored and reported to the Executive Committee.
Market risk	The risk of loss arising from unfavorable movements in market prices	The Board's risk appetite sets limits to the acceptable level of interest rate and foreign exchange risk. The Asset and Liability Committee monitors adherence to these limits. A new Asset and Liability Management system is being implemented to enhance the management of market risk.
Credit risk	The risk of financial loss arising from the failure of a borrower or other counterparty to meet its contractual financial obligations to the Company	The Board risk appetite sets limits on sector and individual concentration. Lending is guided by a conservative credit policy and is overwhelmingly secured on property in the UK. Stress testing and exception monitoring identify potential credit weaknesses which are closely managed.
Financial crime risk	The risk of failure to comply with statutory obligations to prevent money laundering, terrorist financing, bribery or corruption	The Financial Crime unit develops the financial crime policy and exercises oversight on the customer due diligence which is carried out for new customers and periodically for existing customers.
Legal and regulatory risk	The risk of financial loss or reputational damage arising from the failure to comply with applicable laws or regulations	Horizon scanning identifies new regulations and legal requirements. Where these affect the Company, a gap analysis identifies the actions which are required. For significant new requirements, such as those introduced by the General Data Protection Regulation (GDPR), a project team manages implementation projects.

Outlook for 2018 and other matters

The UK economic outlook is benign to marginally positive over the next three to five years with economic fundamentals underpinning modest growth in coming years, but with global and local uncertainties (e.g. Brexit) heightening downside risks. Whilst the property market outlook remains positive it has softened. We continue to manage the Company through quarterly updates to the outlook and our strategy, and remain sensitive and responsive to market indicators at all times.

Our 2018 focus will be to complete our customer remediation programme, continue to invest in our systems and processes and the continuation of our diversification and growth strategy.

As I conclude this review, I would like to take the opportunity to thank our valued customers and also the Company's staff, in all offices, for their hard work, loyalty and dedication during the year.

By order of the board

Nick Fahy
Chief Executive Office

Directors' report

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

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 2017 are set out in the income statement on page 19. The directors endorse the information and views set out in the Chairman's statement and Chief Executive Officer's review and strategic report.

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
Due to the impact of the customer redress provision, the following factors were taken into consideration when preparing the going concern statement: capital injection received from the parent company (note 25), the conversion of the subordinated debt (note 24), and the projected operating performance of the company. The directors are satisfied that the Company is able to meet its working capital liabilities through the normal cyclical nature of receipts and payments.

A statement of responsibilities of the directors in relation to the financial statements is shown on page 11.

Capital
The current regulatory capital is shown in note 30 of the financial statements.

Liquidity
The Company manages liquidity with an internal methodology which fully meets and exceeds the regulatory LCR measure and as a result during 2017 the Company fully met all its regulatory liquidity requirements relating to the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR).

Dividends
The Company did not declare or pay a dividend in 2017 (2016: nil).

Future developments
The directors' aim is to maintain the current strategy which has resulted in the growth in business in recent years. They consider that next year will demonstrate a material conclusion to the remediation programme, ongoing investment in the organisation across processes, people and systems to provide strength in depth, and resilience to any headwinds, and finally further growth in lending across the three key lending pillars, delivering on the diversification and growth strategy.

Events after the reporting period
There are no events after the reporting period that require disclosure in these financial statements.

Financial instruments
The Company, where appropriate, uses interest rate swaps to hedge against interest rate risk and foreign exchange contracts to hedge against foreign exchange rate risk. Details of financial instruments are provided in notes 16 and 28 of the financial statements.

Human resources
The Company had 248 permanent employees at 31 December 2017 (2016: 225). During the year, the Company invested £241,000 (2016: £200,000) in staff development.

Board of directors
Full details of the board of directors are shown on page 2. Since 1 January 2017 the following changes have taken place:

Name of director	*Date of appointment*	*Date of resignation*
Melanie Leask		13 February 2017
Kim Rebecchi	11 July 2017	
Soteris Antoniades		18 September 2017
Francesca Hampton	26 September 2017	

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.

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 they are obliged to take as a director in order to make themselves 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.

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 risks are carefully managed and controlled. The following are in place to ensure that this happens:

At board level, the 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 Human Resources and Remuneration Committee makes recommendations to the Parent Company regarding remuneration policy for staff generally and on base pay, variable pay and pension arrangements for the executive directors, other members of the Executive Committee and the Head of Internal Audit with a view to managing human resources risk.

At executive level, risks are overseen and managed by a number of committees.

The main risk is credit risk, which is the risk that customers will be unable to repay their borrowings and will fail to perform under their contractual commitments. Credit risk is managed through credit policies, credit approval procedures and controls and analysis in relation to quality, sector and geographical area. The risk is monitored at executive level by the Credit & 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 Change and Technology Committee, which meets quarterly and regulatory and operational risks are monitored by the Conduct and Risk Committee, which meets monthly. The People Committee, which meets quarterly, monitors resources risk in terms of our people and succession planning.

More information on risk management is set out in note 28 of the financial statements.

Subsidiary
The Company is the immediate owner of 100% of the shares of a UK company, Bank of Cyprus Financial Services Limited (BOCFS), a previously appointed representative of Legal & General Partnership Services Limited. Until 30th September 2017 BOCFS sold insurance and protection products of Legal & General.

Charitable donations
During 2017 the Company made charitable donations totalling £18,955 (2016: £15,000).

Political donations
During 2017 the Company did not make any political donations (2016: £nil).

Third party indemnity provisions for the benefit of directors
The Company has taken out directors' and officers' liability insurance.

By Order of the Board

Paul Jordan
Secretary

Directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law 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;
- make judgements and estimates that are reasonable and prudent

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

Opinion

We have audited the financial statements of Bank of Cyprus UK Limited (the "Company") for the year ended 31 December 2017 which comprise the Income Statement, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Comprehensive Income, the Statement of Changes in Equity and the related notes1 to 33, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In our opinion, the financial statements:

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Use of our report

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

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

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

Overview of our audit approach

Key audit matters	• Provisions for conduct, customer remediation and litigation. • Impairment of loans and advances. • Revenue recognition – loan arrangement fees using the effective interest rate
Materiality	• Overall materiality of £1,150,000 which represents 1% of equity.

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Provision for conduct risk, customer remediation and litigation **(Provision at year end: £41,516 thousand, PY comparative £14,910 thousand)** *Refer to the Accounting policies (page 23); and Note 22 of the Financial Statements (page 37)* Management judgement is needed to determine whether an obligation exists and a provision should be recorded at 31 December 2017 in accordance with the accounting criteria set under IAS 37. The measurement of the provisions is based on the best estimate of the expenditure required to settle the present obligation. Given the inherent uncertainty in the estimate, the risk is that the provision does not reflect management's best estimate of the economic outflow that the Company will suffer as a result of this issue. The Company engaged an external specialist to support management in identifying the affected population and to build the redress calculator to provide redress amounts for every affected customer. The risk was mitigated by an indemnity agreement signed with the Company's parent, through which the parent agreed to provide funds for the purposes of meeting the Company's liabilities for the Remediation Programme including costs and consequential losses incurred / to be incurred by the Company in respect of customer remediation up to a maximum of £67m including the £16m already provided by the parent by way of capital injection in May 2017. Prior to the signing of the indemnity agreement, the Company had recognized an additional provision of £4m in its income statement.	Our approach focused on: • Understanding the design and operating effectiveness of the Company's key controls over the identification, estimation and monitoring of provisions considering the potential for management override of controls. • Assessing the work of management's specialist with the support of our conduct risk and valuation specialists. • Assessing the provisions recorded by testing the data and assumptions used in the underlying calculations including expected response rates, uphold rates, claim amounts, cost of execution and timing of settlement. We selected a sample of customers and with the support of our conduct risk and valuation specialists, we re-calculated the remediation provision and compared it to the output of the calculator developed by the external specialist for management. • Assessing the key assumptions used by comparing them to the results of the pilot programs run by the Bank. We involved our conduct risk specialists to consider how the Company's provisions compare to the latest relevant industry developments. • Testing the clerical accuracy of management's sensitivity analysis. • Examining with the support of our accounting specialists the indemnity agreement with the parent and assessing its impact on the financial statements of the Company. • Examining management's assessment based on advice by their legal counsel on the potential outcome of the on-going litigation cases and claims to assess for potential over/under provision. • Sending external confirmation requests to the Company's external legal counsels for significant matters. • Examining Board Minutes for discussions on on-going litigations and claims and evidence of potential	Our audit procedures provided the audit team reasonable assurance that the Company's provision for customer remediation and litigation is within a reasonable range, and we are satisfied that there is no evidence of material misstatement. We highlighted to the Audit Committee that this estimate, by nature, requires judgement regarding: • Completeness of provisions recognised: judgement is involved in determining whether an outflow in respect of identified material conduct matters is probable or can be estimated reliably; • Measurement of provisions recognised: appropriateness of assumptions and judgements used in the estimation of material provisions; and • Adequacy of disclosures of provision for liabilities and charges and contingent liabilities. Management has made a number of key assumptions requiring significant judgement in order to estimate the conduct provision such as: • The level of complaint volumes • Expected response rates • Uphold rates, i.e. how many claims are or may be, upheld in the customer's favour • Redress cost, i.e. the average payment expected to be made to customers Management's estimate was towards the middle of our range of outcomes based on reasonable alternative assumptions we determined using the results of the Company's pilot exercises. We were satisfied that appropriate and adequate disclosures have been made in the financial statements in accordance with IFRS.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
	additional commitment and contingencies. • Assessing the appropriateness and adequacy of the disclosures provided on conduct, customer redress and litigation provisions to determine whether it complies with accounting standards.	
Impairment of loans and advances **(Specific impairment provision: £1,604 thousand, PY comparative £2,216 thousand)** **(Collective impairment provision: £2,451 thousand, PY comparative £2,160 thousand)** *Refer to the Accounting policies (page 23); and Note 13 of the Financial Statements (page 33)* The loan loss provision is based on management's determination of incurred credit losses in the Company's loan portfolios in accordance with applicable accounting standards. Management incorporates current environmental factors in its estimate and sufficient, objective evidence must support the loan loss provision estimates as a result of these factors Although a number of objective measures can be used, there is a significant degree of judgement and estimation is required to identify impaired loans, and determine the level of provision against an impaired loan. There is a risk of material misstatement as a result of the following factors: • Credit risk within the loan portfolio may not be reflected in current loss factors when based on actual historical net-charge-offs. • Volatility of commercial real estate values, and the impact on the current macro-economic environment could be significant. • As the Company aims for loan growth in a competitive market, previously tight underwriting standards may loosen.	Our approach focused on: • Testing the design and operating effectiveness of key controls to identify loss events and determine the extent to which impairment losses should be recognised. • Considering the potential for management override of controls. • Attending meetings with management and other key officers to discuss developments. • Examining the credit and impairment methodologies and assessing any changes and their impact on our audit work and the impairment calculations. • Examining correspondence with regulators, board minutes and other key committee minutes in relation to key updates in credit and impairment methodologies and approvals of provisions and write offs. • Performing a review of a sample of performing loans to establish our own view as to whether any loss indicators as described in IAS 39 were present. • Performing a review of a sample of non-performing loans to assess the measurement of the provision by recalculating the loss. With input from our real estate valuation specialists we formed an independent view of the value of real estate collateral. • Assessing the appropriateness and adequacy of the relevant disclosures to be made in the financial statements.	Our audit procedures provided the audit team reasonable assurance over the existence, completeness, and valuation of impairment of loans and advances, and we are satisfied that there is no evidence of material misstatement. We highlighted to the Audit Committee that this estimate, by nature, requires judgement regarding: • Completeness and timing of recognition of loss events in accordance with the relevant provisions of IAS 39. • Specific provisions – the measurement of the provision is dependent on the valuation of collateral, the timing of cash flows and collateral realisations. • Collective provisions – the measurement is dependent upon key assumptions relating to probability of default ("PD"), loss given default ("LGD") and loss emergence period. We were satisfied that the assumptions made by management are reasonable in the context of the Company's loan portfolio and current market conditions. We were satisfied that appropriate and adequate disclosures have been made in the financial statements in accordance with IFRS.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
The level of risk has remained consistent with 2016.		
Revenue recognition – loan arrangement fees using the effective interest rate **(Fee income forming an integral part of the corresponding customer loans' EIR adjustment included in interest income: £3,615 thousand, PY comparative £2,334 thousand)** *Refer to the Accounting policies (page 23); and Note 5 of the Financial Statements (page 31)* There is a component of revenue, the effective interest rate method ("EIR") adjustments to loan arrangement fees that requires a high degree of estimation and judgement by management. These adjustments are manually calculated and recorded and therefore there is a higher risk of misstatement compared to that of revenue computed and recorded by the core banking system. There is a risk of material misstatement of revenue as a result of: • Incorrect application of the EIR method of accounting; • Incorrect assumptions used for the application of the EIR method in respect of the behavioural life of the loans and advances to which the fees relate; • The deferred fee liability and fee income respectively are calculated incorrectly. The level of risk has remained consistent with 2016.	Our approach focused on: • Understanding the design and operating effectiveness of key controls over setting and updating the EIR methodology and assumptions used, the completeness of data including the set up and maintenance of loan contractual terms and fee charges, and access / change controls applied in the excel spreadsheets used for the calculation. • Validating and challenging the assumptions used by management including the behavioural lives of the loans (which reduces the amortisation period from the contractual term to the expected life of the loans), forecast changes in rates and the income/expenses to be included • Understanding changes made to the EIR methodology and assumptions and assessing their impact. • Recalculating the amortisation of fees for a sample of loans to test whether the model has been implemented in accordance with the EIR methodology. • Testing the appropriateness of manual journal entries recorded in the general ledger and any other adjustments made in the preparation of the financial statements • Assessing the appropriateness and adequacy of the relevant disclosures to be made in the financial statements.	Our audit procedures provided the audit team reasonable assurance over the completeness, occurrence and measurement of the revenue stream to which the fraud risk was applied, specifically loan arrangement fees and we are satisfied that there is no evidence of material misstatement. We highlighted to the Audit Committee that this estimate, by nature, requires judgement regarding the expected behaviour and life-cycle of the instruments, as well as other characteristics of the product life cycle such as prepayments. We were satisfied that the assumptions made by management are reasonable in the context of the Company's loan portfolio and current market conditions. We were satisfied that adequate disclosures have been made in the financial statements in accordance with IFRS.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team, with the support of our valuation and risk specialists, IT and tax professionals.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality
The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Company to be £1,150,000 (2016: £1,036,000), which is 1% of equity (2016:1% of equity adjusted to include the subordinated loan by the parent which was converted to equity in May 2017). We believe that equity represents a relevant measure used by the shareholders and regulators when assessing the performance of the Company.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 50% (2016: 50%) of our planning materiality, namely £575,000 (2016: £518,000). We have set performance materiality at this percentage based on our past experience with the entity, our ability to assess the likelihood of misstatements and other factors affecting the entity and its financial reporting.

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £57,500 (2016: £51,800), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

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

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

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

We have nothing to report in respect of the following matters in relation to which 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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 11, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant are: Companies Act 2006, Financial Conduct Authority (FCA) Rules, Prudential Regulatory Authority (PRA) Rules, European Central Bank (ECB) Rules.
- We understood how Bank of Cyprus UK Limited is complying with those frameworks by making enquiries of management, internal audit, risk, and those responsible for legal and compliance matters. We also reviewed correspondence between the Company and UK regulatory bodies; reviewed minutes of the Board of Directors, Executive Committee, Risk Committee and gained an understanding of the Company's approach to governance, demonstrated by the Board's approval of the Company's governance framework and Board's review of the Company's risk management framework and internal control processes.
- For direct laws and regulations, we considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statement items.
- For both direct and other laws and regulations, our procedures involved: making enquiry of those charged with governance and senior management for their awareness of any non-compliance with laws or regulations, inquiring about the policies that have been established to prevent non-compliance with laws and regulations by officers and employees, inquiring about the Company's methods of enforcing and monitoring compliance with such policies, and inspecting significant correspondence with the FCA, the PRA and the ECB.
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur, by considering the controls that the Company has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered areas of significant judgement and the impact these have on the control environment. Where the risk has been considered to be higher, we performed audit procedures to address each identified fraud risk. These procedures included testing manual journals and were designed to provide reasonable assurance that the financial statements were free from fraud or error.
- The Company operates in the banking industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the tam had the appropriate competence and capabilities, which included the use of specialists where appropriate.

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

Other matters we are required to address
We were appointed by the Company on 7 June 2003 to audit the financial statements for the year ending 31 December 2004 and subsequent financial periods. The Company was authorised as a bank by the Financial Services Authority on 19 June 2012. Our total uninterrupted period of engagement is 14 years, covering periods from our appointment through to the year ending 31 December 2017.

- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the audit committee.

Andrew Gilder (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London - 23 April 2018

Notes:
1. The maintenance and integrity of the Bank of Cyprus UK Limited web site 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 web site.
2. 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 2017

	Notes	***2017***	*2016 (Restated note 2)*
		£000	*£000*
Interest income	5	**52,715**	43,419
Interest expense	6	**(15,318)**	(16,340)
Net interest income		**37,397**	27,079
Fee and commission income	7	**2,360**	2,556
Foreign exchange gains	8	**302**	348
Net (loss)/gains on financial instrument transactions	9	**(38)**	68
Total operating income		**40,021**	30,051
Staff costs	10	**(18,689)**	(13,260)
Depreciation and amortisation	11	**(1,509)**	(1,426)
Other operating expenses	12	**(14,404)**	(9,465)
Total operating expense before conduct and legal provision		**(34,602)**	(24,151)
Provision for customer redress	22	**(4,000)**	(14,910)
Profit/(loss) before provisions for impairment of loans and advances		**1,419**	(9,010)
Provisions for impairment of loans and advances	13	**497**	898
Profit/(loss) before tax		**1,916**	(8,112)
Income tax expense	14	**(1,055)**	(908)
Profit/(loss) after tax		**861**	(9,020)
Other comprehensive income		**-**	-
Other comprehensive income not to be reclassified to profit or loss In subsequent periods (net of tax):			
Revaluation of own properties, net of tax	14, 20	**-**	5,057
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		**-**	5,057
Other comprehensive income for the year, net of tax		**-**	5,057
Total comprehensive profit/(loss) for the period attributable to the equity holders		**861**	(3,963)

The notes on page 23 to 56 form an integral part of these financial statements.

Statement of financial position

As at 31 December 2017

			2017	*2016*
		Notes	***£000***	*£000*
Assets				
Cash and balances with central banks		15	**358,724**	205,062
Placements with banks		15	**32,625**	67,948
Placements with related entities		15, 31	**25,226**	24,949
Loans and advances to customers		17	**1,407,200**	1,083,922
Other assets		18	**35,547**	3,411
Intangible assets		19	**1,623**	840
Property and equipment		20	**15,773**	16,445
Investment in subsidiary				
	400	29	**400**	400
400				
Total assets			**1,877,118**	1,402,977
Liabilities				
Placements by related entities		31	**26,605**	28,381
Customer deposits		21	**1,656,975**	1,257,403
Provision for customer redress		22	**41,516**	14,910
Other liabilities		23	**9,767**	6,365
Subordinated loan		24	**29,537**	30,061
Total liabilities			**1,764,400**	1,337,120
Equity				
Share capital		25	**111,000**	65,000
Revaluation and other reserves			**8,389**	8,389
Accumulated losses			**(6,671)**	(7,532)
Total equity			**112,718**	65,857
Total liabilities and equity			**1,877,118**	1,402,977

The notes on pages 23 to 56 form an integral part of these financial statements.

These financial statements were approved by the board of directors on 18.4.18 and were signed on its behalf by:

Philip Nunnerley
Chairman

Nick Fahy
Chief Executive Officer

Statement of changes in equity

For the year ended 31 December 2017

	2017				*2016 (Restated note 2)*
	Share capital	***Revaluation and other reserves***	***Accumulated losses***	***Total***	*Total*
	£000	***£000***	***£000***	***£000***	*£000*
1 January	**65,000**	**8,389**	**(7,532)**	**65,857**	69,820
Profit / (loss) for the year after tax		**-**	**861**	**861**	(9,020)
Other comprehensive income	**-**	**-**	**-**	**-**	5,057
Total comprehensive profit/(loss) for the year attributable to the equity holders	**-**	**-**	**861**	**861**	(3,963)
Issue of share capital (note 25)	**46,000**	**-**	**-**	**46,000**	-
31 December	**111,000**	**8,389**	**(6,671)**	**112,718**	65,857

The notes on pages 23 to 56 form an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2017

	2017	*2016*
	£000	*£000*
Operating activities		
Profit / (loss) before tax	**1,916**	(8,112)
Adjustments for:		
Provisions for impairment of loans and advances	**(497)**	(898)
Depreciation of property and equipment	**940**	969
Amortisation of intangible assets	**569**	457
Interest on subordinated loan	**949**	2,264
Tax (paid) / received	**(820)**	(1,495)
Collection of previously written off debt	**249**	-
Foreign exchange gains	**(302)**	(348)
Changes in operating assets		
Increase in mandatory deposits with central bank	**(464)**	(258)
Increase in loans and advances to customers	**(323,808)**	(258,336)
Increase in other assets	**(32,309)**	(363)
Decrease / (increase) in accrued income and prepaid expenses	**235**	(338)
Changes in operating liabilities		
Increase in customer deposits	**398,877**	207,610
Increase in other liabilities and provision for customer redress	**27,381**	13,036
Increase in accrued expenses	**2,627**	1,028
Net cash flow from / (used in) operating activities	**75,543**	(44,784)
Investing activities		
Purchase of property and equipment	**(268)**	(380)
Purchase of intangible assets	**(1,352)**	(654)
Net cash flow used in investing activities	**(1,620)**	(1,034)
Financing activities		
Issuance of new subordinated loan	**29,464**	-
Proceeds from issuance of new share capital	**16,000**	-
Interest paid on subordinated loan	**(938)**	(2,265)
Net cash flow from / (used in) financing activities	**44,526**	(2,265)
Net increase/ (decrease) in cash and cash equivalents for the period/year	**118,449**	(48,083)
Cash and cash equivalents (see note 15)		
1 January	**268,981**	308,796
Net foreign exchange differences	**1,479**	8,268
Net increase / (decrease) in cash and cash equivalents for the year	**118,449**	(48,083)
31 December	**388,909**	268,981
Operational cash flows from interest		
Interest paid	**15,315**	14,654
Interest received	**52,393**	42,779

Refer to notes 15 and 24 for disclosures of cash and cash equivalents and changes in liabilities arising from financing activities respectively. The notes on pages 23 to 56 form an integral part of these financial statements.

Notes to the financial statements

1 Corporate information

Bank of Cyprus UK Limited (the "Company") is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (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 ultimate Parent company, Bank of Cyprus Holdings Public Limited Company is incorporated in Ireland and listed on the London Stock Exchange.

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 Parent company, Bank of Cyprus Public Company Limited, which are publicly available. These financial statements have been prepared on a standalone basis. Also as an intermediate parent the company is exempt from preparing consolidated financial statements under IFRS 10. The accounting policies used by the Company that are relevant to an understanding of the financial statements are stated in note 3.

2 Basis of preparation

These standalone financial statements have been prepared on a historical cost basis, except for land and buildings classified as property and derivative financial instruments that have been measured at fair value. 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 International Financial Reporting Standards ("IFRSs") as adopted by the EU and the requirements of the Companies Act 2006.

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 28.

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, and to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by an accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Company.

Restatement of Statement of Comprehensive Income for the year ended 31 December 2016

The statement of comprehensive income for the year ended 31 December 2016 has been restated to include the presentation of own properties revaluation (net of tax) as other comprehensive income for 2016 which was omitted in error in the prior year. The revaluation gain net of tax was correctly accounted for and included in the revaluation reserve in the statement of changes in equity. There is no impact on the results, financial position or any other notes to the financial statements as a result of this omission.

The presentation of the statement of changes in equity for the year ended 31 December 2016 has been changed to include a separate line item for the other comprehensive income. There is no impact on the results, financial position or any other notes to the financial statements as a result of this change in presentation.

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.

3 Accounting policies

Accounting standards and interpretations adopted during the period

The Company has adopted for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2017. The Company has not early adopted any other standard, interpretation or amendment that has been issued but is not effective / adopted by the EU.

The nature of each new standard or amendment is described below:

IAS 7 - Statement of Cash Flows (disclosure initiative amendment): The amendments enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments require entities to provide disclosures that enable investors to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes.

IAS 12 - Income Taxes: The amendment addresses how to account for deferred tax assets related to debt instruments measured at fair value which gives rise to a deductible temporary difference when the holder expects to recover the carrying amount of the asset by holding it to maturity and collecting all the contractual cash flows. IAS 12 provides requirements on the recognition and measurement of current or deferred tax liabilities or assets. The amendment clarifies the requirements on recognition of deferred tax assets for unrealised losses, to address diversity in practice.

IFRS 12 – Disclosure of Interests in Other Entities (IASB annual improvement 2014-2016 cycle): Clarified the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10-B16, apply to an entity's interests listed in paragraph 5 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations.

There were no other standards or interpretations relevant to the Company's operations which were adopted during the period.

New accounting standards and interpretations issued by the IASB but not yet adopted by the EU

The standards and interpretations that are issued, but not yet adopted, up to the date of issuance of the Company's financial statements and are relevant to its operations are disclosed below. The Company intends to adopt these standards when they become effective.

Except where otherwise stated, the Company does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the financial statements:

IFRS 9 - Financial Instruments: In July 2014, the IASB issued 'IFRS 9 Financial Instruments' which is the comprehensive standard to replace 'IAS 39 - Financial Instruments: Recognition and Measurement' and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. The standard is effective for annual periods beginning on or after 1 January 2018 with the classification, measurement and impairment requirements applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date. The Company initiated an IFRS 9 implementation project to assess the impact of the adoption of IFRS 9 on 1 January 2018. The impacts of this adoption are disclosed in Note 32.

IFRS 15 - Revenue from Contracts with Customers: The objective of IFRS 15 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash flows arising from a contract with a customer. The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework: identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognise revenue when (or as) the entity satisfies a performance obligation. IFRS 15 is effective for periods beginning on or after 1 January 2018. At present management believes that IFRS 15 will have no material impact on the financial statements and plans to adopt the new standard on the required effective date.

IFRS 16 - Leases: Effective for annual periods beginning on or after 1 January 2019. The scope of IFRS 16 includes leases of all assets, with certain exceptions. A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. IFRS 16 requires lessees to account for all leases under a single on-balance sheet model in a similar way to finance leases under IAS 17. The standard also requires lessees and lessors to make more extensive disclosures than under IAS 17. Management is currently evaluating the impact of adopting this standard on contracts it has entered into as a lessee.

IAS 12 – Income Taxes (IASB annual improvement 2015-2017 cycle): The amendments clarify that all income tax consequences of dividends (i.e. a distribution of profits) should be recognised in the statement of comprehensive income, regardless of how tax arises. Amendments are effective for annual periods beginning on or after 1 January 2019.

IAS 23 – Borrowing Costs (IASB annual improvement 2015-2017 cycle): The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings. Amendments are effective for annual periods beginning on or after 1 January 2019.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatments: Effective for annual periods beginning on or after 1 January 2019. In June 2017, the IASB issued IFRIC Interpretation 23 Uncertainty over Income Tax Treatments which clarifies application of the recognition and measurement requirements in IAS 12 Income Taxes when there is uncertainty over income tax treatments. Management is currently evaluating the impact of adopting the interpretation on its financial statements.

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 (e.g. prepayment options) excluding future credit losses.

Fee and commission income

Fees that the Bank considers to be an integral part of the corresponding financial instruments include: loan origination fees, loan commitment fees for loans that are likely to be drawn down and other credit related fees. The recognition of these fees (together with any incremental costs) form an integral part of the corresponding financial instruments and are recognised as interest income through an adjustment to the EIR.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. When the effect of the time value of money is material, the Bank determines the level of provision by discounting the expected cash flows at a pre-tax rate reflecting the current rates specific to the liability. The expense relating to any provision is presented in the income statement net of any reimbursement in other operating expenses. Detailed disclosures are provided in Note 22.

Retirement benefits

The Company operates a defined contribution pension plan in the UK. 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 tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Current tax and deferred tax relating to items recognised directly in equity are also recognised in equity and not in the statement of comprehensive income.

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 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 / (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.

Collateral valuation

The Company uses collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, guarantees, real estate, receivables, other non-financial assets and credit enhancements such as netting agreements. Although the value of collateral is not recognised directly in the financial statements, collateral is valued for the purposes of risk management and in connection with the assessment of impairment of secured loans and advances to customers. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Company's credit policy. Some collateral, for example cash or securities relating to margining requirements, is valued daily.

To the extent possible, the Company uses active market data for valuing financial assets held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as professional real estate valuers, mortgage brokers, housing price indices, and other independent sources.

Financial guarantees

The Company provides guarantees in the normal course of business on behalf of its customers. In the majority of cases, the Company will hold collateral against the resultant exposure or have a right of recourse to the customer, or both. The main types of guarantees provided are financial guarantees given to banks and financial institutions on behalf of customers to secure banking facilities and guarantees to Her Majesty's Revenue and Customs. The nominal principal amount of these guarantees is set out in Note 26.

Subordinated loan

The subordinated loan 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 had the right to redeem the subordinated loan stock. Interest on the subordinated loan is included as part of 'Interest expense' in the income statement. Details in respect of the subordinated loan are set out in Note 24.

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.

Funding for Lending Scheme ("FLS")

The Company is a participant in the FLS which enables it to borrow highly liquid UK Treasury Bills in exchange for eligible collateral. The Treasury Bills issued are for an original maturity of nine months and if delivered back prior to their maturity date can be exchanged for further nine month Bills. Costs of borrowing are charged directly to the Income Statement. The Treasury Bills are not recorded on the Company's balance sheet as ownership remains with the Bank of England. The risk and rewards of the collateral provided remains with the Company and continues to be recognised in the Company's Financial Statements.

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 observable data indicating 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 income' as interest income from impaired loans and advances.

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 included in the collective impairment calculation are those which are individually assessed for impairment for which no impairment loss is recognised, as well as those not individually assessed. 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 a 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. Placements by related entities which are repayable on demand and form an integral part of the Company's cash management are also included as a component of cash and cash equivalents for the purposes of the Statement of cash flows.

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. Management reassesses the carrying amount to ensure that it does not differ materially from the fair value at the end of each intervening reporting period. 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 the 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

An intangible asset is recognised only 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 Bank. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life, or the expected pattern of consumption of future economic benefits embodied in the asset, are accounted for by changing the amortisation period or methodology, as appropriate, which are then treated as changes in accounting estimates.

Intangible assets are reviewed for impairment when events relating to changes to 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.

Amortisation is calculated using the straight–line method to write down the cost of intangible assets to their residual values over their estimated useful lives, as follows:

- Computer software – 3 years
- Core application software – 10 years
- Core deposits systems – 5 years

4 Significant accounting judgments, estimates and assumptions

The preparation of the financial statements requires the Company's management to make judgments, 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 judgment including the use of estimates and assumptions are set out below.

Critical judgments and estimates

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

Estimates and management assumptions are reviewed on a regular basis and when new information becomes available. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in subsequent accounting periods.

The judgments and assumptions that are considered to be the most important in the portrayal of the Company's financial affairs are those related to the conduct risk and legal provision included in these accounts.

Provision for conduct risk, customer remediation and litigation

The Company operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it is involved in various litigation, arbitration, conduct and regulatory investigations and proceedings, arising in the ordinary course of the Company's business.
When the Company can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the Company is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Company does not include detailed, case-specific disclosures in its financial statements.
Given the subjectivity and uncertainty of determining the probability and amount of losses, the Company takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgment is required to conclude on these estimates.

The Company has established a provision for redress payable in respect of historic conduct issues. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. Details of the provision for customer redress are presented in Note 22 to the financial statements.

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 £198,000.

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 judgment 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 a stable economic environment, historical experience provides an objective and relevant basis of information which can be used 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 judgment are highly subjective. The methodology and the assumptions used in calculating impairment losses are reviewed regularly.

The effective interest rate method

The Company's interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost, fair value to profit and loss and fair value through other comprehensive income.
The EIR is the rate that exactly discounts estimate future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.
The Company recognises interest income at a rate of return that represents the best estimate of a constant rate of return over the expected behavioural life of loans and deposits and recognises the effect of potentially different interest rates charged at various stages and other characteristics of the product life cycle (including prepayments and penalty interest and charges). This estimation, by nature, requires an element of judgment regarding the expected behaviour and life-cycle of the instruments, as well as expected changes to the Company's and the Central Bank base rate and other fee income/expense that are integral parts of the instrument.

Provisions and other contingent liabilities

The Company operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it is involved in various litigation, arbitration, conduct and regulatory investigations and proceedings in the UK, arising in the ordinary course of the Company's business.

When the Company can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the Company is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Company does not include detailed, case-specific disclosures in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the Bank takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgment is required to conclude on these estimates.

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. Judgment 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 judgment and are subject to uncertainty.

Revaluation of land and buildings classified as property

The Company carries its land and buildings classified as property at fair value, with changes in fair value being recognized in the statement of other comprehensive income.

5 Interest income	***2017*** ***£000***	*2016* *£000*
Loans and advances to customers	**51,678**	41,853
Placements with banks and central banks	**558**	873
Placements with related entities	**479**	693
	52,715	43,419

Interest income from loans and advances to customers includes interest from impaired loans and advances amounting to £96,000 (2016: £514,000) and fee income forming an integral part of the corresponding financial instruments through an adjustment to the instruments effective interest rate ("EIR"). This amounted to £3,615,000 (2016: £2,334,000).

6 Interest expense

Customer deposits	**13,607**	13,353
Amounts due to related entities	**703**	574
Subordinated loan (note 24)	**949**	2,264
	15,259	16,191
Derivative financial instruments	**59**	149
	15,318	16,340

7 Fee and commission income

Other banking fees and commissions	**2,360**	2,556
	2,360	2,556

8 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 period, and the revaluation of foreign exchange derivatives.

9 Net (loss) / gains on financial instrument transactions

Net (loss)/gains arising from fair value hedges (see note 16)	**(38)**	68

10 Staff costs

Salaries	**15,359**	11,006
Social security costs	**1,596**	1,035
Retirement benefit costs - defined contribution scheme	**1,734**	1,219
	18,689	13,260

The number of staff employed (including two executive directors) by the Company as at 31 December 2017 was 248 (December 2016: 225).

11 Depreciation and amortisation	***2017*** ***£000***	*2016* *£000*
Depreciation	**940**	969
Amortisation of intangible assets	**569**	457
	1,509	1,426

12 Other operating expenses

Information technology	**3,032**	2,340
Professional fees	**979**	977
Money transmission	**985**	879
Communication	**349**	343
Advertising	**216**	216
Premises	**1,220**	729
Financial Services Compensation Scheme levy and registration fees	**215**	264
Printing and stationery	**250**	205
Other operating expenses – refer to analysis below	**7,158**	3,512
	14,404	9,465

Professional fees include fees payable to the Company's auditor of £539,900 (2016: £319,800) which are analysed below (amounts including VAT) :

Audit of the Company's financial statements	**297**	253
Audit of the subsidiary's financial statements	**8**	9
Other assurance related services	**119**	-
Non-audit related services	**116**	30
	540	292

Other operating expenses are further analysed below:

Subscriptions and publications	**163**	155
Directors fees	**271**	186
Recruitment	**503**	371
Training	**241**	200
Travel and entertaining	**324**	161
Strategy initiatives	**4,111**	1,994
Other insurances	**258**	113
Miscellaneous	**374**	217
Other operating expenses	**913**	115
	7,158	3,512

13 Provisions for impairment of loans and advances

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

	2017			2016
	£000	£000	£000	£000
	Individual impairment	Collective impairment	Total	Total
1 January	**2,216**	**2,160**	**4,376**	6,209
Applied in writing off impaired loans and advances	**(73)**	**-**	**(73)**	(935)
Credit for the period	**(539)**	**291**	**(248)**	(898)
31 December	**1,604**	**2,451**	**4,055**	4,376

During the year, an amount of £249,000 was collected in respect of impaired loans and advances previously written off and derecognised. This amount is included in "Provision for impairment of loans and advances, credit" in the Statement of Comprehensive Income.

14 Taxation

	2017	2016
	£000	£000
UK corporation tax		
Charge for the year	**1,011**	1,105
	1,011	1,105
Deferred tax		
Charge / (credit) for the year	**44**	(197)
Tax charge for the year	**1,055**	908

A reconciliation of the tax charge in the income statement for the year and the accounting profit multiplied by the standard rate of corporation tax in the United Kingdom of 19.25% (December 2016: 20%) is presented below:

Profit/(loss) before tax	**1,916**	(8,112)
Tax calculated at 19.25% (December 2016: 20%)	**369**	(1,623)
Tax effect of:		
Expenses not deductible for tax purposes	**686**	2,519
Tax rate change	**-**	12
Tax charge for the year	**1,055**	908

The net deferred tax liability arises from:

Difference between capital allowances and depreciation	**228**	179
Property revaluation	**(1,125)**	(1,125)
Other provisions	**37**	130
Net deferred tax liability	**(860)**	(816)

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

1 January	**(816)**	(212)
Revaluation of properties	**-**	(801)
Deferred tax recognised in the income statement	**(44)**	197
31 December	**(860)**	(816)

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

Difference between capital allowances and depreciation	**51**	70
Other temporary differences	**(95)**	139
Change in tax rates	**-**	(12)
Deferred tax (charge) / credit for the year	**(44)**	197

Corporation tax rate reduces to 19% effective from 1 April 2017 enacted in November 2015 and 17% effective from 1 April 2020 enacted in September 2016. Accordingly, the deferred tax asset is calculated at 18.67% (31 December 2016: 18.75%).

15 Cash, balances with central banks and placements with banks

	2017	*2016*
	£000	*£000*
Cash	**486**	330
Balances with the Bank of England	**358,238**	204,732
	358,724	205,062
Placements with related entities	**25,226**	24,949
Placements with banks	**32,625**	67,948
Cash and cash equivalents	**416,575**	297,959

Placements with banks earn interest (or in some cases are charged interest) based on the inter-bank rate for the relevant term and currency.

Balances with central banks include mandatory deposits of £1,061,000 (31 December 2016: £597,000) 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.

Cash and cash equivalents for the purposes of the Statement of cash flows are presented below:

	2017	*2016*
	£000	*£000*
Cash	**486**	330
Balances with the Bank of England	**358,238**	204,732
Less: Mandatory deposits with the central bank	**(1,061)**	(597)
Placements with related entities	**25,226**	24,949
Less: Placements by related entities	**(26,605)**	(28,381)
Placements with banks	**32,625**	67,948
Cash and cash equivalents per the Statement of cash flows	**388,909**	268,981

16 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:

	2017	*2016*
	£000	*£000*
(Losses)/gains from change in fair value of trading derivatives	**(38)**	72
Gains/(losses) from change in fair value of hedging instruments	**173**	(105)
(Losses)/gains from change in fair value of hedged items	**(173)**	101
	(38)	68

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.

	2017			*2016*		
	Notional amount	***Fair value***		*Notional amount*	*Fair value*	
		Assets	***Liabilities***		*Assets*	*Liabilities*
	£000	***£000***	***£000***	*£000*	*£000*	*£000*
Interest rate contracts	**33,058**	**135**	**(13)**	162,822	69	(106)
Foreign exchange contracts	**32,033**	**8**	**(92)**	138	1	-
Total derivative contracts	**65,091**	**143**	**(105)**	162,960	70	(106)

17 Loans and advances to customers

	2017			*2016*		
	Loans	***Overdrafts***	***Total***	*Loans*	*Overdrafts*	*Total*
	£000	***£000***	***£000***	*£000*	*£000*	*£000*
Gross loans and advances	**1,390,457**	**20,798**	**1,411,255**	1,074,513	13,785	1,088,298
Provisions for impairment of loans and advances	**(3,858)**	**(197)**	**(4,055)**	(4,192)	(184)	(4,376)
	1,386,599	**20,601**	**1,407,200**	1,070,321	13,601	1,083,922

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

Neither past due nor impaired	**1,353,510**	**20,024**	**1,373,534**	1,051,663	13,220	1,064,883
Past due but not impaired	**34,185**	**665**	**34,850**	17,886	444	18,330
Impaired	**2,762**	**109**	**2,871**	4,964	121	5,085
	1,390,457	**20,798**	**1,411,255**	1,074,513	13,785	1,088,298

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

Up to 30 days	**20,470**	**637**	**21,107**	10,677	141	10,818
31 to 90 days	**6,471**	**4**	**6,475**	276	35	311
91 to 180 days	**2,819**	**4**	**2,823**	2,746	6	2,752
181 to 365 days	**2,907**	**3**	**2,910**	541	5	546

Over one year	**1,518**	**17**	**1,535**	3,646	257	3,903
	34,185	**665**	**34,850**	17,886	444	18,330

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. There is no repossessed collateral held at the reporting date.

At 31 December 2017 the Company has pre-positioned £142.9m of loans and advances to customers with the FLS, which are available for use as collateral for the Company's participation in the scheme (31 December 2016:£209.7m).

18 Other assets	***2017***	*2016*
	£000	*£000*
Debtors	**365**	356
Receivable from the Parent Company towards redress payments (note 22)	**31,460**	-
Prepaid expenses	**906**	1,141
Receivables from payment service provider	**1,687**	1,625
Assets under construction	**785**	-
Other	**344**	289
	35,547	3,411

Assets under construction include cost incurred in relation to new software. These assets are not complete and will be included in Intangible assets and amortised once ready and in use. The Bank has assessed and concluded there is no indication of impairment .

19 Intangible assets

	2017	*2016*
	£000	*£000*
Computer software		
Cost at 1 January	**5,668**	5,011
Additions	**1,352**	657
Cost at 31 December	**7,020**	5,668
Accumulated amortisation at 1 January	**(4,828)**	(4,371)
Amortisation charge for the year	**(569)**	(457)
Accumulated amortisation at 31 December	**(5,397)**	(4,828)
Net book value at 31 December	**1,623**	840

20 Property and equipment

	2017					*2016*
	Freehold property	***Leasehold property***	***Computer equipment***	***Furniture & equipment***	***Total***	*Total*
	£000	***£000***	***£000***	***£000***	***£000***	*£000*
Cost or valuation at 1 January	**15,028**	**551**	**3,381**	**7,816**	**26,776**	20,538
Revaluation	**-**	**-**	**-**	**-**	**-**	5,858
Additions	**-**	**-**	**190**	**78**	**268**	380
Cost or valuation at 31 December	**15,028**	**551**	**3,571**	**7,894**	**27,044**	26,776
Accumulated depreciation at 1 January	**(792)**	**(51)**	**(2,842)**	**(6,646)**	**(10,331)**	(9,362)
Depreciation charge for the year	**(235)**	**(5)**	**(196)**	**(504)**	**(940)**	(969)
Accumulated depreciation at 31 December	**(1,027)**	**(56)**	**(3,038)**	**(7,150)**	**(11,271)**	(10,331)
Net book value at 31 December	**14,001**	**495**	**533**	**744**	**15,773**	16,445

Property includes land amounting to £6,513,000, of which £6,450,000 relates to freehold property and £63,000 relates to leasehold property. No depreciation is charged for land.

In the prior year, based on their assessment management had concluded that the fair value of property differed materially from its carried amount, and proceeded with a further revaluation of the entire class of properties by independent qualified valuers, per the requirements of IAS 16. The gain on revaluation had been accounted for as per the provisions of IAS 16, as outlined in the accounting policy disclosed in Note 3. This had resulted in an increase in the value of the Company's property of £5,858,000.

21 Customer deposits

	2017	*2016*
	£000	*£000*
Customer deposits by category		
Demand	**678,298**	335,608
Notice	**119,788**	118,427
Term	**858,889**	803,368
	1,656,975	1,257,403
Customer deposits by geographical area		
United Kingdom	**1,291,083**	877,005
Cyprus	**279,756**	290,121
Greece	**64,525**	64,866
Other countries	**21,611**	25,411
	1,656,975	1,257,403

22 Provision for customer redress

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will result in an outflow of resources (payment), and it can be reliably estimated.

The most significant of the provisions recognised as at 31 December 2017 is the conduct and legal risk provision for customer redress relating to historic conduct issues (2008 to 2012). This provision is underwritten by the Parent Company.

In October 2016, after a review of an issue which had been a source of complaints and litigation against the Company, and following a clarification of the legal situation in an Appeal Court Decision in June 2016 (*Alexander vs West Bromwich*), the Company concluded that the manner in which it re-priced a group of loans breached an FCA conduct principle and the matter was notified to the FCA.

Remediation principles were agreed and in 2016 the Company made an initial assessment of the level of provision that was considered appropriate to meet current and future expectations in relation to the customer remediation exercise. As a result, a provision for £14.9m was established for the year ended 31 December 2016.

Management have exercised judgement around the key assumptions that underpin the estimates. Key assumptions include customers' opt in rate, uphold rate, consulting and operational costs, Financial Ombudsman Service referrals, and expected level of consequential loss. The most significant of these assumptions is the combined response rate and opt-in rate. The sensitivity of the provision to this combined assumption is shown in the table below.

Sensitivity analysis based on customer opt-in rates

Customer Opt-in Rate*	Total Provision £000
65%	44,965
70%	46,678
75%	48,250
81%	50,370
100%	56,415

*Opt-in rate is calculated across all the population affected by the remediation

In the course of 2017 the Company has reassessed the level of provision that was considered appropriate and concluded that a further charge of £35.46m is required incorporating the new estimate based on new information that became available. £4m of this charge has been booked in the Company with the remaining £31.46m booked in the Parent Company with the

correspondent booking as a receivable in the intercompany accounts of the Company (see note 31). Any potential increase in the provision would have no impact on the Company as a consequence of the Deed of Support agreed with the Parent Company.

The receivable noted above has been included as a separate asset on the balance sheet (see note 18), and it has not been offset against the conduct provision which is presented gross as a liability on the face of the statement of financial performance.

The total redress cost to be borne by the Company was estimated at £50.37m as at the reporting date of 31 December 2017.

This provision constitutes one of the Company's critical accounting estimates as disclosed in note 4 to the financial statements.

Provision for customer redress	***2017*** ***£000***	*2016* *£000*
At 1 January	**14,910**	623
Arising during the year:		
Charged in the Company's statement of comprehensive income	**4,000**	14,910
Provided for by the Parent Company under the Deed of Support (note 18)	**31,460**	-
Payments made during the year	**(8,854)**	(623)
At 31 December	**41,516**	14,910

23 Other liabilities

Trade creditors	**5,777**	3,149
Financial Services Compensation Scheme levy (note 27)	**268**	269
Interest rate swaps (held for trading)	**7**	106
Items in the course of settlement	**1,359**	980
Deferred tax liability (note 14)	**860**	816
Tax payable (note 14)	**593**	316
Other	**903**	729
	9,767	6,365

24 Subordinated loan

Unsecured subordinated loan	**29,537**	30,061

With the prior consent of the Prudential Regulation Authority, the subordinated loan due to parent was converted into share capital during May 2017 generating 30,000,000 new ordinary shares of £1 each.
In December 2017, the Bank issued a £30 million unsecured and subordinated Tier 2 capital loan (the loan), priced at par. Interest is payable semi-annually on the loan at a coupon of 8.00% per annum up to 21 December 2022 and then at the 5-year swap rate plus a margin of 6.99% per annum up to the loan maturity on 21 December 2027. Subject to meeting contractual notice conditions, the Bank has the option to redeem the loan on 21 December 2022. The loan is unlisted.

Changes in liabilities arising from financing activities

Changes in liabilities arising from financing activities

	1 January 2017 ***£000***	**Cash flows** ***£000***	**Conversion to equity** ***£000***	**Other** ***£000***	**31 December 2017** ***£000***
Unsecured subordinated loan	**30,061**	**29,464**	**(30,000)**	**12**	**29,537**

25 Share capital

	Number of shares	***£000***	*Number of shares*	*£000*
Issued and fully paid:				
Ordinary shares of £1 each	**111,000,000**	**111,000**	65,000,000	65,000

In May 2017, the Bank issued 16,000,000 ordinary shares at their par value of £1 each to its parent company, with a total value of £16,000,000. The subordinated loan capital due to the Parent was also converted into share capital in May 2017, resulting in additional capital of £30,000,000. Refer to note 24 for further information.

26 Contingent liabilities and commitments

26.1 Guaranteed 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:

	2017	*2016*
	£000	*£000*
Acceptances, guarantees and cashing facilities	**1,020**	1,195
Commitments to advance	**99,944**	12,823
	100,964	14,018

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.

26.2 Conduct risk related matters

There continues to be significant uncertainty and thus judgement required in determining the quantum of conduct risk related liabilities with note 22 reflecting the Company's current position in relation to redress provisions in respect of the re-pricing breach. The final amount required to settle the Company's potential liability for this, including any consequential and / or reputational loss is materially uncertain.

Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated. The Company will continue to reassess the adequacy of the provision in this respect and the assumptions underlying the calculation at each reporting date based upon experience and other relevant factors at that time.

Any contingent liabilities in excess of the amount already provided in the financial statements will be met by the Parent Company, subject to the terms of the Deed of Support and with prior approval from the ECB.

27 Financial Services Compensation Scheme levy

The FSCS has provided compensation to eligible depositors following the collapse of a number of deposit takers, such as Bradford & Bingley plc. The compensation paid out was funded by £20 billion of loans to the FSCS from the Bank of England and HM Treasury. Under the FSCS Levy rules, all deposit takers, including Bank of Cyprus UK Ltd, will be required to pay a proportion of any irrecoverable principal amounts on the loans. 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 individual bank's market share of deposits protected through the FSCS.

During 2015, the FSCS levy was also charged to institutions for the third of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings, which remains after the three annual levies have been paid, is expected to be repaid from the realisation of the assets of the defaulted institutions.

The Bank accrued £267,500 as at 31 December 2017 (2016: £269,000) in respect of its estimated share of the management expenses and interest costs for 2017/18. The accrual is based on the Bank's estimated share of total market protected deposits at 31 December 2016.

The ultimate cost of the FSCS Levy to the industry as a result of the 2008 collapses is dependent upon various uncertain factors, including: the value of potential recoveries of assets by the FSCS; changes in the interest rate on the loans; the level of protected deposits and the population of FSCS members at the time.

28 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 committees, including the Credit and Advances, Conduct and Risk and Asset & Liability Committees and the board Audit and 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.

		31 December 2017		*31 Dec 2016*	
	Notes	***Carrying value***	***Fair value***	*Carrying value*	*Fair value*
		£000	***£000***	*£000*	*£000*
Financial assets					
Cash and balances with central banks	(a)	**358,724**	**358,724**	205,062	205,062
Placements with banks	(b)	**32,625**	**32,625**	67,948	67,948
Placements with related entities	(b)	**25,226**	**25,226**	24,949	24,949
Derivative financial assets	(e)	**143**	**143**	70	70
Loans and advances to customers	(c)	**1,407,200**	**1,415,956**	1,083,922	1,094,749
Financial liabilities					
Amounts due to banks	(b)	**-**	**-**	-	-
Amounts due to related entities	(b)	**26,605**	**26,605**	28,381	28,381
Customer deposits	(d)	**1,656,975**	**1,656,812**	1,257,403	1,256,456
Derivative financial liabilities	(e)	**105**	**105**	106	106
Subordinated loan	(f)	**29,537**	**29,537**	30,061	30,061

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

(a) The carrying amounts of these financial assets largely due to the short term maturities of these instruments 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 and related entities are re-priced every three months at market rates. As a result, these carrying values approximate fair values.
(c) The carrying value of loans and advances to customers is net of allowance for impairment losses and unearned income. The estimated fair value of the advances is calculated by discounting the cash flows using prevailing market interest rates adjusted for risk premium of the Company.
(d) The carrying value of customer deposits is calculated by discounting the cash flows using prevailing market interest rates. The estimated fair value of deposits with no stated maturity, which include 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 the carrying value approximates fair value.

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

31 December 2017	***Level 1***	***Level 2***	***Level 3***	***Total fair value***
	£000	***£000***	***£000***	***£000***

Derivative financial assets	**-**	**143**	**-**	**143**
Derivative financial liabilities	**-**	**(105)**	**-**	**(105)**

31 December 2016	*Level 1*	*Level 2*	*Level 3*	*Total fair value*
	£000	*£000*	*£000*	*£000*
Derivative financial assets	-	70	-	70
Derivative financial liabilities	-	(106)	-	(106)

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. Liquidity risk is managed each day by the Bank's Treasury department under the supervision of the Asset & Liability Committee. To manage liquidity risk the Company maintains a portfolio of high quality liquid and marketable assets sufficient to meet the liquidity requirements of 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.

Under CRD IV LCR became the Pillar I standard for liquidity in the UK on 1 October 2015, with a minimum standard of 80%, thereafter a 10% increase on I January 2017 and 2018, to reach 100% on 1 January 2018. The objective of the LCR is to ensure that banks have sufficient high quality liquid assets (HQLA) that can be converted easily into cash to meet their liquidity needs for a 30 calendar day liquidity stress scenario. Assets which are eligible for inclusion as HQLA include, balances held at the Central Bank and holdings of securities issued by central banks.

The Company's LCR as at 31 December 2017 was 691%, and is in excess of the current minimum requirement of 100% set by the PRA. The Bank has continued to maintain a significant level of HQLA throughout the year.

In October 2016 the Company was admitted to the Bank of England's Funding for Lending Scheme (FLS), which provides an additional source of liquid assets.

Analysis of assets and liabilities by expected maturity

31 December 2017	***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	**358,724**	**357,663**	**-**	**1,061**	**-**	**-**
Placements with banks	**32,625**	**32,625**	**-**	**-**	**-**	**-**
Placements with related entities	**25,226**	**5**	**25,221**	**-**	**-**	**-**
Investment in subsidiary	**400**	**-**	**-**	**-**	**-**	**400**
Loans and advances to customers	**1,407,200**	**39,169**	**53,726**	**96,962**	**821,178**	**396,165**
Property and equipment	**15,773**	**-**	**-**	**-**	**533**	**15,240**
Intangible assets	**1,623**	**-**	**-**	**-**	**1,623**	**-**
Other assets	**35,547**	**1,688**	**-**	**33,859**	**-**	**-**
Total assets	**1,877,118**	**431,150**	**78,947**	**131,882**	**823,334**	**411,805**
Liabilities and equity:						
Amounts due to banks	**-**	**-**	**-**	**-**	**-**	**-**
Amounts due to related entities	**26,605**	**1,064**	**-**	**25,143**	**-**	**398**
Customer deposits	**1,656,975**	**678,297**	**261,945**	**551,893**	**164,840**	**-**
Provision for customer redress	**41,516**	**-**	**-**	**41,516**	**-**	**-**
Other liabilities	**9,767**	**-**	**-**	**9,767**	**-**	**-**
Subordinated loan	**29,537**	**72**	**-**	**-**	**-**	**29,465**
Total liabilities	**1,764,400**	**679,433**	**261,945**	**628,319**	**164,840**	**29,863**
Total equity	**112,718**	**-**	**-**	**-**	**-**	**112,718**
Total liabilities and equity	**1,877,118**	**679,433**	**261,945**	**628,319**	**164,840**	**142,581**
Acceptances and guarantees	**1,020**	**1,020**	**-**	**-**	**-**	**-**

31 December 2016	*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	205,062	204,465	-	597	-	-
Placements with banks	67,948	67,948	-	-	-	-
Placements with related entities	24,949	5	24,944	-	-	-
Investment in subsidiary	400	-	-	-	-	400
Loans and advances to customers	1,083,922	21,229	59,518	88,496	588,184	326,495
Property and equipment	16,445	-	-	-	-	16,445
Intangible assets	840	-	-	-	-	840
Other assets	3,411	1,625	-	1,786	-	-
Total assets	1,402,977	295,272	84,462	90,879	588,184	344,180
Liabilities and equity:						
Amounts due to banks	-	-	-	-	-	-
Amounts due to related entities	28,381	3,295	-	24,686	-	400
Customer deposits	1,257,403	335,608	257,032	404,422	260,341	-
Other liabilities	21,275	-	-	21,275	-	-
Subordinated loan	30,061	61	-	-	-	30,000
Total liabilities	1,337,120	338,964	257,032	450,383	260,341	30,400
Total equity	65,857	-	-	-	-	65,857
Total liabilities and equity	1,402,977	338,964	257,032	450,383	260,341	96,257
Acceptances and guarantees	1,195	1,195				

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

	2017				
	Demand	***Up to 3 months***	***3 months to 1 year***	***1 year to 5 years***	***Over 5 years***
	£000	***£000***	***£000***	***£000***	***£000***
Amounts due to related entities	**1,064**	**-**	**25,143**	**-**	**398**
Customer deposits	**678,297**	**261,945**	**551,893**	**164,840**	**-**
Subordinated loan	**72**	**-**	**-**	**-**	**29465**

	2016				
	Demand	*Up to 3 months*	*3 months to 1 year*	*1 year to 5 years*	*Over 5 years*
	£000	*£000*	*£000*	*£000*	*£000*
Amounts due to related entities	3,295	-	24,686	-	400
Customer deposits	335,608	257,032	404,422	260,341	-
Subordinated loan	61	-	-	-	30,000

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 lending policies and 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 Credit and Advances Committee, which has management oversight of credit risk. The Company maintains a dedicated credit risk function with responsibility for managing credit risk and monitoring management of advances by the Company's business units.

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

An analysis of impairments and watch list customer advances (advances which show symptoms of credit weakness) is shown below:

	2017			*2016*		
	Loans	***Overdrafts***	***Total***	*Loans*	*Overdrafts*	*Total*
	£000	***£000***	***£000***	*£000*	*£000*	*£000*
Individually impaired	**2,762**	**109**	**2,871**	4,965	121	5,086
Allowance for impairment	**(1,495)**	**(109)**	**(1,604)**	(2,103)	(113)	(2,216)
	1,267	**-**	**1,267**	2,862	8	2,870
Non impaired recoveries and watch list						
High risk	**6,277**	**14**	**6,291**	7,817	236	8,053
Medium risk	**11,742**	**365**	**12,107**	3,750	57	3,807
Substandard advances	**18,019**	**379**	**18,398**	11,567	293	11,860
Other advances	**1,369,676**	**20,310**	**1,389,986**	1,057,981	13,371	1,071,352
Allowance for collective impairment	**(2,363)**	**(88)**	**(2,451)**	(2,089)	(71)	(2,160)
Carrying amount	**1,386,599**	**20,601**	**1,407,200**	1,070,321	13,601	1,083,922

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

	2017	*2016*
	£000	*£000*
Business sector		
Property investment	**1,125,669**	849,821
Property development	**47,515**	49,068
Hotels, catering and leisure	**95,919**	100,705
Manufacturing	**5,757**	6,063
Retail and wholesale	**12,428**	12,082
Other business sectors	**47,530**	44,635
Personal sector	**76,437**	25,924
	1,411,255	1,088,298
Allowance for impairment	**(4,055)**	(4,376)
Carrying amount	**1,407,200**	1,083,922

The amount of loans and advances subject to forbearance is analysed below. Forbearance means the active agreement by the Company with the customer to vary the terms of a loan agreement, either temporarily or permanently, to assist a customer to overcome financial stress and repay a loan.

31 December 2017	***Total***	***Neither past due nor impaired***	***Past due but not impaired***	***Impaired***
	£000	***£000***	***£000***	***£000***
Temporary conversions from repayment to interest only	**1,621**	**1,223**	**-**	**398**
Term extensions for capital repayment	**694**	**111**	**583**	**-**
Capitalisation of arrears	**-**	**-**	**-**	**-**

Payment holidays	**1,962**	**1,933**	**29**	**-**
Amortisation profile change	**2,406**	**113**	**138**	**2,155**
Refinance	**2,351**	**1,631**	**216**	**504**
Others	**317**	**27**	**63**	**227**
	9,351	**5,038**	**1,029**	**3,284**

31 December 2016	*Total*	*Neither past due nor impaired*	*Past due but not impaired*	*Impaired*
	£000	*£000*	*£000*	*£000*
Temporary conversions from repayment to interest only	1,260	1,070	70	120
Term extensions for capital repayment	1,136	828	308	-
Capitalisation of arrears	511	511	-	-
Payment holidays	133	100	33	-
Amortisation profile change	2,090	-	410	1,680
Refinance	1,248	741	-	507
Others	8	-	-	8
	6,386	3,250	821	2,315

Loans and advances which have been subject to forbearance continue to be classified as being subject to forbearance until the loan or advance is redeemed or upon completion of a minimum 24 months monitoring period subject to their ongoing performance.

Maximum exposure to credit risk and collateral and other credit enhancements

The table below shows the maximum exposure to credit risk and the tangible and measurable collateral held. It also shows the net exposure to credit risk, which is the exposure after taking into account the impairment loss and tangible and measurable collateral held. Where guarantees are held the collateral shown below includes any collateral supporting the guarantee. In normal circumstances the Company does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet. It is the Company's policy to dispose of the repossessed assets in an orderly fashion. For financial assets recognised on the balance sheet, the gross exposure to credit risk is equal to the carrying amount.

31 December 2017	***Maximum exposure***	***Fair value of collateral held by the Company***			***Net exposure***
		Cash	***Property***	***Net collateral***	
	£000	***£000***	***£000***	***£000***	***£000***
Assets:					
Balances with central banks	**358,724**	**-**	**-**	**-**	**358,724**
Placements with banks	**32,625**	**-**	**-**	**-**	**32,625**
Placements with related entities	**25,226**	**25,143**	**-**	**25,143**	**83**
Loans and advances to customers	**1,407,200**	**5,185**	**2,991,371**	**1,396,244**	**10,956**
Other assets	**35,547**	**31,460**	**-**	**31,460**	**4,087**
On-balance sheet total	**1,859,322**	**61,788**	**2,991,371**	**1,452,847**	**406,475**
Contingent liabilities:					
Acceptances, guarantees and cashing facilities	**1,020**	**21**	**4,597**	**1,020**	**-**
Commitments to advance	**99,944**	**57**	**166,465**	**96,302**	**3,642**
Off-balance sheet total	**100,964**	**78**	**171,062**	**97,322**	**3,642**
Total credit risk exposure	**1,960,286**	**61,866**	**3,162,433**	**1,550,169**	**410,117**

31 December 2016	*Maximum exposure*	*Fair value of collateral held by the Company*			*Net exposure*
		Cash	*Property*	*Net collateral*	
	£000	*£000*	*£000*	*£000*	*£000*
Assets:					
Balances with central banks	205,062	-	-	-	205,062
Placements with banks	67,948	-	-	-	67,948
Placements with related entities	24,949	24,686	-	24,686	263
Loans and advances to customers	1,083,922	7,408	2,499,325	1,076,800	7,122
Other assets	3,411	-	-	-	3,411
On-balance sheet total	1,385,292	32,094	2,499,325	1,101,486	283,806
Contingent liabilities:					
Acceptances, guarantees and cashing facilities	1,195	26	4,861	1,195	-
Commitments to advance	12,823	88	29,567	12,739	84
Off-balance sheet total	14,018	114	34,428	13,934	84
Total credit risk exposure	1,399,310	32,208	2,533,753	1,115,420	283,890

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 indicators 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. Interest rate risk arising from the mismatch between the Company's lending and deposit rates is actively managed. The majority of the advances and deposits are priced off market rates and margins are closely monitored and evaluated. In managing these mismatches the Company makes use of appropriate interest rate derivative contracts including interest rate swaps. The exposure to interest rate changes and sensitivity is regularly reported to and reviewed by the Asset & Liability Committee, which manages the overall exposure within an agreed limit.
A summary of the Company's interest rate gap position based on the contractual re-pricing date of assets and liabilities is as follows:

31 December 2017	***Carrying value***	***Non-interest bearing***	***Up to 3 months***	***3 months to 1 year***	***1 year to 5 years***
	£000	***£000***	***£000***	***£000***	***£000***
Assets:					
Cash and bank advances	**391,349**	**566**	**389,722**	**1,061**	**-**
Placements with related entities	**25,226**	**127**	**25,099**	**-**	**-**
Investment in subsidiary	**400**	**400**	**-**	**-**	**-**
Loans and advances to customers	**1,407,200**	**-**	**1,273,389**	**45,037**	**88,774**
Fixed assets	**17,396**	**17,396**	**-**	**-**	**-**
Other assets	**35,547**	**-**	**-**	**35,547**	**-**
Total assets	**1,877,118**	**18,489**	**1,688,210**	**81,645**	**88,774**
Liabilities:					
Amounts due to banks	**-**	**-**	**-**	**-**	**-**
Amounts due to related entities	**26,605**	**32**	**26,573**	**-**	**-**
Customer deposits	**1,656,975**	**227,579**	**717,630**	**548,177**	**163,589**
Provision for customer redress	**41,516**	**-**	**-**	**41,516**	**-**
Other liabilities	**9,767**	**-**	**-**	**9,767**	**-**
Subordinated loan	**29,537**	**72**	**-**	**-**	**29,465**
Total liabilities	**1,764,400**	**227,683**	**744,203**	**599,460**	**193,054**

Derivatives	**-**	**-**	**-**	**-**	**-**
Interest rate gap	**112,718**	**(209,194)**	**944,007**	**(517,815)**	**(104,280)**

31 December 2016

Assets:					
Cash and bank advances	273,010	355	272,058	597	-
Placements with related entities	24,949	124	24,825	-	-
Investment in subsidiary	400	400	-	-	-
Loans and advances to customers	1,083,922	-	1,071,100	-	12,822
Fixed assets	17,285	17,285	-	-	-
Other assets	3,411	-	-	3,411	-
Total assets	1,402,977	18,164	1,367,983	4,008	12,822
Liabilities:					
Amounts due to banks	-	-	-	-	-
Amounts due to related entities	28,381	57	28,324	-	-
Customer deposits	1,257,403	194,274	404,435	400,718	257,976
Other liabilities	21,275	-	-	21,275	-
Subordinated loan	30,061	61	30,000	-	-
Total liabilities	1,337,120	194,392	462,759	421,993	257,976
Derivatives	-	-	-	-	-
Interest rate gap	65,857	(176,228)	905,224	(417,985)	(245,154)

The Company monitors its exposure to interest rate risk. The annualised 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:

	2017	*2016*
	£000	*£000*
Increase of 1%	**12,143**	8,280
Decrease of 1%	**(1,785)**	(1,902)

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 for a year arising from a parallel rise or fall in all market interest rates and do not take into account the effect of any actions to mitigate the effect.

The Company is exposed to foreign currency risk as a result of 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. The potential impact on profit after tax and on equity of a change in currency exchange rates is negligible at the reporting date.

Set-off
Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Company currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Company is party to a number of arrangements that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

The table below shows potential effect of the amounts that could be offset under the Company's right of set-off but which are shown gross in the financial statements.

	2017			*2016*		
	Gross amounts presented in the balance sheet	***Offset amounts***	***Net amounts***	*Gross amounts presented in the balance sheet*	*Offset amounts*	*Net amounts*
	£000	***£000***	***£000***	*£000*	*£000*	*£000*
Financial assets						
Placements with banks	**32,625**	**-**	**32,625**	67,948	-	67,948
Placements with related entities	**25,226**	**25,226**	**-**	24,949	24,949	-

Loans and advances to customers	**1,407,200**	**67,994**	**1,339,206**	1,083,922	62,505	1,021,417
Financial liabilities						
Amounts due to banks	**-**	**-**	**-**	-	-	-
Amounts due to related entities	**26,605**	**25,226**	**1,379**	28,381	24,949	3,432
Customer deposits	**1,656,975**	**67,994**	**1,588,981**	1,257,403	62,505	1,194,898

Conduct risk

Conduct risk is defined as the risk that the Company's behaviour, offerings or interactions with unfair outcomes for its customers results in fines, compensation, redress costs and reputational damage.

The Company manages conduct risk in a way that is consistent with its overall risk appetite and with its business strategy. Conduct risk involves treating customers fairly, in line with regulatory requirements arising from FCA rules and guidance.

As at the end of 2017, the total redress cost to be borne by the Company since the historic conduct issue (2008 to 2012) was identified in 2016 amounts to £50.37m. Details of the provision for customer redress are presented in note 22 to the financial statements.

29 Investment in subsidiary

Bank of Cyprus Financial Services Limited (BOCFS), whose principal place of business is England and Wales and whose registered office is 27-31 Charlotte Street, London, W1T 1RP, is a wholly owned subsidiary of the Company. BOCFS was an appointed representative of Legal & General Partnership Services Limited. Until 30th September 2017 BOCFS sold insurance and protection products of Legal & General. The investment in subsidiary is accounted for at cost.

30 Capital management

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 stresses without parental support. The company has complied in full with all its externally imposed capital requirements over the period reported.

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. The PRA reviews the Internal Capital Adequacy Assessment Process document and issues 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.

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

31 Related party transactions

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 ultimate Parent company, Bank of Cyprus Holdings Public Limited Company is incorporated in Ireland and listed on the London Stock Exchange.

The Company has one wholly-owned subsidiary company, BOCFS, a previously appointed representative of Legal & General Partnership Services Limited until 30th September 2017. BOCFS sold life assurance and other protection products of Legal & General.

During 2017, the following transactions entered into with the Parent by the Company remained in force:

- 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 2017 the Company's deposits with the Parent totalled £25,093,000 (31 December 2016: £24,820,000) and there was accrued interest on them of £127,000 (31 December 2016: £124,000). The Parent's deposits with the Company at the same date totalled £25,111,000 (31 December 2016: £24,629,000) and there was accrued interest of £32,000 (31 December 2016: £56,000). 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 £5,000 at 31 December 2017 (£5,000 at 31 December 2016).

- Vostro accounts held by the Parent with the Company with a total credit balance of £1,029,000 at 31 December 2017 (£2,883,000 at 31 December 2016).

On 22 January 2015 the company entered into a service level agreement with the Parent under which the Company manages a portfolio of loans totalling £1.4m as at 31 December 2017 on the Parents behalf. During the year fees of £31,000 were charged to the Parent and £167,000 of the company's own costs were recharged to the Parent.

During 2017, the Company levied a management charge of £65,000 (2016: £107,000) on its subsidiary, BOCFS, for the provision of staff and other support services. At 31 December 2017 there was an interest free liability of £400,000 with BOCFS (2016: £400,000).

During 2017, the following transactions entered into with fellow subsidiaries of the Parent remained in force:

- Credit balances on vostro accounts held by Bank of Cyprus Channel Islands Limited (in liquidation), a wholly owned subsidiary of the Parent, with a total balance of £34,000 at 31 December 2017 (2016: £412,000).

In the course of 2017 the Company has booked £31.5m receivable from the Parent company relating to extra provision required in relation of the customer redress issue. See note 22 for further details in respect of this provision.

Placements with and by related entities were as follows:

	2017	*2016*
	£000	*£000*
Placements with related entities		
Balance under deposit agreement of 4 July 2012 including accrued interest	**25,221**	24,944
Credit balances on nostro accounts	**5**	5
	25,226	24,949
Placements by related entities		
Balance under deposit agreement of 4 July 2012 including accrued interest	**25,143**	24,686
Credit balances on vostro accounts held by Parent	**1,029**	2,883
Credit balance on vostro account held by Bank of Cyprus Channel Islands Limited (in liquidation)	**33**	412
Balance owed to BOCFS	**400**	400
	26,605	28,381

The Company made contributions to an employee savings plan during the year ended 31 December 2017 totalling £359,649 (2016: £290,403). The contributions are held as a deposit in the Company.

The total 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 Executive Committee of the Company during 2017.

	2017	*2016*
	£000	*£000*
Directors' emoluments	**1,085**	748
Compensation of key management personnel	**1,150**	605

The total remuneration of the highest paid director was £326,250 (2016: £283,333). The amount of pension contributions paid by the Company to the pension scheme on behalf of the highest paid director was £64,459 (2016: £24,468).

Directors, key management personnel and their connected persons as of 31 December 2017 have the following balances with the Company in the normal course of business.

	Number of key management personnel	***Amounts £000***
Secured loans, unsecured loans and overdrafts		
1 January 2017	**1**	**1**
Net movements in the year	**(1)**	**(1)**
31 December 2017	**-**	**-**

Deposit accounts and current account credit balances

1 January 2017	**3**	**597**
Net movements in the year	**(1)**	**(240)**
31 December 2017	**2**	**357**

32 Adoption of IFRS 9 'Financial Instruments'

32.1 Changes in accounting policies and disclosures

The Company will adopt IFRS 9 and IFRS 7R with effect from 1st January 2018. The company will apply these standards in the financial statements for the year ended 31 December 2018. The impact of the adoption of these standards is set out below:

i) IFRS 9 Financial instruments

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Company elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39.

The Bank will not restate comparative information for 2017 in the 2018 financial statements, for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 will be reported under IAS 39 and will not be comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 will be recognised directly in retained earnings as of 1 January 2018.

ii) Changes to classification and measurement

From a classification and measurement perspective, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets will be replaced by: debt instruments at amortised cost; debt instruments at fair value through other comprehensive income (FVOCI) with gains or losses recycled to profit or loss on de-recognition; equity instruments at FVOCI with no recycling of gains or losses or profit or loss on de-recognition; financial assets as fair value through profit or loss (FVPL).

The accounting for financial liabilities will largely be the same as the requirements of IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements will be presented in OCI with no subsequent reclassification to the income statement, unless an accounting mismatch in profit or loss would arise.

Having completed its initial assessment in 2016, the Company concluded that the majority of loans and advances to customers and placements with banks that are classified as loans and receivables and held at amortised cost under IAS 39, will be measured at amortised cost under IFRS 9 and financial assets and liabilities held for trading and financial assets and liabilities designated at FVPL under IAS 39 will continue to be measured at FVPL under IFRS 9.

Details of each financial asset type under IFRS 9 and the associated impact assessment are set out in note 32.2 below.

iii) Changes to the impairment calculation

The adoption of IFRS 9 will fundamentally change the Company's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Company to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. Details of the Company's impairment method are disclosed in Note 32.2.2 below. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 32.3 below.

iv) IFRS 7R 'Financial Instruments: Disclosures'

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 *Financial Instruments: Disclosures* was updated and the Company will adopt it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in Note 32.3, detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are set out in Note 32.2.2.

IFRS 7R also requires additional and more detailed disclosures for hedge accounting even for entities opting to continue to apply the hedge accounting requirements of IAS 39.

32.2 Summary of significant accounting policies

i) Financial Assets

IFRS9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. Based on these factors the Company classifies its debt instruments into one of the following three measurement categories:

Amortised Cost: Assets that are held for the collection of contractual cash flows, where those cash flows represent solely payments of principal and interest ('SPPI') and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by an expected credit loss allowance recognised and measured as described in 32.1. Interest

income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of the impairment gains or losses, interest revenue and foreign exchanges gains and losses on the instruments amortised cost which are recognised in the profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit

Fair value through profit or loss (FVPL): Assets that do not meet the criteria for amortised cost of FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of the hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net Investment Income'. Interest income from these financial assets is included in 'Interest Income' using effective interest rate method.

ii) Business model assessment
The Company determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the Company's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated;
- The expected frequency, value and timing of sales are also important aspects of the Company's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Company's original expectations, the Company does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

iii) The SPPI test
As a second step of its classification process the Company assesses the contractual terms of financial assets to identify whether they meet the SPPI test. 'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount). The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Company applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set. In contrast, contractual terms that introduce a more than *'de minimis'* exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

32.2.1 De-recognition of financial assets and liabilities
IFRS9 incorporates the requirements of IAS39 for de-recognition of financial assets and financial liabilities without substantive amendments. However, it contains specific guidance for the accounting when the modification of a financial instrument not measured at FVTPL does not result in de-recognition. Under IFRS9, the Company will recalculate the gross carrying amount of the financial asset (or the amortised cost of the financial liability) by discounting the modified contractual cash flows at the original effective interest rate and recognise any resulting adjustment as a modification gain or loss in profit or loss. Under IAS39, the Company does not recognise any gain or loss in profit or loss on modification of financial liabilities and non-distressed financial assets that do not lead to de-recognition. The company expects an immaterial impact from adopting these new requirements.

32.2.2 Impairment of financial assets
The impairment of financial assets under IFRS 9 is based on an expected credit loss (ECL) model which replaces the current incurred loss methodology under IAS 39 and is the area where IFRS 9 will have the most significant impact. IFRS 9 requires a 12 month (Stage 1) ECL calculation where financial assets have not experienced a significant increase in credit risk since origination; and a lifetime ECL calculation where it has been demonstrated that there has been a significant increase in credit risk (Stage 2 and 3). The lifetime ECL calculation is further refined into separate stages depending on whether the financial asset is credit impaired or not. The area of IFRS 9's impairment criteria where the greatest judgment is required relates to when financial assets display a significant deterioration in credit quality since initial recognition and subsequently move from a 12 month ECL calculation (Stage 1) to a non-credit impaired lifetime ECL calculation (Stage 2).

i) Overview of the ECL principles
The adoption of IFRS 9 has fundamentally changed the Company's loan loss impairment method by replacing IAS 39's incurred loss approach with a forward-looking ECL approach. From 1 January 2018, the Company will record the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, including loan commitments in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12m ECL) as outlined in note 32.4. The Company's policies for determining if there has been a significant increase in credit risk are set out in note 32.4.

The 12m ECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Based on the above process, the Company groups its loans into Stage 1, Stage 2 and Stage 3 as described below:

- Stage 1: When loans are first recognised, the Company recognises an allowance based on 12m ECLs. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
- Stage 2: When a loan has shown a significant increase in credit risk since origination, the Company records an allowance for the LTECLs. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
- Stage 3: Loans considered credit-impaired. The Company records an allowance for the LTECLs.

For financial assets for which the Company has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) de-recognition of the financial asset.

ii) The Calculation of ECLs

The Company calculates ECLs based on three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

- *Probability of Default (*"PD"): The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio. The concept of PDs is further explained in note 32.4
- *Exposure at Default (*"EAD"): The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in note 32.4
- *Loss Given Default (*"LGD"): The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. The LGD is further explained in note 32.4

When estimating the ECLs, the Company considers three scenarios: good, average, bad ('downside 1'). Each of these is associated with different PDs, EADs and LGDs, as set out in note 32.2.2. When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset. The maximum period for which the credit losses are determined is the contractual life of a financial instrument.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value

The mechanics of the ECL method are summarised below:

- Stage 1: The 12m ECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Company calculates the 12m ECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the three scenarios, as explained above.
- Stage 2: When a loan has shown a significant increase in credit risk since origination, the Company records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.
- Stage 3: For loans considered credit-impaired, the Company recognises the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.
- Loan commitments: When estimating LTECLs for loan commitments, the Company estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at the expected EIR on the loan.
- Overdrafts: The Company does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Company's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Company's expectations, the period over which the Company calculates ECLs for these products, is five years for corporate and seven years for retail products. The interest rate used to discount the ECLs for overdrafts is based on the average effective interest rate that is expected to be charged over the life of the

instrument.

iii) Forward looking information
In its ECL models, the Company relies on a broad range of forward looking information as economic inputs, such as:

- GDP growth;
- Unemployment rates;
- Central Bank base rates;
- House price indices.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

32.2.3 Collateral valuation
To mitigate its credit risks on financial assets, the Company seeks to use collateral, where possible. The collateral comes in various forms, such as real estate, cash, securities, letters of credit/guarantees, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The Company's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same is it was under IAS 39. Collateral, unless repossessed, is not recorded on the Company's statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a quarterly basis.

To the extent possible, the Company uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on professional valuations.

32.2.4 Forborne and modified loans
The Company sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or otherwise enforcing collection of collateral. The Company considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Company would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants, or significant concerns raised by the Credit Risk Department. Forbearance may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Company's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur. De-recognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

From 1 January 2018, when the loan has been renegotiated or modified but not derecognised, the Company also reassesses whether there has been a significant increase in credit risk, as set out in note 32.4. The Company also considers whether the assets should be classified as Stage 3. Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In order for the loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of its facilities has to be considered performing;
- The probation period of two years has passed from the date the forborne contract was considered performing;
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period;
- The customer does not have any contract that is more than 30 days past due

32.3 Transition disclosures: impact assessment
The adoption of IFRS 9 will affect the classification and measurement of financial assets held as at 1 January 2018 as follows:

- Loans and advances to banks and to customers that are classified as loans and receivables and measured at amortised cost under IAS 39 will in general also be measured at amortised cost under IFRS 9;
- Trading assets and derivative assets held for risk management, which are classified as held for trading and measured at FVTPL under IAS 39, will also be measured at FVTPL under IFRS 9;
- Equity investment is classified as not held for trading and measured at FVTPL under IAS 39, is held for long-term strategic purposes and will be designated as FVOCI under IFRS 9

32.3.2 Reconciliation of carrying amounts under IAS 39 to the balances under IFRS 9 as at 1 January 2018

The following tables reconcile the asset and liability categories impacted by the transition from IAS 39 to IFRS 9

Gross customer loans and advances:

	As at 31 December 2017	Re-classification on adoption of IFRS9	As at 1 January 2018
	£000	£000	£000
Gross customers loans and advances	1,411,255	-	-
Gross customers loans and advances- Stage 1	-	-	1,327,057
Gross customers loans and advances- Stage 2	-	-	67,764
Gross customers loans and advances- Stage 3	-	-	16,434
	1,411,255	-	1,411,255

Balances with Central banks:

	As at 31 December 2017	Re-classification on adoption of IFRS9	As at 1 January 2018
	£000	£000	£000
Balances with central banks	358,238	-	-
Balances with central banks - Stage 1	-	-	358,238
	358,238	-	358,238

Balances with other banks:

	As at 31 December 2017	Re-classification on adoption of IFRS9	As at 1 January 2018
	£000	£000	£000
Placements with banks	57,851	-	-
Placements with banks - Stage 1	-	-	57,851
	57,851	-	57,851

There was no impact on the measurement of gross loans, balances with central bank and balances with other banks respectively, upon adoption of IFRS9 as these were not reclassified into a fair value measurement category.

The impact upon adoption of IFRS9 on the loan impairment provision is as follows:

Equity:

	As at 31 December 2017	Re-classification on adoption of IFRS9	Re-measurement on adoption of IFRS9	As at 1 January 2018
	£000	£000	£000	£000
Retained losses	(6,671)	-	100	(6,571)

32.3.3 Reconciliation of loan loss provision under IAS 39 to the ECL allowance under IFRS9 at 1 January 2018
The following table reconciles the aggregate opening loan loss provision allowance under IAS39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS37 Provisions, Contingent Liabilities and Contingent Assets to the ECL allowance under IFRS9.

	Loan loss provision under IAS 39 as at 31 December 2017	Re-classification on adoption of IFRS9	Re-measurement on adoption of IFRS9	ECL's under IFRS 9 as at 1 January 2018
	£000	£000	£000	£000
Provisions - Collective	(2,451)	-	2,451	-
Provisions - Specific	(1,604)	-	1,604	-
Individually assessed - Stage 1	-	-	(795)	(795)
Individually assessed - Stage 2	-	-	(324)	(324)
Individually assessed - Stage 3	-	-	(2,509)	(2,509)
Collectively assessed - Stage 1	-	-	(300)	(300)

Collectively assessed - Stage 2	-	-	(27)	(27)
	(4,055)	-	100	(3,955)

The impact of the reduction of provisions upon transition to IFRS 9 is taken directly to reserves on 1 January 2018.

32.4 Changes to Risk Management (policy applicable from 1 January 2018)

The adoption IFRS 9 and IFRS 7R from 1 January 2018 necessitates changes to the Company's risk management policies, specifically credit risk. The risk management policies which the Company will formally adopt are noted below and should be read in conjunction with the significant account policies applicable from 1 January 2018 as set out in note 32.2.

Definition of default and cure

The Company considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Company considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Company also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Company carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default;
- The borrower requesting emergency funding from the Company;
- The borrower having past due liabilities to public creditors or employees;
- The borrower is deceased;
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral;
- A material decrease in the borrower's turnover or the loss of a major customer;
- A covenant breach not waived by the Company;
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection.

It is the Company's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least eighteen consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition. The Bank's criterion for 'cure' for ECL purposes is less stringent than the 24 months requirement for forbearance which is explained in note 32.2.2.

i) The Company's internal rating and PD estimation process

The Company's independent Credit Risk Department operates its internal rating systems. The Company runs separate systems for its key portfolios in which its customers are rated using internal grades. The systems incorporate both qualitative and quantitative information. PDs are assigned to the internal credit grades based on historical experience, where such experience is sufficient to establish a robust estimate of PD. Where there is insufficient historical experience PDs are estimated on the basis of information from a credit rating agency. PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward looking information and the IFRS 9 Stage classification of the exposure. This is repeated for each economic scenario as appropriate.

ii) Treasury, trading and interbank relationships

The Company's counterparties comprise financial services institutions and central banks. For these relationships, the Company's credit risk department analyses publicly available information such as financial information and other external data, e.g., the rating of Moody's or Standard and Poor.

iii) Corporate and small business lending

For corporate and small business lending, the borrowers are assessed by relationship managers under the oversight

of the Credit Risk unit of the Company. The credit risk assessment is based on a credit grading system that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the grading techniques varies based on the exposure of the Company and the complexity and size of the customer.

iv) Consumer lending and retail mortgages

Consumer lending comprises unsecured personal loans and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest re-pricing;
- Retail mortgages: GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest re-pricing.

v) Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

For loans, EAD is modelled on the basis of the contractual amortisation profile of the loan but assuming that for the last 90 days before default no further repayments are made. No account is taken of early repayments made at the option of the borrower. For overdrafts, the EAD is taken as the full amount of the approved limit or, if higher, the overdrawn balance at the balance sheet date. Undrawn facilities which have been offered in the last three months before the balance sheet data are assumed to draw down in full, as are the undrawn portions of staged loans, such as property development loans.

vi) Loss given default

LGD values are assessed at least every three months by account managers and reviewed and approved by the Bank's specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The LGD rate for customer advances is based on the following principal inputs:

- The probability that the account will cure after default, in which case the loss will be nil. The estimate of the probability of cure is based on historical experience and is a function of LTV.. For cases that are in Recoveries the probability of cure is taken to be nil.
- The LTV of the borrower at the time of detault
- The forced sale discount, which is determined on a probability distribution with a mean of 26% for residential properties and 33% for commercial properties
- The cost of realisation, which is assumed to be 5%, based on the bank's experience of recoveries case in the past.

- The discount rate applied to the realisation proceeds, which is the effective interest rate of the exposure
- The time to sale, which is assumed to be 18 months from the date of default, based on the bank's experience and based on the bank's assessment of industry practice
- Post write-off recoveries, which are assumed to be nil.

Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in collateral values including property prices for mortgages, payment status or other factors that are indicative of losses in the group. The Company estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2 and Stage 3 IFRS 9 segment of each asset class. These are repeated for each economic scenario as appropriate.

vii) Significant increase in credit risk

The Company continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Company assesses whether there has been a significant increase in credit risk since initial recognition. The Company considers an exposure to have significantly increased in credit risk when any of the following has occurred:

- The exposure is forborne;
- The exposure is placed on the Watch List;
- The exposure is graded D or E using the Company's internal grading methodology;
- The exposure has been downgraded from A to C using the bank's internal grading methodology

In certain cases, the Company may also consider that events explained note 32.4 are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

For borrowers with exposure less than £100,000 there is no annual review, so the grade is not re-assessed unless there are symptoms of credit weakness, such as arrears. For these accounts (which account for 2% of total customer advances), a separate assessment of the evidence of a significant deterioration and an adjustment is made to the ECL estimate as a management overlay, if appropriate.

33 Events after the reporting period

There are no events after the reporting period that require disclosure in these financial statements.

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