USB BANK PLC

Pillar 3 disclosures for the year ended 31 December 2016

September 2017

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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 14 branches and 2 ATM locations. 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 according to the requirements of part 8 of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit Companies and investment firms and amending Regulation (EU) No 648/2012 (the "CRR")

The Report is published annually on the Bank's website http://www.usbbank.com.cy (Investor Relations) and in conjunction with the Bank's Annual Financial Report, in accordance with regulatory guidelines. The Report provides additional information on the capital and risk profile of the Bank.

There is no difference in the basis of consolidation for accounting purposes with the basis used for prudential purposes.

2. Risk management objectives and policies

Risk is considered to be an integral part of the Bank's operations and as such the BoD and Senior Management take all reasonable steps to recognize and assess risks and develop strategies to manage and mitigate them. The BoD, considering the importance of risks on the Bank's operations, especially given the fragile economic conditions and the demanding regulatory environment in which the Bank operates, has defined the Bank's risk strategy, which is in alignment with the Bank's overall strategic goals and objectives.

The risk strategy of the Bank aims to provide its Management and employees with a general framework for the management of the different types of risk in line with the Bank's risk appetite capacity. The risk strategy is in alignment with the business strategy and operational targets, as well as the external and internal environment of the Bank. The Bank recognizes the importance of sound risk management to its business success, therefore the overall objective of the risk management process is to establish a framework within the Bank which is able to effectively manage, control and mitigate risks.

The Bank's risk management strategy is based on the following principles:

- Create value for the shareholders by accommodating the capital needs for value-enhancing growth;
- Comply with the regulatory requirements;
- Manage capital effectively through reliable measurement of the current capital situation and forecasts of its future developments;
- Promote transparent risk disclosure through clear communication lines to the Bank's Senior Management.

2. Risk management objectives and policies (continued)

The Bank recognizing that credit risk is its most material risk has formulated credit policies which aim to achieve the following:

- Avoid large concentrations of credit exposures to a number of industries/sectors;
- Monitor the exposures on a connected client basis;
- Implement sound procedures and controls for the assessment and granting of credit facilities;
- Implement sound procedures for the monitoring and reporting of customer exposures;

2.1 Risk management framework

The Board of Directors of USB Bank PLC is explicitly and exclusively responsible for setting the Bank's strategic objectives, the appetite for risk, the allocation of responsibilities and authorities between Departments as well as the reporting lines and for ensuring that the Bank has an adequate system of internal controls. The Board of Directors is also responsible for monitoring and evaluating the actions and output of the Bank's Executive and Senior Management as well as ensuring that these bodies collectively and individually conform to the policies in place.

The Risk Management Unit (RMU) reports to the CEO and the BoD through the Risk Management Committee (RMC). RMU is subject to audit by the Internal Audit Unit (IAU) in relation to the adequacy and effectiveness of risk management procedures. The RMU is made up of thirteen persons, other than the Risk Manager allocated as follows:

- Credit Risk Management Unit: 3 employees
- Credit Systems & Processes: 2 employees
- Operational Risk, Physical Security and Information Security: 2 employees
- Legal Services & Corporate Governance: 5 employees
- Personal assistant of the Risk Manager: 1 employee

The main role of the RMC is to assist the Board of Directors in the process of establishing a strategy for handling risks and managing of funds that reflect the business goals of the Bank. The RMC comprises of five members of whom three are independent non-executive directors and two are non – independent non-executive directors. During 2016, the RMC met 7 times.

The Bank's management together with its Board of Directors is committed in taking appropriate action to create robust risk management environment and strengthen the Bank's position by addressing material risks in its profile.

The new strategic direction of the Bank and the recapitalization in 2016 are evidence of the commitment of the shareholders and Board to implement measures to improve the capital position and profitability of the Bank.

2.1 Risk management framework (continued)

Some key actions that have been identified and prioritized by the Bank for implementation as part of this initiative are:

- Effective management of NPEs
- Implement and monitor evolving regulation and compliance issues relating to CBC directives, CRD IV, EU directives, FATCA, Correspondent Bank demands, changes to the legal framework
- Enhance human resources through targeted staff recruitment
- Improvements and changes in systems, policies, processes and procedures in order to improve the efficiency and effectiveness of the Bank's operations
- Relocation of Headquarters

The Bank's risk framework consist of the general risk management framework and specifically the credit, market operational and information security risk frameworks. Each of the frameworks are updated if needed by the Bank's RMU in co-operation with other Units when deemed necessary, reviewed by the RMC and finally approved by the BoD. These frameworks are based on a set of principles, developed in cooperation with external advisors. The risk management framework of the Bank is currently under revision by the RMU in order to be compliant and consistent with the changing internal and external environment of the Bank and in line with the best banking practices.

The Bank's management and BoD are satisfied that the Risk Management Framework is appropriate given the risk profile of the Bank and its strategy.

The set of basic principles that govern the Bank's risk management are:

A. 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.

B. Framework for managing risk: An overall framework for the management of each of credit, market and operational risks were developed and approved by the BoD.

C. 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.

D. Business line accountability: Business line managers and staff 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.

E. 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.

2.1 Risk management framework (continued)

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

A description of the information flow on risk to the BoD is provided in Appendix III.

2.2 Risk management process

a) Risk assessment

An essential component of the Internal Capital Adequacy Assessment Process is a comprehensive risk assessment process. The assessment is carried out for all the identified material risks of the Bank and the objective assessment is to enhance better risk management and to ensure that adequate regulatory funds are maintained to cover the identified risks.

As a result of the risk assessment process the materiality of each identified risk was derived. Therefore, the analysis was based on a quantitative assessment, in terms of required capital per risk type to protect the Bank against unexpected financial losses, as well as a qualitative assessment, in terms of their importance and measures that the Bank takes in relation to the management of each risk. Based on this analysis, the scale, nature and complexity of the Bank's activities, as well as industry practices, the Bank's risks were classified as Low, Medium or High materiality.

b) Risk appetite framework

USB Bank defines risk appetite as the level/amount of risk that it is willing to take or to avoid in order to achieve its business objectives. The Bank mainly expresses its risk appetite via appropriate limits as well as through appropriate monitoring and control standards based on regulatory limits and prudent practices. The Bank also expresses its risk appetite through its policies, procedures, internal controls, mitigation techniques and limit structures for all the material risks inherent in the Bank's activities. As such the important objectives for the Bank are the evaluation of key risks, the quantification of stress tests, the projections of the outcome for three years (capital planning) and the assessment of current and future capital requirements.

The Bank's quantitative risk appetite may be expressed through the regulatory limits mainly in relation to exposures to counterparties, liquidity, foreign exchange and capital levels that the Bank should abide by as analyzed in the relevant paragraphs of the current report.

It should be noted that the Bank does not bear any significant risks without its parent company's consent (e.g. in relation to key investment decisions and customer credit facilities) while lending delegation limits are approved by the Bank's Board of Directors. The Bank views risk on a case by case basis and in totality ensuring that the Bank is never exposed to undue risk.

c) Capital management

The main regulator that sets and monitors capital requirements for the Bank is the Central Bank of Cyprus (CBC).

The Bank closely monitors its capital adequacy both for compliance with the requirements of the supervisory authority as well as to maintain a base to support and develop its activities and safeguard the interests of its shareholders and all other stakeholders.

2.2 Risk management process (Continued)

As from 1 January 2014, the new Basel III Framework known as Capital Requirement Regulation (CRR) No 575/2013 / Capital Requirement Directive IV (CRD IV) dated 26 June 2013 became effective. CRR establishes the prudential requirements for capital, liquidity and leverage that entities need to abide by. CRD IV governs access to deposit-taking activities, internal governance arrangements including remuneration, board composition and transparency. CRR introduces significant changes in the prudential regulatory regime applicable to banks including amended minimum capital ratios, changes to the definition of capital and the calculation of risk weighted assets and the introduction of new measures relating to leverage, liquidity and funding. CRR permits a transitional period for certain of the enhanced capital requirements and certain other measures, such as the leverage ratio, which are not expected to be fully implemented until 2018.

Basel III Framework comprises of three Pillars:

- Pillar 1 – Minimum capital requirements
- Pillar 2 – Supervisory Review and Evaluation Process
- Pillar 3 – Market discipline

Pillar 1 – Minimum capital requirements

Pillar 1 sets forth the guidelines for calculating the minimum capital requirements to cover the credit risk, the market risk and the operational risk.

The Bank has adopted the Standardised Approach for the calculation of the minimum capital against credit risk. Under this approach, exposures are classified in specified classes and are weighted using specific weights, depending on the class the exposures belong to and their credit rating. According to the directive, there are two methods for the recognition of collateral, the Simple Approach and the Comprehensive Approach. The Bank has applied the Comprehensive Approach, as this enables the fairer recognition and more accurate estimation of the Bank's capital.

Regarding market risk, the Bank has adopted the Standardised Approach, according to which the minimum capital requirement is estimated by adding together the interest rate, equity and debt securities position, foreign exchange and price risk on derivatives using predefined models.

The Bank uses the Basic Indicator Approach for the calculation of the capital requirements for operational risk, based on which the operational risk capital requirement is estimated using a specific percentage on the average sum of total net income on a three year basis.

Pillar 2 – Supervisory Review and Evaluation Process (SREP)

Pillar 2 includes rules to ensure that adequate capital is in place to support any risk exposures of the Bank and requires appropriate risk management, reporting and governance policies.

The Central Bank of Cyprus (CBC), as part of its supervisory role under Directive 2013/36 of the European Parliament and of the Council, has conducted in January 2016 its annual Supervisory Review and Evaluation Process. SREP is a holistic assessment of, amongst other things: the Bank's business model, internal governance and institution-wide control arrangements, risks to capital and adequacy of capital to cover these risks and risks to liquidity and adequacy of liquidity resources to cover these risks. The objective of SREP is for the CBC to form an up-to-date supervisory view of the Bank's risks and viability and to form the basis for supervisory measures and dialogue with the Bank.

2.2 Risk management process (continued)

The Bank applied the Minimum Capital Approach to determine the additional capital required to cover credit risks which are not sufficiently covered by Pillar 1 requirements, such as Residual Risk, as well as risks not recognised by Pillar 1, such as Credit Concentration Risk, Interest Rate Risk in the Banking Book and any external factors affecting the Bank.

Banks are assessing their capital needs relative to their risks with their Internal Capital Adequacy Assessment Process (ICAAP), while at the same time maintaining communication with supervisors on a continuous basis.

In conjunction with the ICAAP banks are required to prepare the Internal Liquidity Adequacy Assessment Process (ILAAP). The ILAAP acts as a control cycle through which the Bank identifies, evaluates, manages and monitors its liquidity risks. The key objective behind ILAAP is to ensure the Bank has sufficient liquidity resources to support its business and be able to withstand any adverse future conditions which may threat its liquidity position.

The ILAAP report is submitted to the CBC on an annual basis and evaluated during the SREP by the CBC in conjunction with the ICAAP report.

Pillar 3 – Market discipline
Pillar 3 sets out required disclosures to allow market participants to assess key pieces of information relevant to the capital structure, risk exposures, risk assessment processes and hence the capital adequacy of the Bank.

Based on the Central Bank Directive, disclosures by banks include information relating to their risk management objectives and policies, the composition of own funds and original and supplementary funds, their compliance with minimum capital requirements and the internal capital adequacy assessment process.

2.3 Credit risk management

2.3.1 Definition

Credit risk is defined as the risk of financial loss if a customer and/or other counterparty fail to meet their contractual obligations with the Bank to any financial instrument. Primarily the risk arises from credit facilities, trade finance and treasury management.

2.3.2 Materiality

Given the high volume of NPE’s the Bank considers credit risk to be of high materiality.

2.3.3 Risk governance

The management of credit risk and its associated risks is performed by the Senior Management, whose responsibilities are outlined in Chapter 3 of the Report on Corporate Governance for the year 2016, which is published in the Bank website (http://www.usbbank.com.cy). Nonetheless, the primary responsibility of the management of credit risk and its associated risks lies with the Credit Risk Unit of the Bank.

2.3.3 Risk governance (continued)

The Credit Risk Unit (referred to as the “Unit”) has the responsibility to evaluate and assess the Bank’s credit risks. The Unit is mainly responsible for evaluating customer credit applications above a certain level, managing Basel issues and reporting to CBC, enhancement of the collateral module, as well as various other risk issues.

In addition to the aforementioned bodies, the IAU contributes to the management of credit risk, through the review from time to time the Bank’s lending portfolio and through the assessment of the adequacy of provisions.

2.3.4 Policies and procedures

The Bank has implemented policies and procedures for all activities in which credit exposures pose a risk, at both the individual credit and portfolio levels, taking into account internal and external factors.

It is ensured that the policies and procedures are:

- Clearly defined and in accordance with the credit risk strategy;
- Consistent with prudent banking practices and relevant regulatory requirements; and
- Commensurate with the nature, scale and complexity of the Bank's activities.

These policies and procedures enable the Bank to:

- Maintain sound credit-granting standards;
- Monitor and control credit risk;
- Properly evaluate new business opportunities; and
- Identify and administer problem credits.

The Bank has adequate risk management procedures and controls in place for new products and activities before these are being introduced or undertaken. Special attention is paid to products that involve unfamiliar markets, pricing, contract law and accounting or risk management principles. The credit policies is always communicated to all relevant functions throughout the organisation, monitored and periodically revised to take into account changing internal and external circumstances.

Staff is always held accountable in cases of non-compliance with established policies and procedures.

2.3.5 Mitigation and measurement

The Bank achieves the mitigation and measurement of credit risk through the techniques outlined in the paragraphs which follow. The Bank implements an effective credit monitoring system that includes measures to:

- ensure that the Bank understands the current financial condition of the borrower;
- monitor compliance with existing terms of approval;
- assess, where applicable, collateral coverage relative to the obligor’s current conditions;
- identify contractual payment delinquencies (i.e. excesses and arrears) and potential problematic credits on a timely basis through non-performing exposure reports;

2.3.5 Mitigation and measurement (continued)

Collaterals: In an effort to mitigate credit risk, the Bank requires collaterals against exposures. The Bank accepts as collateral, items, such as (a) cash pledged within the Bank, (b) land and buildings, (c) listed and non-listed shares, (d) assignment of Life insurance, (e) stocks in bonded warehouses, (g) fixed and floating charges, (h) personal and corporate guarantees, (i) bank and government guarantees as well as (j) bonds / development stock listed or non-listed on a recognized stock exchange. Property collaterals are susceptible to price fluctuations given the economic environment in Cyprus in recent years, which may have either a positive or negative impact on the value of the collateral and consequently provisions.

The table below shows the concentration of each of these securities which make up the collateral portfolio mix of the Bank with recoverable value (calculated per CBC directive) as at 31 December 2016.

Collateral Description	**Recoverable Value in €m**	**%**
Cash Deposits	32,40	11.07%
Bank Guarantees	2,80	0.96%
Stocks – Shares	3,36	1.14%
Life Insurance Policy	3,75	1.28%
Mortgages on Land and Building	242,61	82.86%
Mortgages on Leasehold Property	0,81	0.28%
Registration of Memos	2,95	1.01%
Fixed & Floating Charges	4,11	1.40%
Total	**292,79**	**100%**

Credit granting: The Bank's credit-granting process establishes accountability for decisions taken and designates who has the absolute authority to approve credits or change in credit terms. All the Bank's Business Lines, associated with credit granting, are responsible for (i) assessing and recommending facilities for approval, (ii) approving facilities within pre-defined limits, (iii) applying consistently the credit policies of the Bank, (iv)monitoring regularly customers' arrears, excesses and their collaterals value, (v) assigning credit ratings to customers.

Additionally the Bank ensures that all credit files are up to date by obtaining customers' current financial information and informing the management for any problems which arise.

Credit grading: The Bank has developed and implemented an internal risk grading system which is consistent with the nature, size and complexity of the Bank's activities. The grading system is primarily used by Business line management during the credit granting process where both retail and corporate clients are assigned a score of "1", being the top score and a "5" the worst score, where the Bank initiates legal action against the client.

The grade assigned to individual borrowers or counterparties at the time the credit is granted is reviewed on a periodic basis and individual credits are assigned a new grade when conditions either improve or deteriorate. Credit Risk has initiated and implemented the Moody's Risk Analyst project in July 2013 for grading corporate customers.

2.3.5 Mitigation and measurement (continued)

The Bank's credit grading system is divided into five categories:

Risk Grade Category	Description
"1" **(Outstanding Facilities)**	This rating is applicable for client facilities that do not present any negative indications
"2" **(Satisfactory Facilities)**	This rating is applicable for client facilities that even though are not yet problematic, they are in need of monitoring to avoid possible future problems
"3" **(Attention Required)**	This rating represents client facilities that are problematic and at the current stage there maybe doubts raised as to their collection by the Bank, especially if they were restructured. Moreover, there is a possibility for improvement and repayment of the debt after close handling and monitoring from the Bank through a successful restructuring of their facilities.
"4" **(Problematic Facilities)**	This rating category includes client facilities with long-term difficulties (>90 dpd) and problems. 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 yet even if the customer is flagged as NPE
"5" **(Doubtful Loan Repayment)**	Rating class for clients that legal action has already commenced against them.

Clients with deteriorating ratings ("2", "3", and "4") are subject to additional oversight and monitoring through, for example, more frequent visits from credit officers and business line managers. Additionally, the Bank may obtain additional security or perform restructuring on the facility to improve its position.

Provisioning policy

The Bank reviews the collectability of its loans and advances to customers and assesses whether a provision for impairment should be recorded in the consolidated income statement. The procedure followed by the Bank for provisioning comprises of an individual assessment of the exposures for specific provision and assessment for collective impairment as per the Bank's provisioning policy.

2.3.5 Mitigation and measurement (continued)

Specific provision

The selection criteria for clients which are individually assessed for specific provision and based on the Bank's policy are as follows:

- All exposures to a borrower and his connected parties that are considered significant. A materiality threshold was determined by the Bank.
- All exposures to related parties of the Bank as defined in the Fit and Proper Criteria of the Members of the Management Body Directive of 2006-2007 and their connected parties.
- Any exposure to a borrower which is classified as high risk because of its total banking exposure or industry.

Exposures which are identified from the above selection criteria are assessed for impairment if a "trigger event" existed. The following trigger events are set by the Bank:

- Exposures that are classified as Non Performing
- Exposures that are Performing but Restructured
- Exposures that are Performing without irregularities which are overdue for review as per the Banks' credit policy.

For the exposures that are individually assessed for impairment, discounted cash flow (DCF) calculations are performed. The amount of impairment is the difference between the exposure's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The estimated future cash flows include any expected cash flows from the borrowers operations, any other sources of funds and the proceeds from liquidation of collateral where applicable.

Collective provision

All exposures which are assessed on an individual basis but for which no impairment is recognised and also all exposures not individually assessed are included in a pool of exposures with similar characteristics and are assessed for collective impairment using the applicable Probability of Default (PD) and Loss Given Default (LGD) rates that are set in the Bank's provision policy. The PDs and LGDs assigned to each category in the provision methodology are assigned based on management judgment.

2.3.6 Reporting

The Credit Risk Unit prepares on a frequent basis (i.e monthly, quarterly) reports that are used both for regulatory purposes by CBC and for the use of the Risk Management Committee for their review and decision making if needed. Indicatively some of the reports prepared are: COREP templates, analysis of the credit portfolio by economic sector, reporting on large exposures and exposures to members of the management bodies and major shareholders of the authorized credit institutions etc.

2.3.7 Stress testing

The Board of Directors and the Bank's Senior Management, taking into consideration the current economic environment, the regional downturn and trends as well as the Bank's long term strategy and objectives, has formulated a three year Business Base Plan. The key parameters of the plan were stressed by causing an increase in loss reported together with capital needs:

- Further average decrease of property prices than original Business Plan and increase of NPEs causing additional specific and collective provision
- Decrease in expected interest rates margin by - 0,25% per annum for US Dollars and - 0.50% per annum for all other currencies
- Further average decrease of Investment Properties values
- Operational risk capital needs
- Reduction in the interest rates for lending

2.4 Operational risk

2.4.1 Definition

The Bank defines operational risk as the risk of direct or indirect loss resulting from a wide range of factors relating to procedures and policies of the Bank, the staff, the information technology, the premises infrastructure, the health and safety as well as external factors such as those resulting from non-compliance with Laws and Regulations including outsourcing to third parties. The definition adopted by the Bank includes legal and reputation risk but excludes strategic risk, which is line with the Basel definition. As part of operational risk the following are also monitored:

Human resources risk: Due to the relatively small size of the Bank, the Bank is exposed in certain cases to key personnel risk. Although an effort has been made to transfer the knowledge of key staff to other members of staff within the Bank, there is still work to be done in this area. It is noted that the Bank takes appropriate action on a continuous basis to address this risk.

Legal risk: As at 31 December 2016, with the exception of the case mentioned below the Bank in the ordinary course of business is involved in lawsuits, which the Management of the Bank does not expect to have a significant effect on the financial position and operations of the Bank. At the same time, there are no other pending claims or/and assessments against the Bank, the outcome of which would have a material effect on the Bank's financial position or operations.

Following an investigation, which began in 2010, the Cypriot Commission for the Protection of Competition (CPC) in April 2014 issued its statement of objections, alleging possible violations of Cypriot and EU competition law relating to the activities and/or omissions in respect of card payment transactions by, among others, the Bank. The CPC has investigated the possibility that the market conduct of JCC Payment Systems Ltd (JCC), a card-processing business owned by its shareholder banks, together with the conduct of other banks, violates competition law at both a national and European Union level.

2.4 Operational risk (continued)

By its decision of 24th June 2015, the CPC has concluded that the Bank (as well as other banks and JCC) had breached both national and European applicable law for the protection of competition. The proceedings before the CPC for the determination of the fine had been stalled due to an Administrative Court decision holding that the composition of the CPC was contrary to law, which was however overturned in March 2017 by the Supreme Court on appeal of the Attorney General.

A notification of the final decision was issued by the CPC on 22nd May 2017 with the following orders for execution affecting the Bank:

- JCC together with the Bank (similar to the other banks) which are not its shareholders, have entered into vertical agreements by which they fix interchange fees which affect competition in the market for payment cards and consequently the market for payment card acceptance within Cyprus, in breach of section 3(1)(a) of the Law and of section 1010 of the TFEU.
- Obliges the accused companies to immediately cease the observed violations and to avoid their repetition in the future.
- Imposes a fine upon the Bank in the amount of €121.519.
- The fine is payable within 30 calendar days from 22nd May 2017.

The Bank has taken remedial measures and has ceased the above observed violations since October 2015. The Bank has decided to appeal for the annulment of the CPC's decision. The Bank has also proceeded with a settlement of the fine as per the terms of the decision and therefore will recognize the above loss in its financial results for the year 2017.

Capital requirements: Based on the Bank's risk appetite the operational risk capital requirements under Pillar II is the difference between the maximum 10% on Pillar I capital requirements and the Operational Risk figure for Pillar I. As this is met by the operational risk calculated for Pillar I, the Bank did not consider necessary to increase the operational risk capital charge for Pillar II capital requirements. Moreover, the Bank did not have any material operational losses in the last years.

2.4.2 Materiality

The risk is considered to be of Low to Medium materiality for the Bank.

2.4.3 Risk governance

As operational risk is inherent in all of the Bank's activities, all management and staff of the Bank are responsible for its management and mitigation. Specifically, the Board of Directors and the Senior Management of the Bank, are responsible for the design and implementation of a sound operational risk framework within the Bank. Additionally, the Operational Risk Management Unit is also responsible for the mitigation of operational risk. Its responsibilities include, amongst other, the following:

- Monitoring operational risks within the Bank and taking corrective action to minimize the possibility of an operational loss recurring;
- Assisting management to understand and effectively manage operational risk as per the approved Operational Risk Management framework;
- Assessing the robustness of the Operational Risk framework through the evaluation of reports prepared by the Internal Audit Department, circulars on policies and procedures issued to staff.

2.4.4 Policies and procedures

The Bank has established an Operational Risk Management framework for the management of operational risk. The framework outlines the tools and techniques used for the management of operational risk.

Realizing the importance of operational risk, in May 2012, the Bank has purchased “STORM”, a software system used for the management of operational risk. “STORM” is an operational risk management tool especially developed to automate the process of identifying, measuring and monitoring operational risk. The system combines document and process management with a monitoring and decision support system, enabling the efficient analysis, management and mitigation of risks.

Collection of data losses: Since the implementation of STORM, in May 2012, all data losses as well as near miss events are collected by all Branches/Departments of the Bank. There has been no material operational loss event since historic data begun.

Appointment of operational risk liaison officers: The Bank has appointed Operational Risk liaison officers who are primarily responsible for monitoring the implementation of the Operational Risk Framework in their individual Units, and ensure the appropriate management and reporting of operational losses/events using “STORM”.

Risk Control Self-Assessments (RCSA): The notion of performing self-assessment for operational risk control purposes is well established. The Bank has been performing RCSA exercises since 2012 although progress has been slow and with mixed results due to the difficulty and novelty associated with these types of self-assessment, inexperience and steep learning curve on the part of both the ORMU and the Bank as a whole. Each Bank Department submits its RCSA by November 15 of each year. The submitted RCSA is evaluated by the ORMU and discussed with each Department during a series of meetings. Emphasis is given to high risk issues especially those which survive control mitigation (residual risk remains high). Action plans are discussed and put forth to further reduce risk. The resulting risks and plans are communicated with the Internal Audit in order to create risk based audit plans. At present the majority of risks have been identified and the Bank is in the process of codifying these risks in a comprehensive manner.

2.4.4 Policies and Procedures

Whistle blowing policy: The purpose of this policy is to empower the staff to raise their concerns regarding misconduct taking place within the Bank. The reports can be submitted either via “STORM” system, or via internal/external mail. The Operational Risk Management Unit assesses the reports and takes all necessary measures needed to handle these issues.

2.4.5 Mitigation and measurement

The Bank’s objectives as regards the management of operational risks are focused around improving the Bank’s processes, methods and systems, and for assessing and mitigating all material events depending on their severity and probability of occurrence.

The process of risk assessment entails evaluation of the effectiveness of controls in combating the Bank’s inherent risks and identification and establishment of appropriate protection measures.

The Bank achieves operational risk mitigation through:

- Risk avoidance strategies;
- Risk reduction strategies – Design of strategies to reduce either the impact or the probability of occurrence (e.g. improvement of internal controls, training of employees, disaster recovery planning, implementation of automatic controls etc);
- Risk prevention strategies – Development of new procedures or improvement of existing procedures and training of staff, to ensure the process is correctly executed;
- Risk transfer strategies (e.g. insurance).

New products and services: The Bank has established a formal process for assessing operational risk attached to new and existing products. During this process, all material operational risk are identified and assessed. Furthermore, the Risk Manager participates, in an advisory nature, in the Products and Development Committee, presenting an assessment of risks attached to any new products.

Contingency planning: In an effort to provide for unforeseen events, the Bank:

- Identifies critical business processes, including those where there is dependence on external vendors or other third parties for which rapid resumption of service would be most essential (i.e. identification of alternative mechanisms in case of an outage, off-site restoration of electronic/ physical records, etc);
- Provides for the integration of contingency plan actions into company-wide training to ensure rapid and effective response and link with outside agencies when necessary;
- Formalizes contingency plan actions into Standard Operating Procedures (SOP);
- Periodically reviews its disaster recovery and business continuity plans, to clarify whether they can identify failure early (i.e. early detection is less costly), correctly (i.e. taking the right actions for the right reasons), and have the ability to forecast significant changes in the risk environment (i.e. controlling change rather than reacting to it);
- Creates a framework which can be continuously reviewed and updated, with post event analysis incorporated into best practice.

2.4.6 Reporting

The Operational Risk Management Unit reports on a quarterly basis any loss to the Risk Manager that are also escalated to the Board Risk Committee for awareness and further evaluation.

2.4.7 Capital requirements

The Bank applies the Basic Indicator Approach for the calculation of the minimum capital requirements for operational risk, under Pillar I.

2.4.8 Stress testing

The Bank does not perform any stress testing with regards to Operational Risk as it does not consider typical quantitative stress tests applicable to Operational Risk.

2.5 Market risk

2.5.1 Definition

The Bank defines market risk as the risk of loss arising from adverse movements in interest rates, exchange rates, equity shares and other securities. Specifically, market risk encompasses the following:

i. **Foreign exchange risk:** The risk arises from adverse exchange rate movements in the foreign exchange open positions (either overbought or oversold, in a foreign currency, creating an exposure to a change in the relevant exchange rate) that the Bank holds. These rate movements may cause a significant decrease in profitability should the Open Position held by the Treasury Department is considered large for the Bank.
ii. **Price risk:** Price risk from debt securities, gold and commodity holdings arises from adverse price movements in the aforementioned securities and commodity positions.
iii. **Interest rate risk in the trading book:** The risk arises from changes in interest rates of trading book instruments, both regarding local and foreign currency.
iv. **Equity risk:** The risk arises from price changes on the local and foreign equity holdings of the bank.

Under the market risk framework, the Bank also manages Interest Rate Risk in the Banking Book and Liquidity risk, both of which are discussed under separate sections.

2.5.2 Materiality

Market risk is considered to be of low materiality for the Bank as it does not hold any trading book instruments apart from foreign exchange positions.

2.5.3 Risk governance

Effective identification and monitoring of market risk is essential for maintaining stable profits. The responsibility for the design and implementation of a sound market risk framework, including interest rate risk in the banking book and liquidity risk, lies with the Board of Directors, Senior Management, Risk Management Committee and ALCO whose responsibilities are presented in Chapter 3 of the Report on Corporate Governance for the year 2016.

2.5.4 Policies and procedures

The Bank has developed a Market Risk framework, which outlines the policies regarding the management and mitigation of market risks assumed by the Bank including management of liquidity risk and interest rate risk in the banking book.

2.5.5 Mitigation and measurement

Foreign exchange rate risk

The Bank's policy as regards the management of foreign exchange risk is to maintain it within the limits prescribed by the Central Bank of Cyprus. Specifically, for the management of foreign exchange risk the Bank operates within the following limits:

- The open positions held (total of all currencies) at each day's closing do not exceed 1% of the Bank's capital base;
- The open positions held for each currency individually, at each day's closing, do not exceed 0,25% of the Bank's capital base;
- The daily intraday open positions are monitored on an on-going basis and actions to close (cover) any open position should be implemented accordingly. The maximum intraday open positions should not exceed 6% (total of all currencies) and 2% (for each currency) of the Bank's capital base.
- The Bank executes spot transactions and uses Foreign exchange swaps in order to hedge its foreign exchange risk.

Any deviations from the above limits are reported to the Chief Executive Officer and to the Manager of Risk, whilst a FX open positions report is prepared on a daily basis by the Treasury Department and forwarded for further analysis and review to the Manager of Treasury and the Manager of Risk.

Price risk arising from debt securities, gold and commodity holdings

The Bank's Senior Management has taken the decision that it will not assume any risk arising from gold or commodities as it is the Bank's policy not to hold or sell any such instruments.

With regards to price risk arising from debt securities, the Bank has formulated an investment policy outlining the specific criteria that investments should fulfill if the Bank is to invest in them.

With regards to the monitoring of price risk, the Treasury Department forwards on a regular basis to the ALCO, the Bank's investment portfolio for review, in order to take any corrective actions needed for mitigating market price risk.

Interest rate risk in the trading book

The Bank does not hold any instruments in its trading book apart from daily open foreign exchange positions, thus minimizing the impact of such risk.

Equity risk

To further minimise market risk arising from equities, the Bank's Management has decided not to hold any significant positions in equities. However, according to a BOD decision the Bank may purchase pledged quoted shares (in the CSE) of problematic customers of the Bank (in the Recovery Department) up to 5% of the Bank's capital base (with a maximum limit of 1% of the Bank's capital base per issuer) as per the table in Appendix II. A quarterly report on the holdings of local and foreign equities by the Bank is prepared by the Treasury Department for the preparation of the COREP and is send to the RMU for review. In addition, the Risk Manager is notified by the Recovery Manager on any new acquisitions in equities before the acquisition takes place for comments regarding possible violations of the limits set above.

2.5.6 Reporting

The Treasury department prepares a report for the RMU on a quarterly basis regarding market risk for the preparation of COREP and submission to CBC and BLC.

2.5.7 Capital requirements

The Bank uses the Standardized Approach for the measurement of its capital requirements against Pillar I market risk, under Basel III.

2.5.8 Stress testing

As the Bank does not hold any instruments or equities in its trading book, except from the daily open foreign exchange positions, it does not carry out any stress testing.

2.5.9 Impairment of available for sale equity investments and investments held to maturity

Equity investments classified as available for sale (AFS) are considered 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 judgment include the expected volatility in 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.

For investments classified as held-to-maturity or loans and receivables, the Bank assesses at each reporting date whether there is objective evidence that they have suffered an impairment loss. If there is objective evidence that an impairment loss exists, the amount of the loss is measured as the difference between the book value of the asset and the present value of estimated future cash flows (excluding future credit losses that have occurred).

The book value of the asset is reduced and the amount of loss is recognized in the income statement. If at a later period, the amount of impairment loss decreases and the decrease can be objectively related to an event occurring after the recognition of impairment, the impairment loss previously recognized is reversed, and the amount of the reversal is credited to 'Loss from revaluation, disposal and impairment of financial instruments', in the income statement.

2.6 Liquidity risk

2.6.1. Definition

Liquidity risk is the risk that the Bank is unable to fully or promptly meet current and future payment obligations as and when they fall due. This risk includes the possibility that the Bank may have to raise funding at higher cost or sell assets at a discount.

It reflects the potential mismatch between incoming and outgoing payments, taking into account unexpected delays in repayment or unexpectedly high payment outflows. Liquidity risk involves both the risk of unexpected increases in the cost of funding of the portfolio of assets and the risk of being unable to liquidate a position in a timely manner on reasonable terms.

The Bank has developed internal control processes and contingency plans for managing liquidity risk. These incorporate an assessment of expected cash flows and the availability of collateral which could be used to secure additional funding if required.

2.6.2 Materiality

Liquidity risk is considered to be of Low materiality for the Bank given the strict rules applied by the CBC and the fact that the average liquidity ratio was above the minimum allowed by the CBC.

The calculation of protective liquidity in Euro and other currencies for supervisory purposes is submitted to the Central Bank of Cyprus every quarter, while on a weekly basis additional information in relation to liquidity is submitted. These statements are monitored by management at ALCO level. The minimum percentage of liquid assets is 20% of total Euro deposits (adding other liabilities with remaining maturity up to 1 year) while the respective percentage for foreign currencies is 70%.

The Bank's liquidity ratio in Euro was as follows:

	2016	2015
	%	%
As at 31 December	29.66	**23.20**
Average Ratio	30.18	**26.98**
Maximum Ratio	38.55	**29.93**
Minimum Ratio	26.01	**23.20**

The Bank’s liquidity ratio in Foreign Currencies was as follows:

	2016	2015
	%	%
As at 31 December	84.28	**70.00**
Average Ratio	76.68	**70.00**
Maximum Ratio	84.28	**70.00**
Minimum Ratio	70.00	**70.00**

Other liquidity ratio requirements

In accordance with the requirements set forth by Pillar 1 of Basel III Framework known as Capital Requirement Regulation (“CRR”) No 575/2013 / Capital Requirement Directive IV (CRD IV) dated 26 June 2013, the Bank has to comply with Liquidity Coverage requirement ratio (LCR) calculated as the sum of the values which cover the liquidity outflows less the liquidity inflows under stressed conditions so as to ensure that institutions maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under stressed conditions over a period of thirty days. During times of stress, institutions may use their liquid assets to cover their net liquidity outflows.

The LCR of the Bank was at 623% as at 31 December 2016 compared to the regulatory liquidity requirement of 70%.

Recent developments

Cyprus has exited its economic adjustment program in March 2016. However the credit ratings of the Republic of Cyprus by the main credit rating agencies continue to be below investment grade albeit on a rising trend.

On the 16th of March 2016, the ECB issued a decision which was effective from the 1st of April 2016, and which stated that the Eurosystem's standard criteria and credit quality thresholds should apply in respect of marketable debt instruments issued or fully guaranteed by the Republic of Cyprus and that such debt instruments would be subject to the standard haircuts according to the ECB guidelines. This was a consequence of the completion of Cyprus economic and financial adjustment program and it effectively meant that the bonds issued by the Government of Cyprus held by the Bank would no longer be accepted as collateral for the purposes of Eurosystem monetary policy operations. This decision has led to a temporary breach of the prudential liquidity ratios of the Central Bank of Cyprus. However on the 2nd June 2016, CBC issued a decision effective immediately, which allowed Cypriot banks to consider their holdings in Cyprus Government securities as liquid for prudential liquidity reporting purposes. This decision will remain in place for as long as the Cyprus sovereign debt is rated below investment grade (and hence non-ECB eligible) until the 2nd June 2017 since the decision was issued, and would be subject to certain conditions being met. On the 24th March 2017 the CBC with a new decision extended this period until 31.12.2017 subject to the same conditions being met.

As a result of the above and taking into consideration the ineligibility of the Cyprus Government Bonds, the liquidity ratios on 4th of April 2016 were adjusted downwards to 16.56% from 27.64% for Euro and 59.16% from 70.00% for Foreign Currency. Following the capital injection of €23m by the main shareholder of the Bank into an escrow a/c in May 2016 in order to facilitate the issue of additional share capital in July 2016, the Bank complies with the minimum regulatory liquidity ratios for both Euro and Foreign Currency.

2.6.3 Risk governance

The design and implementation of sound liquidity risk management is the responsibility of the same Bodies/Units responsible for the management of market risk.

2.6.4 Policies and procedures

The Bank uses the market risk framework for the management of liquidity risk as presented in the previous section.

2.6.5 Mitigation and measurement

For the effective management/minimization of liquidity risk, the Bank is following the guidelines set by the Central Bank Cyprus by setting the following limits:

- The liquidity ratio of the Bank (as defined by the CBC circulars) in local currency should never fall below 20%;
- The liquidity ratio in foreign currency should never fall below 70%. In case where the ratio falls below 70%, then liquidity from local currency may be transferred to cover the shortfall;
- The protective liquidity ratio of the Bank (as defined by CBC circulars) should always be less than -10% for the 0 - 7 days maturities band;
- The protective liquidity ratio of the Bank (as defined by CBC circulars) should always be less than -25% for the 8-30 days maturities band.

For better management of the liquidity risk the Bank has also set early warning limits for both the regulatory and internal indicators. If the limits set by the Bank are breached, USB Bank will be deemed outside of its liquidity and Risk Appetite Framework. In order to assist in avoiding this situation, once the warning indicators are reached, mitigation actions will be triggered in order to prevent further drop and breach of the defined limits

The early warning indicators set by the Bank are the following:

- Liquid Assets Ratio in Euro 24%
- Liquid Assets Ratio in foreign currency 75%
- LCR > 125%
- Survival days > 90 days
- ILAAP stress coverage ratio > 100%
- Gross Loans to Deposits ratio < 85%

The above mentioned indicators are further presented and explained in Appendix 2.

The Bank can mitigate and manage appropriately liquidity risk through:

(i) Obtaining liquidity if needed from ECB by pledging high liquid eligible marketable assets
(ii) Not renewing expiring investments and placements with other banks
(iii) Capping balance sheet growth
(iv) Selling Cyprus Government Bonds held at fair value and
(v) The Bank could use high quality non-marketable assets which are eligible collateral for Eurosystem monetary policy operations.

2.6.6 Reporting

With regards to liquidity, the Finance Department prepares on a daily, weekly and monthly basis reports which are communicated both to the ALCO and the CBC.

2.6.7 Stress testing

With regards to stress testing the Treasury Department carries out on a periodic basis a stress test on the Bank's interest bearing assets and liabilities through upward and downward parallel shifts of the yield curve. The stress tests are designed to assess the possible effect on the Bank's liquidity levels and to calculate the effect on both the net interest income and the economic value of the Bank.

3. Own funds

The own funds of the Bank as at 31/12/2016 were €66.678 (2015: €42.163) thousand as shown below:

Original Own Funds (Tier 1)	**€000**
Share Capital	32.174
Share Premium	55.620
Accumulated Losses	(28.178)
AFS Reserve	6.275
Intangible Assets	(620)
Common Equity Tier 1	**65.271**
Total Tier 1	**65.271**
Additional Own Funds (Tier 2)	
Property Revaluation Reserve	1.407
Total Tier 2	**1.407**
Total Own Funds	**66.678**

3.1 Original own funds

Share capital

The share capital of the Bank at 31 December 2016 amounted to €32.173.733 divided into 321.737.330 of nominal value of €0.10 each (2015: €20.673.733 divided into 206.737.330 shares of nominal value of €0.10 each), while the share premium reserve increased to €55.620.065 at 31 December 2016 (2015: €44.120.065).

In the Annual General Meeting ("AGM") held on the 26th July 2016 a special resolution was passed whereby the Bank was authorized to proceed with the issue and allotment of 115.000.000 new ordinary shares of nominal value of €0,10 to BLC Bank SAL at the issue price of €0,20 per share (the "Issue"). With the successful issue and allotment of 115.000.000 new ordinary shares to BLC Bank SAL the issued share capital of the Bank amounts to €32.173.733 divided into 321.737.330 ordinary shares of nominal value €0,10 per share. The new 115.000.000 ordinary shares rank pari passu with the existing shares of the Bank.

Share premium

The share premium reserve is maintained pursuant to the provisions of section 55 of the Companies Law, Cap. 113 and is not available for distribution to equity holders in the form of a dividend.

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 Bank has adopted the Standardised approach for the calculation of the minimum capital against credit risk. Under this approach, exposures are classified in specified classes and are weighed using specific weights, depending on the class the exposures belong to and their credit rating. The following table shows the Standardised approach used to calculate the minimum capital requirement in accordance with the requirements laid down in Article 92 of the CRR:

Exposure class	**2016**	**2015**
	€000	**€000**
Central governments or central banks	-	-
Public sector entities	-	171
Institutions	6.359	16.709
Corporate	36.843	40.446
Retail	11.476	12.209
Secured by mortgages on immovable property	54.592	60.557
Exposures in default	125.235	225.232*
Items associated with particularly high risk	95.345*	4.115
Other items	82.746	58.458
Total	**412.596**	**417.897**

* As per CRR Article 128: Institutions shall assign a 150% risk weight to exposures that are associated with particularly high risks. Based on the CBC circular letter dated 05/04/2016, it has been specified that exposures related to speculative immovable property financing shall be classified in the 'items associated with particular high risk' class. It should be noted that the above exposures in year 2015 have been classified in the 'exposures in default' class.

4.2 Market risk - Standardised approach

Regarding market risk, the Bank has adopted the Standardised approach, according to which the minimum capital requirement is estimated by adding together the interest rate, equity and debt securities position, foreign exchange and price risk on derivatives using predefined models.

Based on the existing policy and limits followed by the Treasury department, our Bank does not face any open Position, foreign exchange and commodity risks under Standardised Approach (SA), that are required to be reported.

The Bank holds equity shares listed on the Cyprus Stock Exchange with nil book value following their full impairment thus it does not face any risk from investments in equities positions.

4.3 Operational risk - Basic indicator approach

The Bank uses the Basic indicator approach for the calculation of the capital requirements for operational risk, based on which the operational risk capital requirement is estimated using a specific percentage on the average sum of gross income on a three year basis. According to the Directive for the calculation of capital requirements and large exposures, the relevant indicator is the average over three years of the sum of net interest income and net non-interest income of the last three financial years.

The same figure of Operational risk capital requirements as at 31 December 2016, will also be reported on the next three quarterly returns upon preparation of the COREP (31 March 2017, 30 June 2017 and 30 September 2017) i.e. will be the same figure as at 31st December 2016.

The table below shows the calculation of capital requirement for operational risk under the Basic Indicator approach.

Gross Income (€000)				Capital Requirement (Average * 15%) €000
2014	2015	2016	Average	
30.099	28.534	28.661	29.098	4.365

4.4 Capital position

Based on the provisions of the Macroprudential Oversight of Institutions Law of 2015 which came into force on 1 January 2016, the CBC is the designated Authority responsible for setting the macroprudential buffers that derive from the CRD IV. In accordance with the provisions of this law, the CBC sets, the Countercyclical Capital buffer level on a quarterly basis and based on the methodology described in this law. The Countercyclical Capital buffer has been set at 0% for year 2016 and for the first quarter of 2017.

The Capital Conservation buffer level is set by the CBC in accordance with the Business of Credit Institutions Law of 1997 to 2016. Until the amendment of the law on 3 February 2017 the Bank took into account a fully loaded Capital Conservation buffer of 2,5%. Since 3 February 2017 the Banking law has been amended and the Capital Conservation buffer for a transitional period is gradually phased-in retroactively as follows:

• From 1 January 2016 until 31 December 2016 : 0,625%
• From 1 January 2017 until 31 December 2017 : 1,25%
• From 1 January 2018 until 31 December 2018 : 1,875%
• From 1 January 2019 onwards is fully implemented: 2,5%.

Following the completion of the Supervisory Review and Evaluation Process (SREP) of the Bank by CBC in January 2016 and the capital injection of €23 million in May 2016, the minimum Total Supervisory Capital Ratio shall always be maintained above 12,25% including a fully loaded Capital Conservation buffer of 2,5%.

Also following the enactment of the amendments in the Cypriot Banking Law on 3 February 2017 regarding the gradual phase-in of the Capital Conservation buffer, this has been set at 0,625% in 2016, 1,25% in 2017, 1,875% in 2018 and fully implemented on 1 January 2019 at 2,5%. The minimum Total Supervisory Capital Ratio is consequently reduced to 10,375% as at 31 December 2016, and 11% as from 1 January 2017, which is applicable until the next SREP by CBC.

The information presented below represents the Bank's capital position under the CRR/CRD IV, including the application of the transitional arrangements as set by the CBC.

At 31 December 2016 the Common Equity Tier 1 ratio was 13,97% (2015: 8,54%), the Tier 1 ratio was 13,97% (2015: 8,54%) and the Total Capital ratio was 14,27% (2015: 8,98%).

The table below presents the position of the Bank's regulatory capital, in accordance with the principles of Basel II, at 31 December 2016:

	2016	**2015**
	€ '000	**€ '000**
Regulatory Capital		
Transitional Common Equity Tier 1 capital (CET1)	65.271	40.135
Transitional Tier 1 capital (T1)	65.271	40.135
Transitional Tier 2 capital (T2)	1.407	2.028
Total transitional regulatory capital	**66.678**	**42.163**
Risk weighted assets – credit risk	412.596	417.897
Risk weighted assets – operational risk	54.563	51.813
Risk weighted assets – market risk	-	-
Total Risk weighted assets	**467.159**	**469.710**
Transitional Common Equity Tier 1 ratio	13.97%	8.54%
Transitional Tier 1 ratio	13.97%	8.54%
Transitional Tier 2 ratio	0.30%	0.44%
Transitional Total Capital Ratio	**14.27%**	**8.98%**

5. Counterparty credit risk

As at 31 December 2016 and 2015, 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

6.1 Large concentrations to individual counterparties and their connected persons

There are restrictions on credit risk concentrations which are imposed by the Banking Law and the relevant Directive of the Central Bank of Cyprus. According to these restrictions, banks are prohibited from lending more than 25% of their capital base to a single customer group after taking into account the effect of credit risk reduction techniques as they are defined in the Capital Requirements Regulation (EU) No 575/2013. Also, the Banking law provides for limitations and prohibitions in relation to transactions involving members of the Board of Directors and main shareholders of the Bank.

The Bank is in total compliance with all the above regulatory limits as at 31 December 2016. The Banks' exposure to credit risk arising from customer groups, who have credit facilities amounting to more than 10% of the Bank's capital base as at 31 December 2016, was €97,8 million (2015: €178,4 million), before any provision and credit risk reduction techniques.

6.2 Impaired and not Impaired Loan/Exposures

Past due loans and advances

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.

Impaired loans and advances

Represent the loans and advances for which the Bank determines that there is objective evidence for impairment as a result of one or more loss events occurring after initial recognition and which have an impact on the estimated future cash flows as assessed either on an individual basis or on a collective basis.

Impairment of loans and advances

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. In particular, management is required to estimate the amount and timing of future cash flows in order to determine the amount of provision required and as a result the calculation of the impairment allowance involves the use of judgment. Such estimates are based on assumptions about a number of factors and therefore actual impairment losses may differ. The Bank takes into consideration factors such as the customer's payment record, the customer's overall financial position and the realisable value of any collateral. If such evidence exists, the net present value of estimated cash flows is calculated and a provision is made for loan impairment and is charged to the income statement.

The procedure followed by the Bank for the provisioning exercise comprises of an individual assessment of the exposures for specific provision and assessment for collective impairment as per the Bank's provisioning policy.

Loans together with the associated provisions are written off when there is no realistic prospect of future recovery. Partial write-offs, including non-contractual write-offs, may also occur when it is considered that there is no realistic prospect for the recovery of the contractual cash flows. In addition, write-offs may reflect restructuring activity with customers who are subject to the terms of the agreement and satisfactory performance.

The Bank may change certain estimates from period to period, however it is impracticable to estimate the effect of such individual estimates due to interdependencies between estimates and as the profile of the population of loans changes from period to period.

A very important factor for the estimation of provisions is the timing and net recoverable amount from foreclosure of collaterals that mainly comprise real estate assets.

Assumptions have been made about the future changes in property values, as well as the timing for the realization of the collateral and for taxes and expenses on the repossession and subsequent sale of the collateral. Indexation has been used to estimate updated market values of properties, while assumptions were made on the basis of a macroeconomic scenario for future changes in property values in accordance with the Loan Impairment and Provisioning Procedures Directives of 2014 and 2016 of the Central Bank of Cyprus. The timing of recovery from real estate collaterals has been estimated to be on average 3 years.

The average liquidity haircut and selling expenses used in the provisions calculation is 14,25% of the projected market value of the property collaterals at the time of their liquidation. Any changes in these assumptions or difference between assumptions made and actual results could result in significant changes of required provisions for impairment of loans and advances.

For individually significant assets, impairment allowances are calculated on an individual basis and all relevant considerations that have a bearing on the expected future cash flows are taken into account (for example, the business prospects for the customer, the realizable value of collateral, the Bank's position relative to other claimants, the reliability of customer information and the likely cost and duration of the work-out process). The level of the impairment allowance is the difference between the present value of future cash flows (discounted at the loan's original effective interest rate), and its carrying amount. Subjective judgments are made in the calculation of future cash flows.

Furthermore, judgments change with time as new information becomes available or as work-out strategies evolve, resulting in frequent revisions to the impairment allowance as individual decisions are taken. Changes in these estimates would result in a change in the allowances and have a direct impact on the impairment charge.

In addition to provisions for impairment on an individual basis, the Bank also makes collective impairment provisions. The Bank adopts a formulaic approach for collective provisions, which includes assigning probabilities of default and loss given default for portfolios of loans. This methodology is subject to estimation uncertainty, partly because of the absence of detailed individual assessment of the cash repayment particularities surrounding each exposure, due to the large number of exposures in each portfolio.

The total amount of the Bank's provision for impairment of loans and advances is inherently uncertain because it is highly sensitive to changes in economic and credit conditions which are influenced by many factors. The methodology and the assumptions used in calculating impairment losses are reviewed regularly.

Further details on impairment allowances and related credit information are set out in the Bank's Annual Report in Notes 3.2, 13 and 33 of the Financial Statement for the year ended 31/12/2016.

The tables 1, 2, 3 and 4 below provide an analysis of impaired exposures and not impaired exposures of which past due, specific and collective credit valuation adjustments during the year 2016, analyzed by major geographical area which is based on the country of origin of the counterparty of the relevant exposures:

Table 1: Impaired and not impaired loans and advances as at 31 December 2016

	Neither past due nor impaired	**Past due but not impaired**	**Impaired**	**Total**
	€000	**€000**	**€000**	**€000**
Total	148.737	33.295	254.976	437.008

6.2 Impaired and not impaired loan/exposures (continued)

Table 2: Impaired and not impaired exposures by geographical area

Counterparty country of origin	Impaired exposures	Not impaired exposures	of which: past due but not impaired	Total exposure before credit risk valuation adjustments	Credit risk valuation adjustments	Credit risk valuation adjustments of which specific	Credit risk valuation adjustments of which collective	Total exposures after credit risk valuation adjustments
	€'000	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**
Cyprus	253.872	174.841	33.071	428.713	110.923	87.293	23.630	317.790
Greece	348	470	89	818	347	-	347	471
United Kingdom	717	902	118	1.619	213	-	213	1.406
Lebanon	-	4.719	-	4.719	7	-	7	4.712
Others *1	39	1.100	17	1.139	30	-	30	1.109
Grand Total	**254.976**	**182.032**	**33.295**	**437.008**	**111.520**	**87.293**	**24.227**	**325.488**

*1: The main exposures are to United Arab Emirates.

6.2 Impaired and not impaired loan/exposures (continued)

Table 3: Impaired and not impaired exposures by industry

Impaired and not impaired exposures by main industry before and after credit risk valuation adjustments (€000)	Impaired exposures €'000	Not impaired exposures €'000	of which: past due but not impaired €'000	Total exposures before credit risk valuation adjustments €'000	Credit risk valuation adjustments €'000	Credit risk valuation adjustments of which specific €'000	Credit risk valuation adjustments of which collective €'000	Total exposures after credit risk valuation adjustments €'000
Manufacture	5.148	2.383	268	7.531	1.455	742	713	6.077
Property and Construction	87.933	17.859	1.511	105.792	33.572	32.117	1.455	72.220
Tourism	27.997	21.374	3.217	49.371	7.885	5.947	1.939	41.485
Personal and professional	87.936	86.434	16.693	174.370	42.333	27.598	14.735	132.038
Domestic Trade	20.200	27.754	3.972	47.954	10.288	7.404	2.884	37.666
Agriculture	12.385	812	228	13.197	8.902	8.517	385	4.295
Imports	11.699	8.392	2.708	20.091	6.474	4.787	1.687	13.617
Transport and Communication	355	11.271	4.160	11.626	316	-	316	11.310
Other Industries*[2]	1.323	5.753	538	7.076	295	181	113	6.780
Grand Total	**254.976**	**182.032**	**33.295**	**437.008**	**111.520**	**87.293**	**24.227**	**325.488**

*[2]: The main exposures are to Investments.

6.2 Impaired and not impaired loan/exposures (continued)

Table 4: Movement of provisions for impairment of loans and advances to customers

Provisions for impairment of loans and advances	
	€000
1 January 2016	104.046
Collections/reversals	(116)
Charge for the year :	12.126
Net charge for the year	12.010
Restriction of interest on impaired loans	7.190
Write-offs	(11.726)
	7.474
31 December 2016	**111.520**

Approximately 98% of the loans provided relate to local resident customers.

6.3 Total amounts of original exposures

The table below presents the total amount of original exposures with the off-balance sheet amounts being presented before the application of credit conversion factors and 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:

Total Amounts of Original Exposures			
Exposure Class	**Original Exposure Amounts 31/12/2016**	**Average Exposure Amount for 2016**	**Original Exposure Amount for 2015**
	€'000	**€'000**	**€'000**
Central governments or central banks	241.229	196.698	152.166
Public sector entities	410	376	342
Institutions	28.648	46.910	65.171
Corporate	69.344	68.044	66.744
Retail	38.767	40.631	42.495
Secured by real estate property	96.533	100.060	103.588
Items associated with particularly high risk	99.861	51.672	3.483
Exposures in Default	186.067	240.011	293.955
Other items	90.930	79.496	68.062

6.4 Breakdown of the exposures by Industry and exposure classes

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

Industry or counterparty types	Retail	Corporate	Institutions	Central Goverments and Central Bank	Secured by mortgages on immovable property	Exposures in default	Items associated with particularly high risk	Public sector entities	Other items	Total
	€'000	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**
Manufacture	386	3.664	-	-	1.538	5.628	-	-	-	11.216
Imports	2.367	18.275	-	-	3.444	11.789	-	-	-	35.875
Domestic Trade	4.870	17.393	-	-	10.814	21.254	632	-	-	54.963
Tourism	1.426	3.716	-	-	18.104	29.495	-	-	-	52.742
Financial Services	-	-	28.648	-	-	-	-	-	-	28.648
Governments and Local Authorities	-	-	-	241.229	-	-	-	-	-	241.229
Property and construction	1.386	3.199	-	-	8.221	22.118	80.387	68	-	115.380
Personal and professional	26.367	13.548	-	-	47.735	83.360	15.379	-	-	186.389
Agriculture	86	66	-	-	780	10.675	1.745	-	-	13.352
Transport and Communication	1.482	9.208	-	-	2.215	401	-	-	-	13.306
Other industries	397*3	274*3	-	-	3.682*3	1.347*3	1.718*3	342*3	90.930*4	98.690
Total	**38.767**	**69.344**	**28.648**	**241.229**	**96.533**	**186.067**	**99.861**	**410**	**90.930**	**851.789**

*3: The main exposures are to Investments, Export and Re-export.

*4: Other items are defined in accordance with Capital Requirements Regulation (CRR) No 575/2013 of 26 June 2013. The main exposure of €59.133.983 in other items relate to property acquired from distressed customers in debt satisfaction, which are held either directly or by entities set up and controlled by the Bank for the sole purpose of managing these properties with an intention to be disposed of.

6.5 Breakdown of the exposures by geographical area

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

	Retail	Corporate	Institutions	Central Goverments and Central Bank	Secured by mortgages on immovable property	Exposures in default	Items associated with particularly high risk	Public sector entities	Other items	Total
	€'000	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**	**€'000**
Cyprus	37.006	65.746	1.198	239.800	93.434	184.823	99.861	410	90.930	813.208
Greece	394	-	-	-	-	440	-	-	-	834
United Kingdom	607	-	7.019	-	330	765	-	-	-	8.721
Lebanon	410	3.598		-	1.876	-	-	-	-	5.883
Other EU countries *[6]	46	-	6.237	-	7	-	-	-	-	6.291
Non-EU countries *[5]	304	-	14.194	1.429	886	39	-	-	-	16.852
Total	**38.767**	**69.344**	**28.648**	**241.229**	**96.533**	**186.067**	**99.861**	**410**	**90.930**	**851.789**

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*[5]: The main exposures are to USA, and Switzerland.

*[6]. The main exposures are to Germany, Belgium and France.

6.6 Breakdown by residual maturity and exposure classes

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

Credit exposure by residual maturity as at 31 December 2016					
	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	142.778	68.034	30.417	-	241.229
Public sector entities	1	66	1	342	410
Institutions	26.633	2.012	3	-	28.648
Corporate	45.756	6.342	6.730	10.516	69.344
Retail	22.055	7.630	4.620	4.462	38.767
Secured by real estate property	24.816	6.265	16.896	48.556	96.533
Items associated with particularly high risk	69.982	21.769	4.062	4.048	99.861
Exposures in default	142.778	15.821	16.074	11.394	186.067
Other items	25.413	65.517	-	-	90.930
Total	**500.212**	**193.456**	**78.803**	**79.318**	**851.789**

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 Standardized Approach, the rating of nominated External Credit Assessment Institutions (ECAI) which are recognized by the CBC are Fitch ratings, Standard and Poor's rating services, and Moody's Investor service are used.

These ratings are used for all relevant exposure classes, which are the following:

- Exposures to central governments or central banks
- Exposures to regional governments or local authorities
- Exposures to public sector entities
- Exposures to institutions
- Exposures to corporate

7.2 Description of the process used to transfer issuer and issuer credit assessments into items not included in the Trading book

When using the ECAIs for the determination of the risk weight to be assigned on the exposures, the general rule which is applied, is based on the following priority:

- Exposure
- Counterparty
- Sovereign

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	50%	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 governments and central banks unless they are specifically stated in the CBC rules to be 0% 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 before credit risk mitigation	Total exposures after credit risk mitigation
	€000	**€000**
Credit quality bands		
0%	241.229	241.229
20%	26.634	26.634
50%	1.962	1.962
100%	53	51

8. Exposures 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.

The Bank has no equity exposures not included in the trading book for the year end 31 December 2015 and 2016.

9. Exposure to interest rate risk on positions not included in the Trading book

Interest rate risk in the Banking rook arises from significant yield curve movements (parallel shift) in both local and foreign interest rates. These movements affect the interests in loans and deposits or other instruments held by the bank. It arises as a result of timing differences in the maturity (for fixed rate) and re-pricing date (for floating rate) of assets and liabilities positions.

The Bank assesses two perspectives with relation to Interest Rate Risk in the Banking book (IRRBB) as per CBC's guidelines:

- The earnings perspective: the focus of the analysis is on the impact of variation in interest rates on reported earnings. On net interest income the bank calculates the impact on profitability of a change of 200 basis points (straight line simple approach) for local and foreign currencies interest rates.

- The Economic Value perspective: it reflects the impact of fluctuation in interest rates on the economic value of the Bank. Economic value of the Bank is viewed as the present value of the future cash flows. The "Economic Value" approach is a long-term measure of interest rate risk. It focuses on the value of the bank's equity today by quantifying the bank's "Net Worth" calculated as the difference between the Net Present Value of Assets & Net Present Value of Liabilities. For monitoring the above, the bank uses re-pricing gap schedules to measure its IRRBB. On Economic value, the bank applies sensitivity weights to each time band (as per the CBC guidelines). 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 Interest rate gap report from the above analysis is prepared for all currencies on a quarterly basis that constitute more than 5% of the own funds of the bank. The corresponding reports are reviewed by ALCO (where decisions of minimizing the risk according to the market conditions prevailing are taken). The above analysis/reports mentioned are also sent on a quarterly basis to the CBC. However, as no instruments are available to the Bank to minimize such a risk, no limit has been set and the risk is accepted as is.

9.1 Impact on net interest income

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 parallel shift in the interest rate of the main currencies:

Change in interest rates	Euro €	US Dollars €	Japanese Yen €	Other currencies €	Total €
2016					
+0,5% for Euro +1% for US Dollars +0,5% for all other currencies	376.454	91.709	613	10.628	**479.404**
-0,25% for Euro 0% for US Dollars -0,25% for all other currencies	(188.227)	-	(307)	(5.314)	**(193.848)**
2015	**Euro €**	**US Dollars €**	**Japanese Yen €**	**Other currencies €**	**Total €**
+0,5% for all currencies	380.047	38.808	580	30.739	450.174
-0,25% for US Dollars and -0,5% for all other currencies	(375.282)	(19.404)	(580)	(30.739)	(426.005)

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 parallel shift in the interest rate of the main currencies:

Change in interest rates	Euro €	US Dollars €	Japanese Yen €	Other currencies €	Total €
+0,5% for all currencies	1.141.564	871	(658)	(1.223)	**1.140.554**
-0,25% for all other currencies	(570.782)	-	329	611	**(569.842)**

10. Remuneration policy and practices

10.1 Recruitment policy in relation to the selection and nomination of new management body members

The Nomination and Internal Governance Committee, based on the terms of reference approved by the Management Body of USB bank PLC has the duty and responsibility of selection and nominating new Members in order to fill vacant posts at the management body level.

In doing so the Committee ensures that at all times the Bank is in compliance with the regulatory requirements including the CBC Directive to ACI's on the Assessment of the Fitness and Probity of the Members of the Management Body and Managers of Authorised Credit Institutions and the CBC Directive on Governance of ACI's and with the Bank's Articles of Association.

The Committee has the responsibility of overseeing the selection and nomination process to ensure that competent and suitable individuals are appointed on the Bank's Management Body. The Committee prepares and submits to the Management Body proposals for the nomination for appointment of the Executive Management Body Members.

10.2 Directorship

Based on the CBC directive of 2014 paragraph 13(3)(a) in relation to the Assessment of Fitness and Probity of Directors and Managers, a director cannot hold more than one of the following combinations:

- One executive directorship with two non-executive directorships.
- Four non-executive directorships.

For the purposes of the above, the following shall count as a single directorship:

- Executive or non-executive directorships held within the same group.

Moreover, the Directive determines that the number of directorships which may be held by a member of the Management Body at the same time shall take into account individual circumstances and the nature, scale and complexity of the activities of the ACI. This is the general principle, applicable to all ACIs both significant and less significant.

USB BANK PLC belongs to the category of "Less Significant Institution" based on an assessment of the Institutions' size, internal organization and the nature, the scope and the complexity of their activities.

Therefore, the strict provisions stated in paragraph 13(3)(a) of the Directive regarding the number of directorships held by the members of the Management Body do not apply in USB's case.

10.3 Diversity policy

The Policy of the Bank for the “Selection and Nomination of Members of the Management Body” incudes relative provisions regarding the diversity of the Board of Directors. More specifically, it is provided that in carrying out the task of identifying suitable candidates for membership to the Board of Directors, the Nominations and Internal Governance Committee of the Board of Directors takes into account the size and composition of the Board of Directors, ensuring that it is sufficiently diverse as regards age, gender and educational and professional background to reflect an adequately broad range of experiences and facilitate a variety of independent opinions and critical challenge. Additionally, in identifying suitable candidates, the Nominations and Internal Governance Committee takes into consideration the underrepresented gender in the Board of Directors and to the extent possible makes recommendations so that it is sufficiently represented. Proposed candidates are considered and approved by the Board of Directors.

10.4 Remuneration policy

USB Bank remuneration policy is in line with the signed collective agreement with the Bank Employees Trade Union (ETYK) and aims to be in line with its business strategy and objectives. The Remuneration policy is consistent with the effective management of risk and does not encourage excessive risk undertaking.

The Bank applies the provisions regarding the Remuneration of the Directors that are included in the Directive on Governance.

The Remuneration Committee proposes to the Board of Directors the remuneration policy that is prepared in accordance with the above. The Directors’ Remuneration Report is submitted for approval at the Annual General Meeting of the shareholders.

The composition and service of the members of the Remuneration Committee during 2016 was as follows:

Current composition	Since	
Chairman: George Galatariotis	21/03/2011	Non Executive, Independent
Members:		
Maurice Sehnaoui	21/03/2011	Non-Executive,Non-Independent
Ziyad Baroud	21/07/2015	Non Executive, Independent

All the members of the Remuneration Committee have sufficient knowledge and experience in remuneration policy. During the year 2016, the Committee has met five times.

The remuneration of the members of the Board of Directors is analysed between remuneration as members of the Board of Directors and remuneration for their executive services (where applicable).

10.4 Remuneration policy (continued)

Fees and emoluments of Directors and key management personnel

Directors emoluments	2016	2015
	€	€
Member Fees:		
Non executives	**315.255**	218.685
Executives	**-**	-
Total Member fees	**315.255**	218.685
Executive directors' emoluments:		
Salaries and other short-term benefits	**264.857**	265.189
Employers' contributions	**31.270**	31.270
Retirement benefit plan costs	**24.783**	23.478
Total executive directors emoluments	**320.910**	319.937
Total Board of Directors emoluments	**636.165**	538.622
Key management personnel emoluments		
Salaries and other short term benefits	**810.065**	854.482
Employer's contributions	**109.861**	114.725
Retirement benefit plan costs	**70.553**	70.892
Total key management personnel emoluments	**990.479**	1.040.099
Total emoluments	**1.626.644**	1.578.721

Remuneration of key management personnel for 2016 (excluding termination benefits) by business line:

	Remuneration	Number of Employees
	€000	
Corporate	114.713	1
Retail	131.836	1
IBU	122.248	1
Head office	621.682	7
Total	**990.479**	**10**

Remuneration of Executive members of the board

The salaries and other short-term benefits of the Executive members of the board totalling €265K (2015: €265K) concern €163K (2015: €163K) for Mr. Andreas Theodorides and €102k (2015: €102K) for Mrs. Despo Polycarpou.

The employment and remuneration of the Executive Directors are governed by the collective agreements as applied to all other staff members of the Bank.

The Executive members of the Board of Directors are also entitled to any other benefits that are offered to the management and personnel of the Bank as part of its overall employment policy and collective agreements.

As far as the remuneration of the Executive Directors is concerned, the Remuneration policy does not provide, for any variable remuneration components or schemes which share options are granted.

10.4 Remuneration policy (continued)

All Executive Members of the Board of Directors are participating in the Staff Retirement Benefits Scheme with the same terms applicable to the personnel of the Bank. The main characteristics of the Scheme are described in Note 6 of the audited financial statements for the year ended 31 December 2016.

Remuneration of Non- Executive Directors

The Remuneration of the Non-Executive members of the Board includes fees for their participation as members in the Board of Directors of the Bank and also as members in the Committees of the Board of Directors.

Based on the existing policy of the Bank, the remuneration of the Non-Executive Directors is based on their responsibilities, time spent on meetings and their participation to the various Committees of the Board of Directors and is not connected with the profitability of the Bank.

Also, in accordance with the Articles of Association of the Bank, the members of the Board of Directors can claim the expenses incurred in relation to their attendance in meetings and in connection with the execution of the business of the Bank.

The revision of the remuneration of the Non-Executive Directors is authorised by the Members of the Bank at a General Meeting of the Bank.

During the Annual General Meeting of the Members of the Bank on the 26th of July 2016, a revision of the remuneration of the Non-Executive Directors was approved, with retrospective effect as from the 1st of August 2015.

Retirement benefits

The Company and its employees contribute to the Government Social Insurance Fund based on employees' salaries. In addition the Bank and its employees make contributions to a defined contribution scheme, the assets of which are held in a separate trustee-administered fund (the "Provident fund of the Employees of USB Bank Plc"). The scheme is funded by payments from employees and by the Bank. The Bank has no legal or constructive obligations to pay further contributions if the scheme does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods.

10.5 Reporting and control

A description of the information flow on risk to the BoD is provided in Appendix III.

11. Leverage

11.1 Definition of Leverage ratio

The disclosure has been prepared using the format set out in Annex I and Annex II of the final "Implementation Technical Standards with regard to disclosure of the Leverage ratio for instructions (Commission Implementing Regulation-EU 2016/200).

According to CRR, Article 429 paragraph 2, the leverage ratio shall be calculated as an institution's capital measure divided by the institution's total exposure measure and shall be expresses as a percentage.

The leverage ratio of the Bank is calculated using two capital measures:
(a) Tier 1 capital: fully phased-in definition.
(b) Tier 1 capital: transitional definition.

As a result, two leverage ratios are calculated.

11.1.1 Tier 1 Capital

Tier 1 capital fully phased-in definition is the amount of Tier 1 capital without taking into account the derogations advised by CRD IV, while the Tier 1 capital under the transitional definition is after taking into account the derogations.

11.1.2 Total exposure measure

Total exposure measure is defined as the sum of exposure values of all assets and all off-balance sheet items not deducted when calculating Tier 1 Capital. Total exposure measure is calculated on a quarterly basis and it is referred to as "3-Month-Value".
Exposure measure includes:

- All On-balance sheet assets;
- Other non-trading book exposures.

11.2 Leverage ratio

As the leverage ratio has not yet been implemented in the reporting framework of the European legislation, the calculation is still based on the Basel III framework. The minimum regulatory requirement of the leverage ratio for the transitional period from 1 January 2015 to 1 January 2017 was set at 3%.

Following the increase in capital of the Bank in May 2016, the Bank's leverage ratio has been increased and as at 31 December 2016, the leverage ratio of the Bank was equal to 8,05% (2015: 5,25%) using a fully phased-in definition of Tier 1 and 8,05% (2015: 5,25%) using a transitional definition of Tier 1. This ratio is well above the 3% regulatory limit.

The Bank's leverage ratio is calculated on a quarterly basis.

11.2 Leverage ratio (continued)

11.2.1 Summary reconciliation of accounting assets and leverage ratio exposures

	Applicable Amount
	€000
Total assets as per published financial statements	**853.034**
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	(40.764)
Other adjustments	(1.246)
Leverage ratio total exposure measure	**811.024**

11.2.2 Leverage ratio common disclosure

	CRR leverage ratio exposures
	€000
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**797.644**
(Asset amounts deducted in determining Tier 1 capital)	(620)
Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)	**797.024**
Other off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	54.765
(Adjustments for conversion to credit equivalent amounts)	(40.765)
Other off-balance sheet exposures	**14.000**
Capital and total exposure measure	
Tier 1 Capital	**65.271**
Leverage ratio total exposure measure	**811.024**
Leverage ratio	
Leverage ratio	**8.05%**

11.2.3 Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)

	CRR leverage ratio exposures
	€000
Total on-balance sheet exposures (excluding derivatives and SFTs) of which:	**797.024**
Banking book exposures, of which:	
Exposures treated as sovereigns	241.229
Institutions	28.596
Secured by mortgages of immovable properties	88.275
Retail	40.864
Corporate	121.613
Exposures in default	185.717
Other items	90.730

Appendix I – Glossary of terms

AFS	Available-for-sale
ALCO	Assets and Liabilities Committee
BoD	Board of Directors
CBC	Central Bank of Cyprus
CCB	Capital Conservation Buffer
CCyB	Countercyclical Capital Buffer
CEO	Chief Executive Officer
CET 1	Common Equity Tier 1
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
IAU	Internal Audit Unit
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
IRRBB	Interest Rate Risk Banking Book
IT	Information Technology
LCR	Liquidity Coverage Ratios
MIS	Management Information System
NPE	Non-Performing Exposure
RMC	Risk Management Committee
RMU	Risk Management Unit

Senior Management:

- Chief Executive Officer
- Internal Audit Manager
- Assistant General Manager/Retail Banking, Products Development and Marketing Manager
- Assistant General Manager/Compliance and Projects Manager
- Risk and Legal Services Manager
- Corporate Banking Manager
- Treasury and Correspondent Banking Manager
- Finance Manager
- Debt Recovery Manager
- International Business Division Manager

Appendix II – Prudential Liquidity ratios

Liquid assets ratio in Euro
The Liquid Assets Ratio in Euro is the ratio of the Bank's Liquid Assets on its total client deposits and other liabilities with remaining maturity up to 1 year. This ratio must be at least 20%. It is defined as follows:

Liquid Assets Ratio (Euro) = Liquid Assets / (Total client deposits + other liabilities with remaining maturity up to 1 year)

Liquid Assets, as far as the CBC is concerned, are the following: a) Cash, b) Central Bank & other bank balances maturing in a period up to 1 month, c) the balance of the Minimum Reserve account (MRR) held at the CBC, d) credit claims that can be used as collateral for Eurosystem monetary policy credit operations and for the provision of intraday credit and e) readily liquefiable investments.

Liquid assets ratio in foreign currencies
Additionally, based on CBC's Directive to Banks on the Computation of Prudential Liquidity in foreign currencies, banks are required to maintain at all times (adequate) liquid assets against their liabilities in foreign currency. A bank's liquid assets, reduced by 90% of credit balances of other banks with remaining maturity up to 12 months, have to exceed 70% of its total client deposits in foreign currency.

Liquid assets ratios (FC) = (Liquid Assets – 90% of other Liabilities in FC with remaining maturity <1 year)/ Total deposits in FC

As far as this Directive is concerned, liquid assets include: a) Cash in foreign currency, b) deposit and other balances with the Central Bank including the Minimum Reserve account (MRR) balance, c) eligible assets in foreign currency that can be used as collateral for Eurosystem monetary policy credit operations and for obtaining intraday credit, d) deposits in foreign currency with other banks maturing in a period up to 6 months with a minimum short-term rating A-1, e) commercial paper in foreign currency of governments or guaranteed by them, with remaining maturity up to 6 months and a minimum short-term rating of A-1, f) bonds and other debt securities in foreign currency of governments or guaranteed by them or of banks, which are traded in recognized exchanges and have a minimum long-term rating of A-.

Banks have to avoid excessive concentration of liquid assets. In this regard, placements with any one bank or banking group and bonds of same group may not exceed 10% of total liquid assets or €50 mil., whichever is higher. Additionally, banks must abide by the provisions of the Directive regarding Large Exposures.

Liquidity mismatch ratio "0 to 7 days"
The Liquidity mismatch Ratio "0 to 7 days" is defined as the net position of the Bank in the next 7 days on its total client deposits regardless of contractual maturity. Net position means all assets that may be available to the Bank in the next 7 days minus the liabilities which may be payable by the Bank in the next 7 days (i.e. expected inflows minus expected outflows of the next 7 days).
Liquidity Mismatch Ratio 0-7 = (Assets maturing within 0-7 days horizon – Liabilities maturing within 0-7 days horizon) / Total client deposits regardless of contractual maturity
Based on CBC's Directive, this liquidity mismatch ratio 0-7 days has to be no less than -10%. The fact that the ratio may be negative, implies that assets (loan repayments within the next 7 days, investments that mature within the next 7 days and investments that are considered as liquid) could be less than liabilities (deposits maturing within the next 7 days, deposits which have no maturity (current accounts - sight, savings/notice) and other liabilities, e.g. expiring loan capital or liabilities to other banks (vostros) falling due within the next 7 days) by as much as 10% of total client deposits in euro.

Liquidity mismatch ratio “0 to 30 days”
Finally, the Liquidity mismatch ratio “0 to 30 days” is defined as the net position of the Bank in the next 30 days on its total client deposits regardless of contractual maturity. As was the case in the previous ratio, net position means all assets that may be available to the Bank in the next 30 days minus the liabilities which may be payable by the Bank in the next 30 days. In other words, expected inflows minus expected outflows over the next 30 days.

Liquidity mismatch ratio 0-30 = (Assets maturing within 0-30 days horizon – Liabilities maturing within 0-30 days horizon) / Total client deposits regardless of contractual maturity
The liquidity mismatch ratio 0-30 days has to be no less than -25%. Again, the fact that the ratio may be negative, implies that assets (loan repayments within the next 30 days, investments that mature within the next 30 days, and investments that are considered as liquid) could be less than liabilities (deposits maturing within the next 30 days, deposits which have no maturity (current accounts - sight, savings/notice) and other liabilities falling due within the next 30 days) by as much as 25% of total client deposits in Euro.

Gross loans to deposits ratio
The Gross loans to deposits ratio is a fundamental ratio for retail and commercial banks which assesses the amount of loan activity which is funded by customer deposits.

Gross loans to deposits ratio = Customer Assets (Gross Loans) / Customer Deposits

Liquidity Coverage ratio
The Liquidity Coverage Ratio (LCR) is a new liquidity ratio that was officially put in force in the EU from 1 October 2015, even though all banks have been required to calculate and report it for the past two and a half years. This LCR ratio essentially ensures that there are sufficient liquid assets to cover expected net outflows (from deposits and other liabilities) over the next 30 days, based on specific run-off rates for different deposit categories, e.g. for retail deposits, for high risk deposits, etc. LCR is defined as follows: LCR = Liquid Assets/ Expected Net Outflows over the next 30 days

The LCR ratio in all currencies should exceed 100% for all banks from 2019 onwards. The minimum LCR has been set at 60% on 1 October 2015 and is expected to rise in equal annual steps to reach 100% on 1 January 2019.

The definition of liquid assets differs from the definition in CBC’s Liquidity Directives. One major change is that bank placements are no longer considered as liquid assets in the numerator of the ratio but instead are considered as expected inflows in the denominator (except for ECB placements which still count as liquid assets). This differential treatment will lead to a lower level of liquid assets and LCR when bonds mature and funds are placed in placements with other banks. A second and more material change is that in the LCR framework, investments in financial institutions are not considered as liquid assets, except if in covered bonds which are mortgaged-backed. Essentially, the new EU framework pushes banks away from investments in the financial sector (for diversification purposes) and into corporate bonds, sovereigns and supranationals.

Net Stable Funding Ratio (NSFR)
The NSFR is defined as the amount of available stable funding relative to the amount of required stable funding. This ratio should be equal to at least 100% on an ongoing basis. “Available stable funding” is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. The amount of such stable funding required ("Required stable funding") of a specific institution is a function of the liquidity characteristics and residual maturities of the various assets held by that institution as well as those of its off-balance sheet (OBS) exposures.
NSFR = Available amount of stable funding / required amount of stable funding.

Available stable funding
The amount of available stable funding (ASF) is measured based on the broad characteristics of the relative stability of an institution's funding sources, including the contractual maturity of its liabilities and the differences in the propensity of different types of funding providers to withdraw their funding. The amount of ASF is calculated by first assigning the carrying value of an institution's capital and liabilities to one of five categories as presented below. The amount assigned to each category is then multiplied by an ASF factor, and the total ASF is the sum of the weighted amounts. Carrying value represents the amount at which a liability or equity instrument is recorded before the application of any regulatory deductions, filters or other adjustments.

Required stable funding
The amount of required stable funding is measured based on the broad characteristics of the liquidity risk profile of an institution's assets and OBS exposures. The amount of required stable funding is calculated by first assigning the carrying value of an institution's assets to the categories listed. The amount assigned to each category is then multiplied by its associated required stable funding (RSF) factor, and the total RSF is the sum of the weighted amounts added to the amount of OBS activity (or potential liquidity exposure) multiplied by its associated RSF factor. Definitions mirror those outlined in the LCR, unless otherwise specified.

ILAAP Stress coverage ratio
The ILAAP Stress coverage ratio is a liquidity ratio that is derived and calculated through liquidity stress testing. It measures the proportion of cumulative cash outflows at a specific point in time under stress that are covered by the Bank's post haircut counterbalancing capacity (i.e. liquid assets portfolio)
ILAAP Stress coverage ratio = Counterbalancing capacity / Net funding Gap (cumulative inflows−cumulative outflows)

Survival Days
Measures the number of days that the Bank can survive under a liquidity stress, given its stressed cash inflows, outflows and counterbalancing capacity. It is expressed in number of days.

Liquid Assets
Liquid Assets, as far as the CBC is concerned, include the following: a) Cash, b) Central Bank & other bank balances maturing in a period up to 1 month, c) the balance of the Minimum Reserve account (MRR) held at the CBC, d) credit claims that can be used as collateral for Eurosystem monetary policy credit operations and for the provision of intraday credit and e) "readily liquefiable investments".
According to the Directive (para. 3.6.1), "readily liquefiable investments" are investments which may be readily liquidated or that can be used in repurchase agreements (repos) or be used as collateral for Eurosystem monetary policy operations as well for the provision of intraday credit.

The following are considered as immediate liquidity investments:

- All assets that are eligible as collateral for Eurosystem monetary policy operations as well for the provision of intraday credit
- All sovereign and non-sovereign bonds and other debt instruments which do not fall under (a) above, but with issuers based in an EU country, Australia, Canada, Japan, Switzerland, the USA and which i) are traded in a regulated market and ii) have at least an A- rating from at least one rating agency (c) Equity shares listed in regulated markets of EU member countries
- Mutual Funds traded in regulated markets

For liquidity purposes, the investments above are classified as liquid investments in the 0-7 days' time zone at their market value after applying relevant haircuts.

The haircuts applicable in the investment categories above are summarized as follows:

- For assets that are eligible for use as collateral in Eurosystem monetary policy operations, a schedule issued by the ECB illustrates the haircuts that apply. For Cyprus Government Bonds+ a haircut of 10% is applied according to the most recent CBC's circular dated 2 June 2016
- For Bonds and other debt instruments falling under (b) above (i.e. not the ECB eligible), a haircut of -10% applies for sovereigns and -20% for corporates (including financials)
- For equities listed in regulated markets, -40%
- For mutual funds traded in regulated markets, haircuts depend on the composition of their investments apply. A haircut of 20% is applied on the debt securities portion of the portfolio, while 40% on the equity portion

<u>Definition of Liquid assets according to the Liquidity Coverage Ratio (LCR)</u>
With regards to the Liquidity Coverage Ratio (LCR) financial bonds are not considered as liquid, except in special cases (e.g. if they are covered or asset backed of high quality, or government guaranteed). More specifically, under the LCR, bonds are considered as Extremely High Quality Liquid Assets if they fulfil the following characteristics:

- Issued or guaranteed by EEA sovereigns and EEA central banks in their domestic currency
- Issued or guaranteed by supranational institutions
- EEA covered bonds rated ECAI 1 with a minimum issue size of €500 million and subject to additional conditions relating to the regulations governing the covered bond structure

Furthermore bonds are considered as high quality liquid assets if they are not included in the above categories and they fulfil the following characteristics:

- Sovereign bonds issued in domestic currency rated ECAI 2 or above, of minimum issue size €100 million
- Covered bonds rated ECAI 1 with a minimum issue size €250 million
- Corporate bonds rated ECAI 4 or above, of minimum issue size €250 million and maximum time to maturity of 10 years
- RMBS (Residential Mortgage Backed Securities) rated ECAI 1 of minimum issue size €100 million and a maximum time to maturity of 5 years subject to additional regulatory requirements
- Issued by local government institutions in EEA currencies, rated ECAI 2 or above, of minimum issue size €250 million and maximum time to maturity of 10 years

Appendix III – Information flow on risk to management body

S/N	Report Name	Report Description	Owner of Report / Preparer	Recipient (Competent Authority)	Frequency
1	Financial activity report	Describes and analyses the financials of the Bank	Finance Department	BoD	Quarterly
2	Annual AML report	A report submitted to both BOD and CBC detailing the progress of the Bank as regards to AML matters as well as identifying and addressing any weaknesses and risks.	AML Dept	1. CBC 2. Audit Committee 3. BoD	Yearly
3	Annual Risk assessment report	A Risk Assessment Report submitted to both BOD and CBC outlining risks, weaknesses and measures if any.	AML Dept	1. CBC 2. Audit Committee 3. BoD	Yearly
4	Annual compliance report	A report submitted to both BOD and CBC detailing the progress of the Bank as regards to Compliance matters as well as identifying and addressing any weaknesses and risks.	Regulatory Compliance Dept	1. CBC 2. Audit Committee 3. BoD	Yearly
5	Quarterly risk report	COREP, new legislation/CBC Directive, new/or additional credit facilities > €400k, liquidity issues, NPE, quarterly operational risk report, provisions, various other risk issues	RMU	Board Risk Committee	Quarterly
6	Annual report on information security	Report of security incidents, actions taken to improve security	ISO	1. CBC 2. Board Risk Committee 3. BoD	Yearly
7	Summary of Investment limits	Monitor on a daily basis compliance with USB Bank's	Treasury and Correspondent Banking Dept.	USB Bank's ALCO	every ALCO
8	Loans arrears resolution targets	Comparison of actual results to the CBC Loan arrears resolution targets	Finance Department / RMU	1. Board Risk Committee 2. CBC	Quarterly

9	Annual risk report	Annual assessment and measurement of all risks and outlook covering, but not limited to specific CBC requirements	RMU	1. BoD 2. Board Risk Committee 3. CBC	Yearly
10	ICAAP	Internal Capital Adequacy Assessment Process	RMU	1. BoD 2. Board Risk Committee 3. CBC	Yearly
11	ILAAP	Internal Liquidity Adequacy Assessment Process	RMU	1. BoD 2. Board Risk Committee 3. CBC	Yearly
12	PILLAR III	Disclosures of information in accordance with Article 431 of the CRR	RMU	1. BoD 2. Board Risk Committee 3. CBC	Yearly
13	Recovery Plan	To formulate the framework in terms of actions capable of restoring the Bank's capital and liquidity metrics under stress scenarios thus strengthening the Bank's ability to restore its financial and economic standing	RMU	1. BoD 2. Board Risk Committee 3. CBC	Yearly