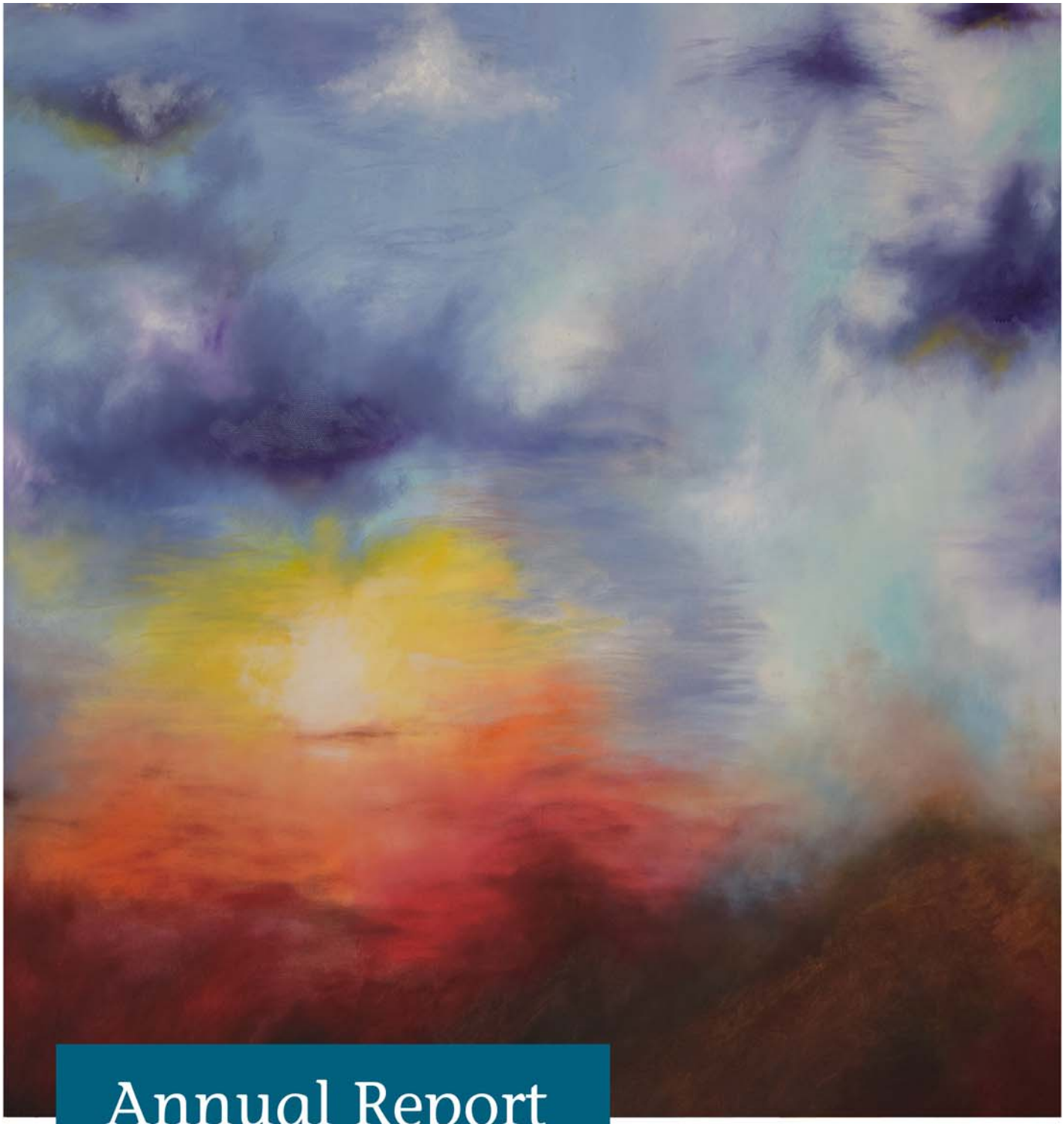


Annual Report 2016

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[1,2] - *Chairman*
Nick Fahy[3] - *Chief Executive, Executive Director*
Soteris Antoniades[3] – *Deputy Chief Executive, Executive Director*
David Green[1, 2] - *Chair of the Remuneration Committee and Independent non-executive director*
Jean Stevenson[1, 2] – Chair of the Audit & Risk Committee *Senior independent non-executive director*
Euan Hamilton[1, 2] - *Non-executive director*

Other senior executives
Francesca Hampton[3] - *Chief Financial Officer*
Andy Hobbins[3] – *Managing Director, Consumer Banking*
Kypros Kyprianou[3] – *Managing Director, Property*
Tony Leahy[3] - *Head of Human Resources & Communications*
Andrew Smith[3] – *Chief Risk Officer*
Greg Jones[3] – *Managing Director, Business Banking and Chief Customer & Commercial Officer*

[1] Member of the Audit & Risk Committee
[2] Member of the Remuneration Committee
[3] Member of the Executive Committee

Company Secretary
Les Cantlay

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

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

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

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

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

Birmingham
123 Parade, Sutton Coldfield B72 1PU

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

Registered in England and Wales under company number 04728421

www.bankofcyprus.co.uk

Chairman's statement

During 2016, year 1 of the new strategy which was approved by the UK Board on 24 March 2016 and by the Group Board on 28 April 2016, the Company saw 32.1% growth in its lending book from 2015. This growth is testimony to our customers' confidence in the Company and its ability and competence in continuing to serve their needs.

We have demonstrated through the year that we can respond successfully to changing economic conditions and have built up a good understanding of our customers. We continue to offer an attractive home for savings and for our entrepreneurial borrowers we offer a level of service and flexibility that the larger banks cannot provide.

We are well placed to continue to grow our lending book, with a strong balance sheet and adequate capital and liquidity. We are working towards creating a strong diversified bank supporting lending to customers in our property, personal banking, and business pillars.

We have strengthened our executive team and invested in more headcount to support our growth strategy and to enhance the customer experience.

In 2009 the Bank embarked on re-pricing its loan book following the market dislocation of interest rates during the 2007 global financial crises. In 2016 the Bank has conducted a review of the loan book and has identified a group of customers, who may have suffered financial damage as a result of the repricing exercise. We are committed to remediating those affected customers where appropriate. The Bank has provided in the 2016 accounts the amount of £14.9M by way of a conduct and legal provision for the estimated cost of redressing these customers. Bank of Cyprus PC Ltd have agreed that they will underwrite the cost of this remediation

I would like to thank my fellow directors, the management and staff for their valuable contribution throughout 2016 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

Strategy

The Bank of Cyprus UK Strategy is "to be a recognised bank for Business Owners and Entrepreneurs supporting our customers, communities and people to prosper and grow". The strategy is based on diversification both geographically and by portfolio type and repositions Bank of Cyprus UK in the market as a sustainable bank with scale supporting the Owner Managed Business sector. The strategy was approved by the UK and Group Boards in the first half of 2016.

We have recruited a new management team to execute the strategy and created three distinct Pillars to meet our customer needs namely Property, Personal Banking and Business Banking. Each Pillar will contribute to the Strategy of lending within our defined Risk Appetite.

Performance on year 1 of the strategy

2016 was an important year for Bank of Cyprus UK and we successfully delivered Year One of our new strategy. We delivered a solid financial performance with lending book growth of 32.1% and net new loans totalling £355m during the year. Net interest income for the year was £24.7m, 29% higher than 2015. Underlying margins remain stable through the year on both the lending and deposit businesses.

The overall loss before tax for the year of £9m is due to a one-off conduct risk provision of £14.9m to cover a customer redress exercise as referred to in the Chairman statement. Total operating income increased by 25% from £24m in 2015 to £30m in 2016.

Operating costs at £24m were tightly managed during 2016. The costs in our financial accounts contain significant investments in the development of the new business pillars.

Alongside the growth in lending, liquidity is strong, with cash and balances with central banks standing at £205m, representing 16.0% of customer deposits. Deposits increased from £1,038m at 31 December 2015 to £1,257m at 31 December 2016, an increase of 21%. The bank has continued to source cost-effective deposits from the retail market, offering an attractive and competitive range of products. The bulk of its funding comes from retail deposits.

The capital position remains strong, with total capital standing at 18.2% of risk weighted assets (2015: 24.4%).

Customers

Our customers are at the heart of our business and we offer them a range of lending and savings products. Our customer focused culture offers dedicated relationship managers who support both property lending and trading businesses and we have expanded our regional network this year and have offices in North, Central and South London, Birmingham and Leeds, with Bristol and Brighton having opened in quarter 1 2017 and Manchester planned for later in the year.

Our vision is to be recognised as a bank that provides excellent service to our customers and we have made a strong start as evidenced by our Net Promoter Score (NPS) which closed at +37 which is a 68% improvement since 2015.

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 54% and by a write back in 2016 of £898k; this standard will be further strengthened by the new diversified business strategy.
The bank's business is to take on risk within limits defined by the Bank's Board and therefore implementing efficient risk management is critical to the Bank's successful operation.

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

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

The Bank 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 2016, the Bank has deployed new systems designed better to articulate the risks that the Bank faces and the controls that limit those risks and to improve the consistency and the effectiveness of its risk control processes. In 2017, the Bank will add further tools intended to allow closer and more rapid monitoring of its asset and liability management.

Outlook for 2017 and other matters

The UK economic outlook is broadly favourable over the next three to five years with economic fundamentals supporting a stable growth environment, however global and local uncertainties (e.g. Brexit) are heightening downside risks. We continue to manage the Bank through quarterly updates to the outlook and our strategy, and remain sensitive and responsive to market indicators at all times.

For 2017 we are focusing on continuing to grow the lending book and improving the quality of service to customers. We will organise our business around key pillars supporting property customers in retirement and wealth building, Business Banking customers, Personal Banking customers with a focus on supporting business owners to buy their homes and Depositing customers with a full savings range

Property: in 2017 we will build on the growth momentum of 2016 with lending supported from our increasing number of key introducers. Business development will continue to focus on property professionals who are ambitious to grow and want a bank that genuinely provides a long term relationship and puts the customer first.

Personal Banking: By June 2017, our Consumer Mortgages Platform for Intermediaries will be open for business. We have partnered with a number of experienced and professional networks who will provide access to the key segments necessary to build a sustainable mortgage business. We have assembled a team of experienced mortgage professionals and will target segments where individual underwriting assessment will attract good quality customers looking for flexibility and competitive terms.

Business: We will look to serve the SME market by providing products and services to meet their needs through a range of current and savings accounts, lending, including overdrafts, working capital lending and general business services, including foreign exchange and payments.

I am also pleased to report that the Group was listed on the London Stock Exchange in January 2017. This is expected to improve the liquidity of the Group's stock, which will enhance the Group's visibility and the confidence of all stakeholders in the Group. It follows the Group's successful return to the debt capital markets and full repayment of Emergency Liquidity Assistance funding since the start of 2017

The Company has adopted a corporate responsibility policy under which it seeks to minimize any adverse environmental impact of its operations by recycling waste and adopting energy efficient methods of heating and lighting

As I conclude this review, I would like to take the opportunity to thank BOC UK's staff, in all offices, for their hard work, loyalty and dedication during the year. Teamwork and responsive service will help differentiate BOC UK from its competitors. I am proud of all our achievements both financial and non-financial during 2016 and thank all of our teams, the Board of Directors and other key stakeholders for their continuous support and commitment.

Nick Fahy
Chief Executive Officer

Directors' report

The directors present their report and financial statements for the year ended 31 December 2016.

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 2016 are set out in the income statement on page 10. 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 BOC UK 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 8.

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

Liquidity
The Bank manages liquidity with an internal methodology which fully meets and exceeds the regulatory LCR measure and as a result during 2016 the Bank 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 2016 (2015: nil).

Hedging policy
The Company uses interest rate swaps to hedge against interest rate risk where appropriate. Hedging is covered in more detail in notes 16 and 28 of the financial statements.

Human resources
The Company had 225 permanent employees at 31 December 2016 (2015: 178). During the year, the Company invested £200,000 (2015: £129,000) in staff development.

Board of directors
Full details of the board of directors are shown on page 2. Since 1 January 2016 the following changes have taken place:

Name of director	*Date of appointment*	*Date of resignation*
Jean Stevenson	14 March 2016	
Euan Hamilton	08 March 2016	
Sypros Neophytou		21 June 2016
Kypros Kyprianou		24 March 2016
Melanie Leask	16 December 2016	13 February 2017
Miltiades Michaelas		16 December 2016

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 Audit & Risk Committee has within its terms of reference the oversight of all risks inherent in the business. This committee meets as and when required and at least quarterly. The Remuneration, Nomination and Corporate Governance Committee makes recommendations to the Parent 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), an appointed representative of Legal & General Partnership Services Limited. BOCFS sells insurance and protection products of Legal & General.

Charitable donations
During 2016 the Company made charitable donations totalling £15,000 (2015: £21,000).

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

By order of the board

Les Cantlay
Secretary

05 June 2017

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.

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 auditors' report

To the members of Bank of Cyprus UK Limited

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Income statement and statement of comprehensive income

For the year ended 31 December 2016

	Notes	***2016***	*2015*
		£000	*£000*
Interest income	5	**43,419**	35,565
Interest expense	6	**(16,340)**	(14,577)
Net interest income		**27,079**	20,988
Fee and commission income	7	**2,556**	2,430
Foreign exchange gains	8	**348**	372
Net gains on financial instrument transactions	9	**68**	209
Total operating income		**30,051**	23,999
Staff costs	10	**(13,260)**	(10,042)
Depreciation and amortisation	11	**(1,426)**	(1,491)
Other operating expenses	12	**(9,465)**	(8,571)
Total operating expense before conduct and legal provision		**(24,151)**	(20,104)
Provision for customer redress	22	**(14,910)**	-
(Loss) / Profit before provisions for impairment of loans and advances		**(9,010)**	3,895
Provisions for impairment of loans and advances	13	**898**	688
(Loss) / Profit before tax		**(8,112)**	4,583
Income tax expense	14	**(908)**	(979)
(Loss) / Profit after tax		**(9,020)**	3,604
Total other comprehensive income		**-**	-
Total comprehensive (Loss) / Profit for the year attributable to the equity holders		**(9,020)**	3,604

The notes on page 14 to 43 and all other primary statements form an integral part of these financial statements.

Statement of financial position

As at 31 December 2016

	Notes	***2016*** ***£000***	*2015* *£000*
Assets			
Cash and balances with central banks	15	**205,062**	228,858
Placements with banks	15	**67,948**	83,373
Placements with related entities	15, 31	**24,949**	21,127
Loans and advances to customers	17	**1,083,922**	820,807
Other assets	18	**3,411**	2,480
Intangible assets	19	**840**	640
Property and equipment	20	**16,445**	11,178
Investment in subsidiary	28	**400**	400
Total assets		**1,402,977**	1,168,863
Liabilities			
Placements by related entities	31	**28,381**	24,216
Amounts due to banks		**-**	7
Customer deposits	21	**1,257,403**	1,038,348
Provision for customer redress	22, 23	**14,910**	-
Other liabilities	23	**6,365**	6,410
Subordinated loan	24	**30,061**	30,062
Total liabilities		**1,337,120**	1,099,043
Equity			
Share capital	25	**65,000**	65,000
Revaluation and other reserves		**8,389**	3,332
(Accumulated losses)/Retained earnings		**(7,532)**	1,488
Total equity		**65,857**	69,820
Total liabilities and equity		**1,402,977**	1,168,863

The notes on pages 14 to 43 form an integral part of these financial statements.

These financial statements were approved by the board of directors on 05 June 2017 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 2016

	2016				2015
	Share capital	**Revaluation and other reserves**	**(Accumulated losses) / Retained earnings**	**Total**	Total
	£000	**£000**	**£000**	**£000**	£000
1 January	**65,000**	**3,332**	**1,488**	**69,820**	66,216
Total comprehensive (loss)/ profit for the year attributable to the equity holders	**-**	**5,057**	**(9,020)**	**(3,963)**	3,604
31 December	**65,000**	**8,389**	**(7,532)**	**65,857**	69,820

The notes on pages 14 to 43 form an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2016

	2016	*2015*
	£000	*£000*
Operating activities		
(Loss)/Profit before tax	**(8,112)**	4,583
Adjustments for:		
Provisions for impairment of loans and advances	**(898)**	(688)
Depreciation of property and equipment	**969**	1,085
Amortisation of intangible assets	**457**	406
Interest on subordinated loan	**2,264**	2,272
Tax paid	**998**	407
Changes in operating assets		
(Increase) in mandatory deposits with central bank	**(258)**	(70)
(Increase) in loans and advances to customers	**(259,271)**	(201,878)
(Increase)/Decrease in other assets	**(366)**	70
(Increase) in accrued income and prepaid expenses	**(338)**	(362)
Changes in operating liabilities		
Increase in customer deposits	**207,610**	84,697
Increase /(Decrease) in other liabilities	**11,495**	(97)
Increase in accrued expenses	**666**	1,099
Net cash flow used in operating activities	**(44,784)**	(108,476)
Investing activities		
Purchase of property and equipment	**(380)**	(178)
Purchase of intangible assets	**(654)**	(364)
Net cash flow used in investing activities	**(1,034)**	(542)
Financing activities		
Interest paid on subordinated loan	**(2,265)**	(2,271)
Net cash flow used in financing activities	**(2,265)**	(2,271)
Net decrease in cash and cash equivalents for the year	**(48,083)**	(111,289)
Cash and cash equivalents (see note 15)		
1 January	**308,796**	422,079
Net foreign exchange differences	**8,268**	(1,994)
Net decrease in cash and cash equivalents for the year	**(48,083)**	(111,289)
31 December	**268,981**	308,796

The notes on pages 14 to 43 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.

Change in classification of fee income

Fees that the Bank considers to be an integral part of the corresponding instruments such as loans origination and other credit related fees previously included "Fee and Commission Income" on the banks income statement have been reclassified to "Interest Income" in 2016 with a corresponding reclassification in comparatives as follows

	2015 *Interest income* *£000*	*2015* *Fee and Commission income* *£000*
As previously presented	33,757	4,238
Reclassification	1,808	(1,808)
As per current presentation	35,565	2,430

Change in classification of mandatory deposits with the central bank in the Statement of cash flows.

Mandatory deposits with the central bank have been excluded from cash and cash equivalents on the Statement of cash flows as they are not available for use in the Company's day to day business. The comparative presentation for the prior year has also been amended to reflect this change.

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 year

The Company has adopted for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2016. 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 16 Property, Plant & Equipment and IAS 38 Intangible assets (Amendment): Clarification of Acceptable Methods of Depreciation and Amortization

This amendment clarifies the principle in IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, the ratio of revenue generated to total revenue expected to be generated cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets.

IAS 1: Disclosure Initiative (Amendment)

The amendments to IAS 1 Presentation of Financial Statements further encourage companies to apply professional judgment in determining what information to disclose and how to structure it in their financial statements. The narrow-focus amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments relate to materiality, order of the notes, subtotals and disaggregation, accounting policies and presentation of items of OCI arising from equity accounted investments. This amendment did not result in any material changes to the financial statements.

Annual Improvements 2012–2014 Cycle The IASB has issued the Annual Improvements IFRSs 2012–2014 Cycle which is a collection of amendments to IFRSs. They include:

- IFRS 7 Financial Instruments—Disclosures: The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. Also, the amendment clarifies that the IFRS 7 disclosures relating to the offsetting of financial assets and financial liabilities are not required in the condensed interim financial report.

Annual Improvements IFRSs 2010–2012 Cycle The IASB has issued the Annual Improvements IFRSs 2010–2012 Cycle, which is a collection of amendments to IFRSs. They include:

- IFRS 13 Fair Value Measurement: This improvement in the Basis of Conclusion of IFRS 13 clarifies that issuing IFRS 13 and amending IFRS 9 and IAS 39 did not remove the ability to measure short-term receivables and payables with no stated interest rate at their invoice amounts without discounting if the effect of not discounting is immaterial.

- IAS 16 Property Plant & Equipment: The amendment clarifies that when an item of property, plant and equipment is revalued, the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount.

- IAS 24 Related Party Disclosures: The amendment clarifies that an entity providing key management personnel services to the reporting entity is a related party of the reporting entity.

- IAS 38 Intangible Assets: The amendment clarifies that when an intangible asset is revalued the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount.

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

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.

The impact of these pronouncements is still being assessed by the Company. 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 15: Revenue from Contracts with Customers (Clarifications) The objective of the Clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 Revenue from Contracts with Customers, particularly the accounting of identifying performance obligations amending the wording of the 'separately identifiable' principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The Clarifications also provide additional practical expedients for entities that either apply IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach. The Clarifications apply for annual periods beginning on or after 1 January 2018 with earlier application permitted.

- Amendments to IAS 12 Income Taxes. Recognition of Deferred Tax Assets for Unrealised Losses The amendment addresses how to account for deferred tax assets related to debt instruments measured at fair value which give 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. The Group does not expect these amendments to have a material impact on its results and financial position. The amendment is effective for annual periods beginning on or after 1 January 2017.

- Amendments to IAS 7: Disclosure Initiative The IASB added an initiative on disclosure to its work programme in 2013 to complement the work being done in the Conceptual Framework project. The initiative is, inter alia, made up of a number of smaller projects that aim at exploring opportunities to see how presentation and disclosure principles and requirements in existing standards can be improved short-term. Among them was a narrow scope project on IAS 7 Statement of Cash Flows to improve information provided to users of financial statements about an entity's financing activities and liquidity.

  The objective of the amendments is to enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments will 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. The Bank does not expect these amendments to have a material impact on its results and financial position. These amendments are effective for annual periods beginning on or after 1 January 2017.

IFRS 9 Financial Instruments

In July 2014, the IASB issued IFRS9 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 early adoption permitted.
An IFRS 9 implementation project has been initiated by the Bank. The project is headed by the Bank Head of Prudential Risk and a Steering Committee was set up to monitor the project, comprising of members of the Executive Management team.

Classification and measurement

From a classification and measurement perspective, the new standard will require 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 will be replaced by: fair Value through profit or loss (FVPL), fair value through other comprehensive income (FVOCI), and amortised cost. IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or fair value through OCI instruments as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instruments that are not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement.

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, the BOC UK has concluded that:

- The majority of loans and advances to customers, placements with banks that are classified as loans and receivables and held at amortised cost under IAS 39 are expected to be measured at amortised cost under IFRS 9.
- Financial assets and liabilities held for trading and financial assets and liabilities designated at FVPL are expected to be continue to be measured at FVPL.

Impairment (including modelling development)

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. When a financial asset is credit impaired (Stage 3), the resultant methodology to calculate the loss allowance under IFRS 9 uses the same criteria as the Group's IAS 39 methodology for specific provisions, however, it is anticipated that not all financial assets which are classified as Stage 3 will already have been subject to a specific provision under IAS 39 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).

Hedge accounting

IFRS 9 allows entities to continue with the hedge accounting under IAS 39 even when other elements of IFRS become mandatory on 1 January 2018. Based on its analysis, the BOC UK has decided to continue to apply hedge accounting under IAS 39.

Transition

The classification, measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

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 profit or loss.

Financial instruments

Date of recognition

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

Initial recognition and measurement of financial instruments

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

Derivative financial instruments

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

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

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

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

Financial assets and financial liabilities designated at fair value through the profit and loss are recognised in the balance sheet at fair value. Changes in fair value are recognised in 'Net gains 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 in issue is initially measured at the fair value of the consideration received, net of any issue costs. It is subsequently measured at amortised cost using the effective interest rate method, in order to amortise the difference between the cost at inception and the redemption value, over the period to the earliest date at which the Company has the right to redeem the subordinated loan stock. Interest on subordinated loan stock in issue is included in 'Interest expense' in the income statement.

Derecognition of financial assets and financial liabilities

Financial assets

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

Financial liabilities

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

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. Based on their assessment for the current year, Management 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 has been accounted for as per the provisions of IAS 16, as outlined in this accounting policy. This has resulted in an increase in the current value of its property. 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. The amortisation expense on intangible assets with finite lives is presented as a separate line item in the income statement.

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 – 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 regular basis and when new information became 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 this accounts.

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, the conversion of the subordinated debt, and the projected operating performance of the company.

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

The Company's capital position remains strong. Stress tests carried out in April 2016 demonstrate that the Company holds sufficient capital and liquidity to continue in business, even if subjected to a severe stress scenario which includes substantial reductions in the value of property held as security for advances and an increased rate of deposit withdrawal.

Accordingly, the financial statements for the year ended 31 December 2016 have been prepared on a going concern basis.

Provision for impairment of loans and advances to customers

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

The amount of provision is affected by the value of collateral held which mainly comprises land and buildings. Any decreases in the fair value of this collateral will translate to increases in the required provisions for impairment of loans and advances. For example, a 5% decrease in the value of collateral for impaired advances would lead to an increase in the provision for impairment by £148,000.

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.

Effective Interest Rate (EIR) method

The Company's EIR methodology recognises interest income using 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 UK 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 disclosers 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	2016 £000	2015 £000
Loans and advances to customers	**41,853**	34,024
Placements with banks and central banks	**873**	1,187
Placements with related entities	**693**	354
	43,419	35,565

Interest income from loans and advances to customers includes interest from impaired loans and advances amounting to £514,000 (2015: £480,000) 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 £2,334 thousand (2015: £1,808 thousand).

6 Interest expense

Customer deposits	**13,353**	11,564
Amounts due to related entities	**574**	448
Subordinated loan	**2,264**	2,272
	16,191	14,284
Derivative financial instruments	**149**	293
	16,340	14,577

7 Fee and commission income

Other banking fees and commissions	**2,556**	2,430
	2,556	2,430

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 year, and the revaluation of foreign exchange derivatives.

	-	-

9 Net gains on financial instrument transactions

Net gains arising from fair value hedges (see note 16)	**68**	209

10 Staff costs

Salaries	**11,006**	8,149
Social security costs	**1,035**	831
Retirement benefit costs - defined contribution scheme	**1,219**	1,062
	13,260	10,042

The number of staff employed (including two executive directors) by the Company as at 31 December 2016 was 225 (2015: 178).

11 Depreciation and amortisation	**2016** £000	2015 £000
Depreciation	**969**	1,085
Amortisation of intangible assets	**457**	406
	1,426	1,491

12 Other operating expenses

Information technology	**2,340**	2,533
Professional fees	**977**	1,856
Money transmission	**879**	895
Communication	**343**	381
Advertising	**216**	502
Premises	**729**	710
Financial Services Compensation Scheme levy	**264**	272
Printing and stationery	**205**	230
Other operating expenses – refer to analysis below	**3,512**	1,192
	9,465	8,571

Professional fees include fees payable to the Company's auditor of £291,820 are analysed below (amounts including VAT) :

Statutory audit of the Company	**253**	180
Statutory audit of the subsidiary	**9**	8
Non audit related services – tax compliance	**20**	36
Non audit related services (other)	**10**	69
	292	293

Other operating expenses are further analysed below :

Subscriptions and publications	**155**	73
Directors fees	**186**	137
Recruitment	**371**	349
Training	**200**	129
Travel and entertaining	**161**	135
Strategy initiatives	**1,994**	-
Miscellaneous	**217**	94
Other operating expenses	**228**	275
	3,512	1,192

13 Provisions for impairment of loans and advances

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

	2016			2015
	£000	£000	£000	£000
	Individual impairment	Collective impairment	Total	Total
1 January	**3,850**	**2,359**	**6,209**	11,768
Applied in writing off impaired loans and advances	**(935)**	**-**	**(935)**	(4,871)
Credit for the period	**(699)**	**(199)**	**(898)**	(688)
31 December	**2,216**	**2,160**	**4,376**	6,209

14 Taxation

	2016	2015
	£000	£000
UK corporation tax		
Charge for the year	**1,105**	621
	1,105	621
Deferred tax		
(Credit) / Charge for the year	**(197)**	372
Adjustments in respect of prior years	**-**	(14)
Deferred tax (credit) / charge for the year	**(197)**	358
Tax charge for the year	**908**	979

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 20% (2015: 20.25%) is presented below:

(Loss)/Profit before tax	**(8,112)**	4,583
Tax calculated at 20% (2015: 20.25%)	**(1,623)**	928
Tax effect of:		
Expenses not deductible for tax purposes	**2,519**	63
Tax rate change	**12**	2
Adjustment in respect of prior years – deferred tax	**-**	(14)
Tax charge for the year	**908**	979

The net deferred tax asset/(liability) arises from:

Difference between capital allowances and depreciation	**179**	112
Property revaluation	**(1,125)**	(324)
Other provisions	**130**	-
Net deferred tax liability	**(816)**	(212)

The movement in the net deferred tax (liability) / asset is set out below:

1 January	**(212)**	146
Revaluation of properties	**(801)**	-
Deferred tax recognised in the income statement	**197**	(358)
31 December	**(816)**	(212)

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

Difference between capital allowances and depreciation	**70**	33
Tax losses brought forward and utilised	**-**	(353)
Other temporary differences	**139**	(50)
Change in tax rates	**(12)**	(2)
Adjustment in respect of prior years	**-**	14
Deferred tax (credit) / charge for the year	**197**	(358)

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

15 Cash, balances with central banks and placements with banks

	2016	*2015*
	£000	*£000*
Cash	**330**	189
Balances with the Bank of England	**204,732**	228,669
	205,062	228,858
Placements with related entities	**24,949**	21,127
Placements with banks	**67,948**	83,373
Cash and cash equivalents	**297,959**	333,358

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 £597,000 (2015: £339,000) 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:

	2016	*2015*
	£000	*£000*
Cash	**330**	189
Balances with the Bank of England	**204,732**	228,669
Less: Mandatory deposits with the central bank	**(597)**	(339)
Placements with related entities	**24,949**	21,127
Less: Placements by related entities	**(28,381)**	(24,216)
Placements with banks	**67,948**	83,373
Less: Amounts due to banks	**-**	(7)
Cash and cash equivalents per the Statement of cash flows	**268,981**	308,796

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:

	2016	*2015*
	£000	*£000*
Gains from change in fair value of trading derivatives	**72**	82
(Losses)/Gains from change in fair value of hedging instruments	**(105)**	286
Gains/(Losses) from change in fair value of hedged items	**101**	(159)
	68	209

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.

	2016			*2015*		
	Notional amount	***Fair value***		*Notional amount*	*Fair value*	
		Assets	***Liabilities***		*Assets*	*Liabilities*
	£000	***£000***	***£000***	*£000*	*£000*	*£000*
Interest rate related contracts						
Swaps	**162,822**	**69**	**(106)**	-	-	-
Collar	**-**	**-**	**-**	2,414	-	(34)
Spot foreign exchange rate contracts	**138**	**1**	**-**	62	1	-
Total derivative contracts	**162,960**	**70**	**(106)**	2,476	1	(34)

17 Loans and advances to customers

	2016			2015		
	Loans	**Overdrafts**	**Total**	Loans	Overdrafts	Total
	£000	**£000**	**£000**	£000	£000	£000
Gross loans and advances	**1,074,513**	**13,785**	**1,088,298**	811,642	15,374	827,016
Provisions for impairment of loans and advances	**(4,192)**	**(184)**	**(4,376)**	(5,906)	(303)	(6,209)
	1,070,321	**13,601**	**1,083,922**	805,736	15,071	820,807

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

Neither past due nor impaired	**1,051,663**	**13,220**	**1,064,883**	782,880	14,702	797,582
Past due but not impaired	**17,886**	**444**	**18,330**	19,252	446	19,698
Impaired	**4,964**	**121**	**5,085**	9,510	226	9,736
	1,074,513	**13,785**	**1,088,298**	811,642	15,374	827,016

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

Up to 30 days	**10,677**	**141**	**10,818**	8,242	16	8,258
31 to 90 days	**276**	**35**	**311**	2,735	33	2,768
91 to 180 days	**2,746**	**6**	**2,752**	1,500	58	1,558
181 to 365 days	**541**	**5**	**546**	647	2	649
Over one year	**3,646**	**257**	**3,903**	6,128	337	6,465
	17,886	**444**	**18,330**	19,252	446	19,698

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 2016 the Company has pre-positioned £209.7m of loans and advances to customers with the FLS, which are available for use as collateral for the Company's participation in the scheme (2015:£nil).

18 Other assets

	2016	2015
	£000	£000
Debtors	**356**	273
Prepaid expenses	**1,141**	803
Balance on account with payment service provider	**1,625**	1,395
Other	**289**	9
	3,411	2,480

19 Intangible assets

	2016	2015
	£000	£000
Computer software		
Cost at 1 January	**5,011**	4,648
Additions	**657**	363
Cost at 31 December	**5,668**	5,011
Accumulated amortisation at 1 January	**(4,371)**	(3,965)
Amortisation charge for the year	**(457)**	(406)
Accumulated amortisation at 31 December	**(4,828)**	(4,371)
Net book value at 31 December	**840**	640

20 Property and equipment

	2016					2015
	Freehold property	Leasehold property	Computer equipment	Furniture & equipment	Total	Total
	£000	£000	£000	£000	£000	£000
Cost or valuation at 1 January	**9,336**	**385**	**3,075**	**7,744**	**20,540**	20,362
Revaluation	**5692**	**166**	**-**	**-**	**5858**	-
Additions	**-**	**-**	**306**	**72**	**378**	178
Cost or valuation at 31 December	**15,028**	**551**	**3,381**	**7,816**	**26,776**	20,540
Accumulated depreciation at 1 January	**(585)**	**(39)**	**(2,645)**	**(6,093)**	**(9,362)**	(8,277)
Depreciation charge for the year	**(207)**	**(12)**	**(197)**	**(553)**	**(969)**	(1,085)
Accumulated depreciation at 31 December	**(792)**	**(51)**	**(2,842)**	**(6,646)**	**(10,331)**	(9,362)
Net book value at 31 December	**14,236**	**500**	**539**	**1,170**	**16,445**	11,178

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. Based on their assessment for the current year, Management 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 has been accounted for as per the provisions of IAS 16, as outlined in the relevant accounting policy. This has resulted in an increase in the current value of its property. The valuations were carried out by independent qualified valuers, on the basis of market value using observable prices and recent market transactions in accordance with guidance published by the Royal Institution of Chartered Surveyors (level 2 of the fair value hierarchy). The movement in the revaluation reserve is shown in the statement of other comprehensive income and the statement of changes in equity.

The net book value of freehold property and leasehold property, on a cost less accumulated depreciation basis, as at 31 December 2016 would have amounted to £5,158,333 and £257,500, respectively (2015: £5,294,300 for freehold property and £263,833 for leasehold property).

21 Customer deposits

	2016	*2015*
	£000	*£000*
Customer deposits by category		
Demand	**335,608**	291,157
Notice	**118,427**	119,754
Term	**803,368**	627,437
	1,257,403	1,038,348
Customer deposits by geographical area		
United Kingdom	**877,005**	667,400
Cyprus	**290,121**	271,337
Greece	**64,866**	64,051
Other countries	**25,411**	35,560
	1,257,403	1,038,348

Customer deposits include cash collateral of £4,390,750 against advances as at 31 December 2016 (2015: £4,967,000).

22 Provision for customer redress

In October 2016 after a review of an issue which has been a source of complaints and litigation against the Bank, and following a clarification of the legal situation in an Appeal Court Decision in June 2016 (*Alexander vs West Bromwich*), the Bank concluded that in 2008/2009 the manner in which we re-priced a group of loans breached an FCA conduct principle and the matter was notified to the FCA. Remediation principles were agreed and as a result a Provision for £14.9m was established for the year ended 2016. This amount is dependent on the response rates to an "invitation complaint". As the remediation progresses we will carefully monitor the actual response rate against our assumptions.

The determination of the conduct and legal risk provision involves a degree of estimates and management judgment to determine the appropriate assumptions. Key assumptions include consulting and operational costs, customers' response rate, level of complaints, FOS referral and uphold rates. This provision constitutes one of the Company's critical accounting estimates in note 4.

The assumptions are subjective, in particular due to uncertainty associated with future claims levels. The resulting provision represents the best estimate of all probable outflows arising from customer redress based on information available to management. However, this is at the early stage of its lifecycle and consequently elements affecting the potential exposure are contingent. Management will continue to reassess the adequacy of provisions for these matters, as well as the assumptions and underlying the calculations at each reporting date based upon experience and other relevant factors prevailing at that time. As such, it is possible that the eventual outcome may differ materially from the current estimate and if this were to be, an adjustment to the provision could be required.

	Litigation	**Redress provision**	**Total**
	£000	*£000*	***£000***
At 1 January 2015	623	-	**623**
Arising during the year	-	-	**-**
Utilised	-	-	**-**
At 31 December 2015	623	-	623
Arising during the year	-	14,910	**14,910**
Utilised	(623)	-	**(623)**
At 31 December 2016	**-**	**14,910**	**14,910**

23 Other liabilities

Trade creditors	**3,149**	2,090
Financial Services Compensation Scheme levy (note 25)	**269**	300
Interest rate swaps (held for trading)	**106**	34
Items in the course of settlement	**980**	2,163
Tax deduction scheme for interest	**-**	235
Deferred tax liability (note 13)	**816**	212
Tax payable (note 13)	**316**	213
Provision for customer redress (note 22)	**14,910**	623
Other	**729**	540
	21,275	6,410

24 Subordinated loan

Unsecured subordinated loan	**30,061**	30,062

The unsecured subordinated loan is due to the Parent. Interest on the loan is payable at 7% above the sterling 3 month London Interbank Offered Rate. The loan has no maturity date, and is repayable at the option of the Company at any time after 22 June 2017, subject to the prior consent of the PRA. The loan is subordinated to the claims of other creditors and is unsecured.

The loan has been converted into share capital in May 2017. At 30M shares of £1 each resulting in total additional share capital of £30M, with the relevant prior consent of the PRA.

25 Share capital

	2016		*2015*	
	Number of shares	***£000***	*Number of shares*	*£000*
Issued and fully paid				
Ordinary shares of £1 each	**65,000,000**	**65,000**	65,000,000	65,000

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

26 Contingent liabilities and commitments

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

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

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

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

	2016	*2015*
	£000	*£000*
Acceptances, guarantees and cashing facilities	**1,195**	1,157
Commitments to advance	**12,823**	14,339
	14,018	15,496

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

Capital commitments

Capital commitments for the acquisition of property, equipment and intangible assets as at 31 December 2016 amount to £21,000 (2015: £151,000).

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 £269,000 as at 31 December 2016 (2015: £300,000) in respect of its estimated share of the management expenses and interest costs for the 2016/17. The accrual is based on the Bank's estimated share of total market protected deposits at 31 December 2015.

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 & 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.

		2016		*2015*	
	Notes	***Carrying value***	***Fair value***	*Carrying value*	*Fair value*
		£000	***£000***	*£000*	*£000*
Financial assets					
Cash and balances with central banks	(a)	**205,062**	**205,062**	228,858	228,858
Placements with banks	(b)	**67,948**	**67,948**	83,373	83,373
Placements with related entities	(b)	**24,949**	**24,949**	21,127	21,127
Loans and advances to customers	(c)	**1,083,922**	**1,083,922**	820,807	795,730
Financial liabilities					
Amounts due to banks	(b)	**-**	**-**	7	7
Amounts due to related entities	(b)	**28,381**	**28,381**	24,216	24,216
Customer deposits	(d)	**1,257,403**	**1,256,456**	1,038,348	1,037,302
Derivative financial liabilities	(e)	**106**	**106**	34	34
Subordinated loan	(f)	**30,061**	**30,061**	30,062	30,062

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 rate 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 rate. 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 reprices in response to changes in market rates so 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 2016	***Level 1***	***Level 2***	***Level 3***	***Total fair value***
	£000	***£000***	***£000***	***£000***
Derivative financial assets	**-**	**70**	**-**	**70**
Derivative financial liabilities	**-**	**(106)**	**-**	**(106)**

31 December 2015	*Level 1*	*Level 2*	*Level 3*	*Total fair value*
	£000	*£000*	*£000*	*£000*
Derivative financial assets	-	1	-	1
Derivative financial liabilities	-	(34)	-	(34)

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.

Loans and advances to customers are at level 3 of the fair value hierarchy. The significant unobservable inputs used in the fair value measurement of loans and advances are the risk premium. A 1% increase in the risk premium would reduce the fair value of loans and advances by £28.3m (2015: £21.2m).

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 2016 was 1,241%, and is in excess of the current minimum requirement of 80% 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 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**	**-**	**-**	**-**	**-**

31 December 2015	*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	228,858	228,519	-	339	-	-
Placements with banks	83,373	83,373	-	-	-	-
Placements with related entities	21,127	5	21,122	-	-	-
Investment in subsidiary	400	-	-	-	-	400
Loans and advances to customers	820,807	24,415	40,803	78,410	340,929	336,250
Property and equipment	11,178	-	-	-	-	11,178
Intangible assets	640	-	-	-	-	640
Other assets	2,480	-	-	2,480	-	-
Total assets	1,168,863	336,312	61,925	81,229	340,929	348,468
Liabilities and equity:						
Amounts due to banks	7	7	-	-	-	-
Amounts due to related entities	24,216	2,727	-	21,089	-	400
Customer deposits	1,038,348	291,157	210,701	381,324	155,166	-
Other liabilities	6,410	-	-	6,410	-	-
Subordinated loan	30,062	62	-	-	-	30,000
Total liabilities	1,099,043	293,953	210,701	408,823	155,166	30,400
Total equity	69,820	-	-	-	-	69,820
Total liabilities and equity	1,168,863	293,953	210,701	408,823	155,166	100,220
Acceptances and guarantees	1,157	1,157				

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

	2016					2015				
	Demand	**Up to 3 months**	**3 months to 1 year**	**1 year to 5 years**	**Over 5 years**	Demand	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years
	£000	**£000**	**£000**	**£000**	**£000**	£000	£000	£000	£000	£000
Amounts due to banks	**-**	**-**	**-**	**-**	**-**	7	-	-	-	-
Amounts due to related entities	**3,295**	**-**	**24,762**	**-**	**400**	2,726	-	21,154	-	400
Customer deposits	**336,391**	**256,536**	**408,154**	**268,083**	**-**	296,185	205,843	385,390	160,552	-
Subordinated loan	**61**	**-**	**-**	**8,166**	**30,000**	62	-	-	8,726	30,000

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

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:

	2016			2015		
	Loans	**Overdrafts**	**Total**	Loans	Overdrafts	Total
	£000	**£000**	**£000**	£000	£000	£000
Individually impaired	**4,965**	**121**	**5,086**	9,510	226	9,736
Allowance for impairment	**(2,103)**	**(113)**	**(2,216)**	(3,648)	(202)	(3,850)
	2,862	**8**	**2,870**	5,862	24	5,886
Non impaired recoveries and watch list						
High risk	**7,817**	**236**	**8,053**	10,517	372	10,889
Medium risk	**3,750**	**57**	**3,807**	8,189	120	8,309
Substandard advances	**11,567**	**293**	**11,860**	18,706	492	19,198
Other advances	**1,057,981**	**13,371**	**1,071,352**	783,426	14,656	798,082
Allowance for collective impairment	**(2,089)**	**(71)**	**(2,160)**	(2,258)	(101)	(2,359)
Carrying amount	**1,070,321**	**13,601**	**1,083,922**	805,736	15,071	820,807

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

	2016	2015
	£000	£000
Business sector		
Property investment	**849,821**	619,892
Property development	**49,068**	38,526
Hotels, catering and leisure	**100,705**	75,480
Manufacturing	**6,063**	6,805

Retail and wholesale	**12,082**	12,488
Other business sectors	**44,635**	46,349
Personal sector	**25,924**	27,476
	1,088,298	827,016
Allowance for impairment	**(4,376)**	(6,209)
Carrying amount	**1,083,922**	820,807

The amount of loans and advances subject to forbearance is analysed below. Forbearance means the active agreement by the bank 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 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 extension for interest only loans	**-**	**-**	**-**	**-**
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**

31 December 2015	*Total*	*Neither past due nor impaired*	*Past due but not impaired*	*Impaired*
	£000	*£000*	*£000*	*£000*
Temporary conversions from repayment to interest only	2,489	921	1,190	378
Term extension for interest only loans	874	-	17	857
Term extensions for capital repayment	2,214	1,766	448	-
Payment holidays	37	-	37	-
Amortisation profile change	2,467	-	340	2,127
Refinance	493	253	-	240
Others	17	-	-	17
	8,591	2,940	2,032	3,619

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 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**

31 December 2015	*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	228,669	-	-	-	228,669
Placements with banks	83,373	-	-	-	83,373
Placements with related entities	21,127	21,090	-	21,090	37
Loans and advances to customers	820,807	4,485	2,010,412	812,776	8,031
Other assets	2,480	-	-	-	2,480
On-balance sheet total	1,156,456	25,575	2,010,412	833,866	322,590
Contingent liabilities:					
Acceptances, guarantees and cashing facilities	1,157	45	6,793	1,157	-
Commitments to advance	14,339	78	35,121	14,199	140
Off-balance sheet total	15,496	123	41,914	15,356	140
Total credit risk exposure	1,171,952	25,698	2,052,326	849,222	322,730

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 repricing date of assets and liabilities is as follows:

31 December 2016	***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	**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)**

31 December 2015					
Assets:					
Cash and bank advances	312,231	1,326	310,566	339	-
Placements with related entities	21,127	105	21,022	-	-
Investment in subsidiary	400	400	-	-	-
Loans and advances to customers	820,807	-	812,272	-	8,535
Fixed assets	11,818	11,818	-	-	-
Other assets	2,480	-	-	2,480	-
Total assets	1,168,863	13,649	1,143,860	2,819	8,535
Liabilities:					
Amounts due to banks	7	7	-	-	-
Amounts due to related entities	24,216	52	24,164	-	-
Customer deposits	1,038,348	151,030	357,166	376,563	153,589
Other liabilities	6,410	-	-	6,410	-
Subordinated loan	30,062	62	30,000	-	-
Total liabilities	1,099,043	151,151	411,330	382,973	153,589
Derivatives	-	-	-	-	-
Interest rate gap	69,820	(137,502)	732,530	(380,154)	(145,054)

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:

	2016	*2015*
	£000	*£000*
Increase of 1%	**8,280**	6,708
Decrease of 1%	**(1,902)**	(2,949)

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.

	2016			*2015*		
	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	**67,948**	**-**	**67,948**	83,373	7	83,366
Placements with related entities	**24,949**	**24,949**	**-**	21,127	21,127	-
Loans and advances to customers	**1,083,922**	**62,505**	**1,021,417**	820,807	38,507	782,300
Financial liabilities						
Amounts due to banks	**-**	**-**	**-**	7	7	-
Amounts due to related entities	**28,381**	**24,949**	**3,432**	24,216	21,127	3,089
Customer deposits	**1,257,403**	**62,505**	**1,194,898**	1,038,348	38,507	999,841

Conduct risk

Conduct risk is related to the risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.

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.

At the end of 2016 the Company has booked a conduct risk and legal provision for £14.9m to cover a customer redress exercise that will be enacted in the course of 2017.

29 Investment in subsidiary

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

Composition of regulatory capital and ratios (Unaudited)

	2016	*2015*
	£000	*£000*
Core Tier 1		
Shareholders' equity	**65,857**	69,820
Core Tier 1 deduction: Intangible assets	**(840)**	(640)
	65,017	69,180
Qualifying Tier 2 capital		
Undated subordinated loan	**30,000**	30,000
Collective provisions	**2,160**	2,359
	97,177	101,539
Deductions from the totals of Tier 1 and Tier 2		
Investment in subsidiary	**(400)**	(400)
Total regulatory capital	**96,777**	101,139
Tier 1 ratio %	**12.1%**	16.6%
Total capital ratio %	**18.2%**	24.4%
Leverage ratio	**4.7%**	6.0%

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

Changes to the Company's capital after the year end are disclosed in note 25.

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, which advises on and sells life assurance and other protection products.

During 2016, the following transactions entered into with the Parent by the Company remained in force:

- An unsecured subordinated loan agreement dated 20 June 2012 for £30m. The interest rate under this agreement is set at 7% above the sterling 3 month London Interbank Offered Rate, and interest is payable annually. At 31 December 2016 the outstanding balance was £30m and there was accrued interest of £61,000 (2015: £62,000). The loan has no maturity date, and is repayable at the option of the Company at any time after 22 June 2017.

- A deposit agreement dated 4 July 2012 under which either party may deposit an amount with the other party up to a maximum of £45m. The total deposits of each party are to equal the total deposits of the other party within a tolerance of 2%. The deposits of the Parent with the Company are subject to a withdrawal notice of 100 days. At 31 December 2016 the Company's deposits with the Parent totalled £24,820,000 (2015: £21,018,000) and there was accrued interest on them of £124,000 (2015: £104,000). The Parent's deposits with the Company at the same date totalled £24,629,000 (2015: £21,038,000) and there was accrued interest of £56,000 (2015: £52,000). 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 2016 (£5,000 at 31 December 2015).

- Vostro accounts held by the Parent with the Company with a total credit balance of £2,883,000 at 31 December 2016 (£1,161,000 at 31 December 2015).

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 £2.8m as at 31 December 2016 on the Parents behalf. During the year fees of £64,000 were charged to the Parent and £341,000 of the company's own costs were recharged to the Parent.

During 2016, the Company levied a management charge of £107,000 (2015: £134,000) on its subsidiary, BOCFS, for the provision of staff and other support services. At 31 December 2016 there was an interest-free debt of £400,000 to BOCFS (2015: £400,000).

During 2016, 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 £412,000 at 31 December 2016 (2015: £1,565,000).

Placements with and by related entities were as follows:

	2016	*2015*
	£000	*£000*
Placements with related entities		
Balance under deposit agreement of 4 July 2012 including accrued interest	**24,944**	21,122
Credit balances on nostro accounts	**5**	5
	24,949	21,127
Placements by related entities		
Balance under deposit agreement of 4 July 2012 including accrued interest	**24,686**	21,090
Credit balances on vostro accounts held by Parent	**2,883**	1,161
Credit balance on vostro account held by Bank of Cyprus Channel Islands Limited (in liquidation)	**412**	1,565
Balance owed to BOCFS	**400**	400
	28,381	24,216

The Company made contributions to an employee savings plan during the year ended 31 December 2016 totalling £290,403 (2015: £289,000). The contributions are held as a deposit in the Company.

The total personnel compensation of key management personnel paid by or on behalf of the Company was as set out below. Key management personnel are defined as persons who are or have been members of the board or the Executive Committee of the Company during 2016.

	2016	*2015*
	£000	*£000*
Directors' emoluments	**748**	507
Short-term employee benefits of key management personnel	**605**	301
Termination payments	**-**	433

The total remuneration of the highest paid director was £283,333 (2015: £193,000). The amount of pension contributions paid by the Company to the pension scheme on behalf of the highest paid director was £24,468 (2015: £46,000).

Directors, key management personnel and their connected persons as of 31 December 2016 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 2016	**4**	**9**
Net movements in the year	**(3)**	**(8)**
31 December 2016	**1**	**1**
Deposit accounts and current account credit balances		
1 January 2016	**7**	**760**
Net movements in the year	**(4)**	**(163)**
31 December 2016	**3**	**597**

32 Events after the reporting date

New ultimate holding company

Following a group restructuring and the relevant court and regulatory approvals, Bank of Cyprus Holdings Public Limited Company, which was incorporated in the Republic of Ireland on 16 July 2016, became the ultimate holding company of the Bank of Cyprus group and the Company. On 19 January 2017, Bank of Cyprus Holdings Public Limited Company's total share capital was admitted to the standard listing segment of the official list of the United Kingdom's Financial Conduct Authority, to trading on the Main Market of listed securities of the London Stock Exchange (LSE), and to trading on the Main Market of the Cyprus Stock Exchange (CSE).

Issue of share capital

In May 2017, the Company issued £16M share capital to its immediate parent, Bank of Cyprus Public Company Limited, Refer to note 25 for further information.

Conversion of subordinated loan to share capital

In May 2017, following a decision by the Board of Directors and the relevant regulatory approval, the unsecured subordinated loan due to the parent was converted into share capital, Refer to note 24 for further information.

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*Calls may be recorded for monitoring and training

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