



USB BANK PLC

Pillar 3 disclosures for the year ended 31 December 2009

May 2010

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1. Introduction

The principal activity of USB BANK PLC (the ‘Bank’) is the provision of banking and financial services in Cyprus through the operation of 19 branches. The activities of the Bank are mainly focused on three large business areas: Retail Banking, Corporate Banking and International Banking.

This report has been prepared pursuant to paragraph 70(1) of Chapter 5 of Unit A (the “Disclosures”) of the Directive to banks for the calculation of the capital requirements and large exposures of banks of 2006 and 2007 (‘the Directive’) issued by the CBC. The Directive implements the European Union’s Capital Requirements Directive (‘CRD’).

The Directive describes the Basel II framework which is based on three pillars:

- Pillar 1 has to do with the standards that set out the minimum regulatory capital requirements that are required for credit, market and operational risk
- Pillar 2 covers the Supervisory Review Process which assesses the internal capital adequacy processes. Banks and Supervisors have to evaluate and assess whether a bank should hold additional capital against risks not covered in Pillar 1
- Pillar 3 (Market discipline) covers transparency and the obligation of banks to disclose meaningful information to the market related to their risks, capital and generally risk management.

The Bank’s Disclosures below have been prepared using 31 December 2009 data in accordance with the Directive.

Although the Bank has one subsidiary, this is not consolidated for accounting purposes in the financial statements of the Bank on the grounds of materiality. This subsidiary has also been excluded from the capital adequacy calculation and consequently from the Disclosures.

2. Risk Management Objectives and Policies

Risk taking constitutes a major characteristic of the business of the Bank, and the development of a robust risk management framework is considered of high importance. The Bank believes and supports the functioning of this framework in the promotion of a risk management culture within the Bank to enable the detection of developments in the internal and external environment which may endanger the institution, as early as possible, in order to facilitate activation of mitigating actions. The identification and classification of risks begins from the definition of the vision and business objectives, which clearly provide guidance and direction, defining the approach that the Bank adopts in order to successfully confront and respond to different risks inherent in its operations and functions.

2.1 Risk Management Framework

The Bank's Board of Directors (BoD), which has the ultimate responsibility for the risk management framework, has delegated the responsibility for the implementation of the approved risk strategy and objectives in a uniform manner throughout the Bank. The responsibility of the day-to-day management of risk is delegated to the different executive managers of the Bank depending on the risk type, e.g. Market Risk, Interest Rate Risk Banking Book (IRRBB) and Liquidity Risk to the Manager Treasury, Planning and Products Development, Credit Risk to the Risk Manager and Operational Risk (Business Continuity and Disaster Recovery, Human Resource issues, Information Technology (IT) security, Legal issues) to the Chief Financial Officer and Chief Operations Officer (CFO & COO).

The Risk Management Unit (RMU), established in August 2009, reports to the Managing Director and the BoD through the Risk Management Committee (RMC). It is subject to audit control by the Internal Audit Unit (IAU) in relation to the adequacy and efficiency of risk management procedures. The RMU is currently made up of three people, which are allocated to the different sub units. Currently there are two employees allocated to the Credit Risk Management and one employee to the Operational and Market Risk Management, who is however dealing with credit risk management issues as well.

The main task of the RMC is to assist the BoD in establishing a policy for handling risks and managing funds that reflect the business goals of the Bank. The RMC comprises of five members of whom three are non-independent non-executive directors, one executive director and one independent non-executive director.

The Bank's credit risk framework has been finalized and approved by the RMC in 2010. The operational and market risk frameworks are currently in draft form and will be adopted by the BoD once they are finalized. These frameworks are based on a set of principles, developed in cooperation with external advisors. These principles are dynamically evolving and reviewed to be compliant and consistent with the changing internal and external environment of the Bank. The set of basic principles that govern the Bank's risk management are:

1. BoD and Senior Management Responsibility: Overall risk management policies and tolerances are set on a comprehensive basis by senior management, reviewed and finally approved by the BoD. Policies and tolerances addressing risk identification, measurement, monitoring and control are communicated to all relevant bank officers.

2. Framework for managing risk: An overall framework for the management of each of credit, market and operational risks will be developed and approved by the BoD. As mentioned above, the Bank's credit risk framework has been finalized and approved by the RMC in 2010. The operational and market risk frameworks are currently in a draft form and will be adopted by the BoD once they are finalized.

3. Integration of risk management: Risks are evaluated both in isolation and in aggregate. The required analysis for the aggregation of risks is carried out on an entity-wide basis.

4. Business Line Accountability: Business lines are accountable for managing the risks associated with their activities and establish tolerances for taking these risks. The accountability exists notwithstanding the presence of any support functions dedicated to risk management activities.

5. Risk evaluation/measurement: All risks are qualitatively evaluated and wherever practical, the evaluation includes quantitative analysis. Risk assessment considers both the effects of likely and unlikely events.

6. Independent review: Risk evaluations are validated by the RMU and the IAU that have the necessary expertise to assess the risks, test the effectiveness of risk management activities and make recommendations for remedy.

2.2 Risk Management Process

Risk appetite is the amount of risk that the Bank is prepared to accept, tolerate, or be exposed to at any point in time and is set by the BoD and implemented and monitored by the Senior Executive Management. The Bank sets its risk appetite specifically for each risk type through policies, controls and procedures that are established and communicated throughout the organization. These procedures suggest the level of risk that each manager is allowed to take, which in turn gives guidance on the risks that the Bank can assume in order to maximize its performance always considering the following:

- The risk strategy and policy of the Bank.
- The risks that are the product of the implementation of the business plan of the Bank.
- The level of the minimum required regulatory capital.

2.3 Credit Risk Management

Credit Risk in USB Bank is defined as the risk of financial loss arising from the default of a customer or counterparty to which the Bank has directly provided credit, or for which the Bank has assumed a financial obligation. The definition includes Residual Value Risk, Concentration Risk, Counterparty Risk, Country Risk, Documentation Risk, Collateral Risk, Cyclicity and Economic Risks.

Credit Risk Management Framework

The BoD is responsible to set the strategy for credit risk management. It is responsible to give a clear definition of credit risk and its management framework. The BoD approves and reviews the overall credit risk management on a regular basis and makes changes whenever necessary.

Senior management has the responsibility for setting and implementing the overall credit risk management policies and tolerances, which are reviewed and approved by the BoD. The framework is consistently implemented throughout the organisation, and the set policies and procedures are communicated to all staff.

Two members of staff are employed in the Credit Risk Management Division. Their responsibilities include:

- Calculation of credit risk capital requirements for Pillar I and COREP submission.
- Identification & assessment of credit risk under Pillar II.
- Assessment of credit granting.
- Preparation of circulars and guidance to credit officers.
- Set up of limits in lending and write-offs.
- Assesses the entrance to new markets and products.
- Assist in the preparation of the information required for Pillar III reporting.
- Reporting to CBC and senior management.

IAU has the responsibility of assessing the robustness of the credit risk framework. The Bank has a simple client rating system, based on the clients' performance, according to which the clients are allocated to one of the five risk grade categories:

1. "1" (Outstanding facilities): Client facilities that do not exhibit any negative indicators.
2. "2" (Satisfactory facilities): Client facilities that even though are not yet problematic, they are in need of monitoring for avoiding possible future problems.
3. "3" (Attention required): Client facilities that are problematic but at the current stage there are no doubts raised as to their collection by the Bank. As a result there is possibility for improvement and repayment of the debt after close handling and monitoring from the Bank.
4. "4" (Problematic facilities): Client facilities with long term difficulties and problems having as a result the possibility of default. The attempts from the Bank for settlement or coverage of the irregularity by the customer have not yet resulted in the desired outcome but no legal measures have been taken.
5. "5" (Doubtful loan repayment): Clients for which legal action has already been initiated by the Bank. For such clients, provisions have been made by the Bank.

The approval and monitoring stages are carried out following the guidelines set by senior management. Segregation of duties exists between credit origination, approval and implementation/monitoring. In addition, individuals responsible for credit administration such as custody of documents, wiring of funds and entering limits in the IT systems, are independent from the credit origination function.

Credit Risk Mitigation

The Bank has a strict credit risk mitigation framework. In accordance with this framework, the Bank in order to assume credit risk needs to obtain adequate collateral. The following assets have been approved to be accepted by the Bank as collateral:

- Cash pledged within the Bank
- Land and Buildings
- Shares either listed or non-listed in a recognized stock exchange

- Bonds/Development Stock either listed or non-listed in a recognized stock exchange
- Assignment of life insurance
- Import Letters of Credit
- Fixed and floating charges on assets
- Guarantees (personal, bank, corporate, sovereign)
- Pledge of insurance policies
- Goods in bonded warehouses

The Bank requires collateral at a value that is initially adequate to provide sufficient cushion against decline in collateral value. Periodic reviews are performed to assess whether the Loan to Value ratio remains at acceptable levels. The Bank has also designed a system for early remedial action on deteriorating credits, managing problematic credits and similar workout situations. A reduction in credit quality should be recognized at an early stage when there may be more options available for improving the credit. The main steps that are followed to monitor amounts in arrears and excesses are the following:

- Regular checking and monitoring of customers' arrears and excesses by credit manager.
- Contacting the client i.e. telephone contacts.
- Meeting with clients.
- Keeping records of agreements with clients for follow up purposes.
- Sending notification letters to the client and to its guarantors.
- Restructuring and obtaining additional collateral.
- Send the client to the Recoveries department if no improvement is made, to initiate legal action.

Credit Risk Limits

The BoD has set-up prudent lending approval limits for credit facilities.

The Bank follows the CBC's directives and limits regarding loans to customers.

The Bank also has controls in place relating to Treasury instruments and counterparties. These controls are clearly defined and documented and relate to:

- The external credit rating of the obligor
- The currency and settlement of the transaction
- The origin of the counterparty

Monitoring and Measurement of Credit Risk

Monitoring of credit risk is done through the following:

- Regular credit reviews are performed by the IAU. At least 70% of the value of the portfolio is reviewed every 18 months (or when deemed necessary).
- Assignment of credit ratings.

- Daily monitoring of counterparty’s account movement and repayment.
- Revaluation of collaterals received and especially real estate property (approximately every 1-2 years).
- A detailed provision review is carried out on a quarterly basis.
- Credit risk capital requirement is calculated on a quarterly basis using the Standardised approach to satisfy Pillar I of Basel II regulations.
- Additional capital is kept aside based on stress tests performed on a yearly basis to satisfy Pillar II of Basel II regulations. The results are reviewed by senior management and appropriate action is taken when necessary.

The concentration risk of the Bank is regularly monitored and more specifically the concentration to specific economic sectors and the collateral risk i.e. pledge of shares. These economic sectors are internally defined and they relate to industries. These sectors are trade and manufacturing, tourism, financial services, governments and local authorities, property and construction, personal and professional and other.

Almost all of the Bank’s loans are granted to customers located in Cyprus, therefore the geographic concentration of credit risk relates to Cyprus only.

2.4 Operational Risk

The Bank defines operational risk as the risk of possible loss arising from problematic internal procedures and systems, human behavior or external factors.

Management Framework

The BoD is aware of the major aspects of the Bank’s operational risks as a distinct risk category that should be managed. The BoD assigns to the RMC of the Bank the responsibility of overseeing the operational risk profile of the Bank. Senior management has the responsibility for implementing the operational risk management framework and ensures that the Bank’s operational risk management policy has been clearly communicated to staff at all levels and units that incur material operational risks. The responsibility for the day to day management of operational risk in relation to Business Continuity and Disaster Recovery, HR issues, IT security and legal issues lies with the CFO, the Banking Operations Manager and the IT Manager. Also the responsibility for the identification and monitoring of the specific operational risks falls on all the departments and units of the Bank.

Within 2009, as provided by the new organizational structure, the Bank has assigned one employee to the Operational and Market Risk Management, who is however dealing with credit risk management issues as well.

The IAU has the responsibility of assessing the robustness of the operational risk framework.

Reporting

The Bank has designed a reporting process that has not yet been implemented, to ensure the effective management of the operational risk. This process is expected to be approved by the BoD and will be implemented in the near future by the Operational Risk Management Division. The information to be reported under this new reporting process will include:

- Critical operational risks faced by the Bank
- Risk events and issues together with remedial actions
- Effectiveness of actions taken
- Status of steps taken to address operational risks

The Business units will report periodically to the RMU on risks relating to their business i.e. actual losses, self assessment, etc. The RMU will in turn report periodically to the RMC on such risks. In addition, the RMU will also inform the BoD on key operational risks inherent in key decisions.

The Bank aims at improving the management framework for operational risk. As mentioned earlier the Bank has carried out a project, in cooperation with external advisors, on the improvement of its risk management framework and it is in the process of assessing the findings of the report.

Control and Measurement

The Bank has a specific internal policy on limiting operational risk exposure. Specifically, the Bank has in place:

- Specific procedures and processes for IT system failure times as part of its business continuity and disaster recovery policy.
- Data backup procedures that prohibit the loss of client data.
- Data protection schemes e.g. specific software on encryption of private data.
- Insurance on Bank property.

The IAU is responsible for identifying specific deviations from the operational risk policy set by the Bank as well as losses arising from operational risk events.

The Bank uses the Basic Indicator Approach for calculating the capital requirements for operational risk.

2.5 Market Risk

The Bank defines Market Risk as the risk of loss arising from adverse movements in interest rates, exchange rates, equity shares and other security prices.

Interest rate risk arises when there is a mismatch between positions, which are subject to interest rate adjustments within a specified period.

Foreign exchange risk arises when there are adverse exchange rate movements in the main currencies used by the Bank causing a decrease in its profitability.

Price risk is the risk of loss from unfavourable changes in the price of financial instruments held by the Bank.

During 2009, the Bank did not maintain a trading book so the market risk of the Bank is confined only in the Banking Book.

Management Framework

Organisational Structure:

The BoD is aware of the major aspects of the Bank's market risk as a distinct risk category that should be managed. The BoD approves and periodically reviews the Bank's market risk management framework. The BoD is responsible for the following:

- To delineate the overall risk tolerance in relation to market risk management.
- To ensure that the Bank's overall IRRBB exposure is maintained at prudent levels.
- To be informed periodically of the market risk exposure of the Bank.
- To review the contingency plans of the Bank for handling disruptions to its ability to fund some or all of its activities in a timely manner.
- To ensure that senior management and individuals responsible for the management of market risk possess adequate knowledge and expertise.

For the above targets, the BoD assigns to the RMC the responsibility of overseeing the market risk profile of the Bank.

Senior management has the responsibility of adopting sound policies and procedures for the management of market risk, for maintaining appropriate limits on risk taking and for maintaining effective internal controls for implementing the market risk management framework approved by the BoD.

IAU has the responsibility of assessing the robustness of the market risk framework.

The Assets and Liabilities Committee (ALCO) is responsible for setting market risk guidelines, strategy and the market risk organizational framework. ALCO comprises of the Managing Director, the Chief Financial Officer & Chief Operations Officer, the Credit Manager, the Manager of Treasury and Planning and Products Development, the Manager of Banking Services Development and the Risk Manager. ALCO discusses among other things about:

- Pricing of Deposits and Loans
- Liquidity
- Interest Rate Risk
- Treasury Limits

The RMU together with Treasury are responsible for providing monthly data to either the Managing Director directly or to the ALCO regarding the levels of market risk.

Treasury and the RMU are responsible for monitoring compliance with predefined CBC limits on an ongoing basis and for escalating any breaches to the Management.

In 2010, a member staff will be appointed to the Market Risk Division of the RMU to carry out the responsibilities set by the RMU for Market Risk.

Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. It arises as a result of timing differences on the repricing of assets and liabilities.

The Bank assesses two perspectives with relation to IRRBB:

- The earnings perspective: the focus of the analysis is on the impact of fluctuation in interest rates on reported earnings.
- Economic value perspective: it reflects the impact of fluctuation in interest rates on the economic value of the Bank. The economic value of the Bank is defined as the present value of the future cash flows.

The Bank uses repricing gap schedules to measure its IRRBB. The Bank recognises that a gap report is a static model where interest sensitive assets, interest sensitive liabilities and off balance sheet items are stratified into various time bands according to their maturity if they are fixed rates or time remaining to their next re-pricing, if floating rates. The size of the gap for a given time band gives an indication of the Bank's re-pricing risk.

The IRRBB risk is reviewed by ALCO and when considered necessary, additional capital is blocked under Pillar 2.

- In addition, the Bank measures the impact of the gap analysis on the following:
 - Net interest income: the Bank calculates the impact on profitability of a 200 basis points change in the yield curve.
 - Economic value: this is accomplished by applying sensitivity weights to each time band. Such weights are based on estimates of the duration of assets and liabilities in each time band, where duration is a measure of the % change in the economic value of a position that will occur given a change in the interest rates.

The analysis is prepared for all currencies that constitute more than 5% of the own funds of the Bank on a monthly basis by the Treasury and it is reviewed by ALCO and the RMC.

Foreign Exchange Risk

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Bank uses FX swaps and FX forward contracts for hedging foreign exchange risk. The Bank does not apply hedge accounting because there are no open positions in any currency, and consequently the impact on net profit and equity of reasonably possible changes in the exchange rates is not expected to be significant.

The Bank ensures the compliance of daily foreign exchange positions with limits originally set by the CBC (pre-Basel II implementation). Additionally ALCO has reviewed and approved limits on open positions by currency. These limits are being monitored by the Treasury. In cases of breach of limits, the Managing Director and the CBC are notified timely.

2.6 Liquidity Risk

Liquidity risk is the risk that the Bank, though solvent, either does not have available sufficient financial resources to meet its obligations as they fall due, or can only do so at excessive cost. The BoD has approved and periodically reviews the Bank's liquidity risk management framework. The framework provides a firm-wide definition of liquidity risk and lays down the principles of how liquidity risk is to be identified, assessed, monitored, and controlled/mitigated.

The BoD is responsible for the following:

- To define the Bank's strategic direction and tolerance level for liquidity risk.
- To continuously monitor the Bank's performance and overall liquidity risk profile.
- To ensure that liquidity risk is identified, measured, monitored and controlled.
- To review the contingency plans of the Bank for handling disruptions to its ability to fund some or all of its activities in a timely manner.

The BoD has delegated the responsibility for overseeing the liquidity risk profile of the Bank to the RMC. Senior management has the responsibility for implementing the liquidity risk management framework approved by the BoD. The framework is consistently implemented throughout the Bank. The Treasury and the RMU are responsible for the day-to-day management and oversight (together with the RMC) and if necessary the update of the liquidity risk management framework. ALCO reviews the liquidity position of the Bank when introducing new products or new activities.

IAU has the responsibility of assessing the robustness of the liquidity risk framework.

For the effective management of liquidity risk, the Bank has set the following limits in accordance with the relevant CBC directives:

– Protective liquidity ratio

- The ratio should always be less than -10% for 0-7 days maturities band.
- The ratio should always be less than -25% for 8-30 days maturities band.

– Concentrations

- The Bank does not accept client deposits that exceed €17 million. Higher amounts can be accepted after the approval of the CBC.

– Deposit of the Bank's funds

- The Bank should invest at least 70% of the client deposits in foreign currencies in liquid assets as defined by CBC circulars. The Bank places its funds to banks according to CBC guidelines and regulations.
- The Bank should invest at least 20% of the client deposits in EURO in liquid assets as defined by CBC circulars.

3. Own Funds

The own funds of the Bank as at 31/12/2009 were €39.246 thousand as shown below:

	€000
Original Own Funds (Tier 1)	
Share Capital	25.869
Share Premium	21.165
Reserves	(19.818)
Subordinated Loan Stock	974
Intangible Assets	(300)
Total Tier 1	27.890
Additional Own Funds (Tier 2)	
Investment Revaluation Reserve	93
Property Revaluation Reserve	3.263
Subordinated Loan Capital	8.000
Total Tier 2	11.356
Total Own Funds	39.246

3.1 Original Own Funds

Share Capital

As at 31/12/2009 the share capital of the Bank comprised of 45.384.453 shares with a nominal value of €0,57 each.

Subordinated Loan Stock

The subordinated loan stock consists of capital securities which were offered to professional investors and to a specific number of non-professional investors in Cyprus and which were issued on 30 December 2005 and have no maturity date. However, they may be redeemed in whole at the option of the Bank subject to the prior consent of the CBC, at their nominal amount together with any outstanding interest payments, five years after their issue date or on any interest payment date thereafter, and provided that they will be replaced with capital of equivalent or more senior ranking unless the CBC concludes that the Bank's capital is at a satisfactory level.

The Capital Securities bear floating interest rate, which is revised at the beginning of each period interest is charged and will be valid for that specific period. Interest rate is equal to the base rate of the Bank at the beginning of each period interest is charged plus 1,60% annually. According to the terms of issue, if the Bank does not proceed with the repurchase of Capital Securities within ten years from their issuance date (i.e. up to 31 December 2015), then from 1 January 2016, the Capital Securities will be bearing floating interest rate that will be revised at the beginning of each period in which interest will be charged and will be equal to the base rate ruling at the beginning of each period interest is charged plus 2,25% annually.

3.2 Additional Own Funds

Subordinated Loan Capital

On 30 December 2009 the Bank issued bonds amounting to €8.000.000 with a maturity date of 31 December 2019. The bonds constitute direct, unsecured, subordinated securities of the Bank and bear a fixed interest rate of 7,50% on the nominal value for the period from the issue date to 31 December 2014. From 31 December 2014 to their maturity, the bonds will bear a fixed annual interest rate of 9% on the nominal value. Excluding the first interest rate period commencing on (and including) 22 December 2009 and maturing on 30 June 2010 (not included), all subsequent interest periods will cover six months.

The Bank has the right to redeem wholly the bonds at any time before their maturity date, in cash at their nominal value, along with any accrued interest relating to the current interest rate period, on 30 June 2015, or on any following interest payment date, upon approval from the CBC.

4. Minimum Required Own Funds for Credit, Market and Operational Risk

The different methods used to assess the adequacy of the capital for the different categories of risks are described below.

4.1 Credit Risk - Standardised Approach

The following table shows 8% of the risk-weighted exposure amounts as at 31/12/2009 for each of the exposure classes specified in paragraph 23 of Unit A of the Directive.

Exposure class	€000
Central governments or central banks	-
Regional governments or local authorities	-
Administrative bodies and non-commercial undertakings	27
Institutions	1.514
Corporates	11.545
Retail	3.364
Secured by real estate property	2.101
Past due items	4.972
Short-term claims on institutions and corporate	-
Other items	629
Total	24.152

4.2 Market Risk

There were no capital requirements for market risk since the Bank does not have a trading book and the overall net foreign exchange position does not exceed 2% of its total own funds.

4.3 Operational Risk - Basic Indicator Approach

Table below shows the calculation of capital requirement for operational risk under the Basic Indicator Approach.

Gross Income (€000)			Average	Capital Requirement (Average * 15%)
2007	2008	2009		
21.665	14.951	15.717	17.444	2.617

5. Counterparty Credit Risk

As at 31 December 2009, the Bank did not have any outstanding securities or commodities lending or borrowing transactions, long settlement transactions, margin lending transactions or derivative instruments transactions.

6. Exposure to Credit Risk and Impairment

Loan Impairment

Past due loans and advances are defined as all loans and advances where the counterparty has failed to make a payment when it is contractually due. Loans and advances are considered past due from the first day of the delay of the payment due.

The Bank reviews its loan portfolio for evidence that it will not be able to collect all amounts due from an individual loan or a portfolio of homogeneous loans. Evidence includes the customer's payment record, his overall financial position and the realisable value of any collateral. If such evidence exists, the recoverable amount is estimated and a provision is made for loan impairment and is charged to the income statement.

The methodology and assumptions used for estimating the provision are reviewed regularly to reduce any differences between estimated and actual losses. In addition to the provisions on an individual basis, the Bank also makes provision for impairment of loans on a collective basis. The percentages of losses are based on estimates, historical data and management experience of the Bank.

Impairment of Available for Sale Equity Investments and Investments Held to Maturity

Available for sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of what is significant or prolonged requires judgment from the Bank. Factors taken into consideration in making this judgement include the expected volatility in the share price. In addition, impairment may be appropriate when there is evidence that significant changes with an adverse effect have taken place in the technological, market, economic or legal environment in which the investee operates.

Bonds held to maturity are impaired when there is objective evidence of impairment in one or more events that occurred after initial recognition of the investment and the loss event (or events) affects the expected future cash flows of investment. The assessment takes into account a number of factors such as the economic situation of the issuer, a breach of the terms of the contract, the likelihood of the issuer to declare bankruptcy or make a financial reorganisation, and therefore requires significant judgments.

6.1 Total Amounts of Original Exposures

The table below presents the total amount of original exposures with the off-balance sheet amounts being presented after the application of credit conversion factors but before credit risk mitigation techniques. Additionally, the table presents the average amount of exposures over the year, broken down by different types of exposure classes.

Exposure class	Original Exposure amounts 31/12/2009	Average exposure amount for 2009
	€000	€000
Central governments or central banks	101.365	90.535
Regional governments or local authorities	-	342
Administrative bodies and non-commercial undertakings	344	345
Institutions	93.802	85.307
Corporates	183.845	192.247
Retail	85.959	80.274
Secured by real estate property	66.850	60.409
Past due items	92.540	88.991
Other items	14.526	16.821
Total	639.231	615.271

6.2 Geographic Distribution of the Exposures

The table below presents the total amount of exposures broken down by significant geographical area, based on the country of residence, and material exposure class.

	Retail Customers	Corporate Customers	Financial Institutions	Governments and Local Authorities	Other	Total
	€000	€000	€000	€000	€000	€000
Cyprus	198.792	222.951	3.670	93.527	14.526	533.466
Greece	44	2.823	24.864	8.182	-	35.913
Other EU countries	3.361	823	21.290	-	-	25.474
Non-EU countries	400	-	43.978	-	-	44.378
Total	202.597	226.597	93.802	101.709	14.526	639.231

6.3 Distribution of the Exposures by Industry or Counterparty Types

The table below presents the total amount of exposures broken down by major industries and material exposure class.

	Retail Customers	Corporate Customers	Financial Institutions	Governments and Local Authorities	Other	Total
	€000	€000	€000	€000	€000	€000
Trade and manufacturing	24.387	48.056	-	-	-	72.443
Tourism	14.557	32.628	-	-	-	47.185
Financial services	-	-	93.802	-	-	93.802
Governments and Local Authorities	-	-	-	101.709	-	101.709
Property and construction	30.184	67.198	-	-	-	97.382
Personal and professional	124.093	58.176	-	-	-	182.269
Other sectors	9.376	20.539	-	-	14.526	44.441
Total	202.597	226.597	93.802	101.709	14.526	639.231

6.4 Residual Contractual Maturity Breakdown of all the Exposures

The table below presents the total amount of exposures broken down by residual contractual maturity and material exposure class.

Credit exposure by residual contractual maturity as at 31 December 2009					
	Less than 1 year	1 to 5 years	5-10 years	More than 10 years	Total
	€000	€000	€000	€000	€000
Central governments or central banks	49.187	49.515	2.663	-	101.365
Administrative bodies and non-commercial undertakings	2	-	-	342	344
Institutions	58.872	34.848	83	-	93.803
Corporates	78.938	63.619	16.517	24.771	183.845
Retail	42.119	15.982	12.290	15.568	85.959
Secured by real estate property	17.080	8.379	8.283	33.107	66.849
Past due items	50.851	1.455	12.753	27.481	92.540
Other items	14.526	-	-	-	14.526
Total	311.575	173.798	52.589	101.269	639.231

6.5 Impaired Exposures and Past Due Exposures

The table below provides an analysis of impaired exposures, past due exposures, value adjustments and provisions, and charges for value adjustments and provisions during the year 2009.

Impaired and past due loans and advances as at 31 December 2009				
	Neither past due nor impaired	Past due but not impaired	Impaired	Total
	€000	€000	€000	€000
Total	229.400	58.688	63.977	352.065

Provisions for impairment of loans and advances	
	€000
1 January 2009	44.349
Collections/reversals	(5.097)
Charge for the year	6.519
Net charge for the year	1.422
Restriction of interest on impaired loans	3.101
Write-offs	(1.692)
Prior years' suspended interest collected	(2.874)
Total	(43)
31 December 2009	44.306

7. The Standardised Approach

7.1 Exposure Classes for Which External Credit Assessment Institutions ('ECAI') or Export Credit Agencies ('ECA') are used

For the purposes of applying the Standardised Approach, the nominated External Credit Assessment Institutions (ECAI) which are recognised by the CBC are Fitch Ratings, Standard and Poor's Rating Services, and Moody's Investor Service.

The Bank uses external ratings from Moody's. These ratings are used for all relevant exposure classes, which are the following:

- Claims or contingent claims on central government or central banks
- Claims or contingent claims on institutions

In the case of financial institutions the credit quality step is determined according to the rating of the country under whose supervision they operate. Exposures with financial institutions with original maturity of three months or less are risk weighted 20% unless the risk weight assigned to its country is higher.

7.2 Description of the Process Used to Transfer Issuer and Issuer Credit Assessments Onto Items Not Included in the Trading Book

For the following exposure classes the external rating of the sovereign in which the counterparty is incorporated is applied:

- Claims or contingent claims on central government or central banks
- Claims or contingent claims on institutions

7.3 Association of External Rating of Each Nominated ECAI or ECA with Credit Quality Steps

The Bank complies with the standard association published by the CBC, regarding the association of the external rating of each nominated ECAI or ECA with the credit quality steps prescribed in Annex VI of the Directive. The table below presents the association of each credit quality step with the external rating of Moody's.

Credit quality step	Moody's rating of central government	Institutions Risk Weight	Sovereigns* Risk Weight
1	Aaa to Aa3	20%	0%
2	A1 to A3	50%	20%
3	Baa1 to Baa3	100%	50%
4	Ba1 to Ba3	100%	100%
5	B1 to B3	100%	100%
6	equal or lower than Caa1	150%	150%

* The above association also applies for central government, central banks and institutions unless they are specifically stated in the CBC rules to be zero risk weighted.

7.4 Exposure Before and After Credit Risk Mitigation

The exposure before and after credit risk mitigation associated with each credit quality step mostly for financial institutions and governments, as at the year-end was as follows:

	Total Exposures
	€000
Credit quality bands	
0%	101.365
20%	93.802

As at the year end there was no credit risk mitigation available for exposures with central governments, central banks and institutions. Therefore, the above amounts indicate the exposures both before and after credit risk mitigation.

8. Exposure in Equities not included in the Trading Book

Non-trading equity risk is defined as the potential variation in the Bank's non-trading income and reserves arising from changes in equity prices. The risk may crystallise during the course of normal business activities or in stressed market conditions.

During 2009 and as at 31 December 2009 the Bank held shares in only one company which is listed in the Cyprus Stock Exchange. The fair value of investments quoted in an active market is based on quoted bid prices. The balance sheet value of the Bank's equity exposures not included in the trading book as at 31 December 2009 was €126.920.

9. Exposure to Interest Rate Risk on Positions not included in the Trading Book

9.1 Impact on Net Interest Income

Information in relation to interest rate risk can be found in Section 2.5. The table below indicates the effect on the Bank's net interest income and profit before tax, over a one-year period, from a reasonable shift in the interest rate of the main currencies:

Change in interest rates	Euro €000	US Dollars €000	British Pounds €000	Other currencies €000	Total €000
+0,5% for all currencies	746	67	26	5	844
-0,25% for USD and -0,5% for all other currencies	(732)	(34)	(26)	(5)	(797)

9.2 Impact on the Economic Value

The table below indicates the effect on the Bank's economic value over a one-year period, from a reasonable shift in the interest rate of the main currencies:

Change in interest rates	Euro €000	US Dollars €000	British Pounds €000	Other currencies €000	Total €000
+0,5% for all currencies	(22)	11	(3)	(2)	(16)
-0,25% for USD and -0,5% for all other currencies	22	(6)	3	2	21

Appendix 1 – Glossary of Terms

CBC	Central Bank of Cyprus
IRRBB	Interest Rate Risk Banking Book
CFO & COO	Chief Financial Officer and Chief Operations Officer
IT	Information Technology
BoD	Board of Directors
ALCO	Assets and Liabilities Committee
RMU	Risk Management Unit
RMC	Risk Management Committee

Senior Management:

- Internal Audit Manager
- Credit Manager
- Manager Banking Services Development
- Chief Financial Officer and Chief Operations Officer
- Risk Manager
- Manager Treasury, Planning & Products Development