USB BANK PLC

Pillar 3 disclosures for the year ended 31 December 2013

December 2013

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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. The activities of the Bank are mainly focused on three large business areas: Retail Banking, Corporate Banking and International Banking.

This report has been prepared pursuant to paragraph 70(1) of Chapter 5 of Unit A (the "Disclosures") of the Directives to banks for the calculation of the capital requirements and large exposures of banks of 2006 to 2011 ('the Directives') issued by the CBC. The Directives implement the European Union's Capital Requirements Directive ('CRD').

The Directives describe the Basel II framework which is based on three pillars:

- Pillar 1 has to do with the standards that set out the minimum regulatory capital requirements that are required for credit, market and operational risk;

- Pillar 2 covers the Supervisory Review Process which assesses the internal capital adequacy processes. Banks and Supervisors have to evaluate and assess whether a bank should hold additional capital against risks not covered in Pillar 1;

- Pillar 3 (Market discipline) covers transparency and the obligation of banks to disclose meaningful information to the market related to their risks, capital and generally risk management.

The Bank's Disclosures below have been prepared using 31 December 2013 data in accordance with the Directive.

The Bank in its normal course of business, acquires properties in satisfaction of distressed customer debt. The properties are acquired by companies which are controlled directly or indirectly by the Bank and whose sole business is the management of these properties. The properties are recognized in the Financial Statements of the Bank as investment properties and are consolidated for accounting purposes, reflecting the substance of these transactions.

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

2.1 Risk Management Framework

The 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 ten persons, other than the Risk Manager. There are four employees allocated to the Credit Risk Management Unit, two employees to the Credit Systems & Processes, two employees to the Operational Risk Management Unit, one employee to the Legal Services Department and the personal assistant of the Risk Manager (one employee).

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

During 2013, the Bank strengthened its human capital base by employing new staff including a Manager of Non-Performing Loans. The Bank transferred 11 persons to this new Unit and in addition to this recruitment, created a new Division named Arrears Monitoring Division where it transferred an existing member of the top management to the position of the Manager of Arrears Monitoring Division plus four persons from the existing staff. The remaining positions have been allocated to both lower level staff and middle management. Also, beginning of 2014 a new recruitment of top management was made for replacing the Internal Audit Manager and transferring the previous Manager to a new Division named Centralized and Support Services.

As a result of new directives issued by the Central Bank of Cyprus during the year following the MOU with Troika as well as to strengthen its internal control framework, the Bank has proceeded with organizational and structural changes as follows:

- Creation of Arrears Management Unit
- Creation of Credit System and Processes Unit
- Strengthening of NPL Monitoring unit staffing levels and the creation of regional NPL Units
- Creation of Acquisition and Disposal Committee at Board Level
- Creation of Appeals Committee to examine customer complains arising from the Arrears Management Framework
- Transfer of Information security Unit under the Risk Department

The Bank's risk framework consist of the general risk management framework and specifically the credit, market and operational risk frameworks which have been finalized and approved by the BoD, following consultation with the Bank's parent company BLC Bank S.A.L. Each of the frameworks are updated if needed by the Bank's RMU, 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. These principles are dynamically evolving and reviewed from time to time be compliant and consistent with the changing internal and external environment of the Bank.

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

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.

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.

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

USB 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 best practices.

The Bank 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 an important objective for the Bank is to continuously improve its capabilities and its measurement techniques in order to achieve a more risk sensitive approach in the future. Specific attention is given to those risks that are not quantifiable, such as reputational risk, and therefore their effective assessment relies on qualitative criteria.

The Bank's quantitative risk appetite may be expressed through the minimum capital adequacy ratios that the Bank should abide by. The Bank has set its Pillar I capital requirements equal to the Pillar I minimum regulatory capital requirements prescribed by the CBC and after taking into consideration the European Union Directive in regards to the calculation of the capital requirements and large exposures of banks (Basel II).

In July 2011, the CBC amended its Directive for capital requirements, introducing a new ratio for Core Tier 1 capital. The minimum level of the new ratio was set at 8% for the period until 30 December 2012. After that date, the minimum level of the ratio increased gradually based on the percentage of Group assets over the gross domestic product of the Republic of Cyprus. The Directive had also set the minimum level of Tier 1 capital as the minimum level of Core Tier 1 ratio plus 1,5%. In addition, it had set the minimum total capital ratio as the Tier 1 ratio plus 2,0%. As a result, the minimum Core Tier 1, Tier 1 and total capital ratios throughout the period and until 30 December 2012 were set at 8,02%, 9,52% and 11,52% respectively. On 31 December 2013, the CBC increased the minimum Core Tier 1 capital ratio from 8% to 9% and the minimum requirements for Tier 1 and total capital ratios have been abolished.

As from 1 January 2014, the new Capital Requirement Regulations (CRR) and amended Capital Requirement Directive IV (CRD IV) became effective. The CBC is assessing the options over the application of transitional provisions relating to Common Equity Tier 1 deductions. On the basis of that assessment, the CBC will set the minimum capital ratios taking into account the parameters of the balance sheet assessment and the EU-wide stress test, in consultation with the Troika and informing European Stability Mechanism.

The minimum required prudential capital ratios as of 31 December 2013, listed below, were calculated using the latest information available from the Statistical Service of the Ministry of Finance for real GDP.

Capital	Minimum capital adequacy ratios	
	2013	2012
Core Tier 1	9%	8,02%
Original Own Funds (Tier 1)	n/a	9,52%
Total Own Funds (Tier 1 and Tier 2)	n/a	11,52%

2.3 Risk Bearing Capacity

The Bank defines its risk bearing capacity as the ability to absorb risks without unacceptable damage to its earnings and capital levels, to the current business plan objectives, as well as to the overall reputation of the Bank. The risk bearing capacity assists the Bank to monitor the risks it faces and to manage them appropriately as it represents the maximum amount of risk that the Bank can maintain.

The risk bearing capacity is expressed as the level of available internal capital the Bank possesses to absorb risks. The available internal capital is defined as Original Own Funds and Additional Own Funds (Tier 2) less deductions. The Bank's definition of internal capital is equal to the definition of regulatory capital. Namely USB's capital base consists of the following elements:

- Original Own Funds (Tier 1 capital) comprise of paid up share capital, share premium, retained losses net of foreseeable dividends and hybrid instrument eligible as Tier 1. The book value of intangible assets including goodwill and prudential filters (i.e. valuation differences arising in AFS equities and property) are deducted in arriving at Tier 1 capital;

- Additional Own Funds (Tier 2 capital) comprise of qualifying subordinated loan capital and prudential filters.

It should be noted that the Bank does not bear any significant risks without its parent company's consent; namely decisions with regards to investments are taken jointly by BLC ALCO and the Bank's ALCO. Similarly any credit facilities to corporate customers above €500k which are unsecured or credit facilities of €1m which are secured with mortgages, are approved by the Credit Committee, which includes BLC and Fransabank representatives, while lending delegation limits are approved by the Bank's Board of Directors. The Bank views risk on a case by case basis ensuring that the Bank is never exposed to undue risk.

Furthermore, the Bank has suspended personal lending delegation limits, and concentrated heavily on its restructurings. Restructurings are approved by the CEO following recommendations by the Risk Management Unit. The Bank's policy is to refrain from new lending with exception of new lending on the basis of cash guarantee or utilization of limits and cases of exceptional rating of existing new customers

2.4 Credit Risk Management

2.4.1 Definition

The Bank defines credit risk as the risk of incurring losses that arise from the default of a borrower or counterparty because his/her financial position has deteriorated to a point that the value of an asset (including off balance sheet assets) is reduced or extinguished.

2.4 .2 Materiality

Credit risk is considered as a medium materiality risk because the amount and percentage of existing NPL's in our Bank is already high based on the existing adverse economic environment and is not expected to increase by more than 5% based on the difference in the assumptions between the Baseline and the Stressed scenario for 2014 before it starts dropping in the following years 2015, 2016.

2.4.3 Risk Governance

The management of credit risk and its associated risks is performed by the board of directors and the Senior Management. Nonetheless, the primary responsibility of the management of credit risk and its associated risks lies with the Credit Risk Department and the Credit Systems and Processes Department which are both reportable to the Risk Manager.

The Credit Risk Department has the responsibility to evaluate and assess the Bank's credit risks as well as manage and control them using the various mechanisms established by the Bank. It is primarily responsible for the implementation of CRR/CRDIV, credit appraisals, reporting to CBC and top management, collateral issues and issuance of credit risk policies.

On the other hand, the Credit Systems and Processes Department is mainly responsible for the development, improvement and upgrading of the Bank's credit related systems, policies and processes. More specifically it is responsible for studying and analyzing all the new directives, issued from time to time by the Central Bank of Cyprus, and issue relevant circulars to staff. It also prepares business analysis requirements and specifications for the purpose of adding new fields in the core banking system, for automating procedures relating to credit and for the creation of various reports in accordance with the needs and requirements of the Bank internally and the Central Bank of Cyprus. Finally, the department is assigned the project management of various credit related projects within the Bank.

2.4.4 Policies and Procedures

The Bank has prepared a credit risk management framework that governs the effective management of credit risk and credit policy.

The Bank's credit risk management framework outlines the tools designed by the Bank for effective management of credit risks, while the credit policy manual describes the Bank's policy with regards to credit granting and assumption of credit risk. Additionally, the credit policy addresses information on the industries/markets available to lend, product mix, pricing policy, structure of limits, approving authorities, MIS reporting, recoveries and provisioning policy.

Both the credit policy and credit framework are designed within the context of the Bank's internal conditions (e.g. size, structure, capital base) and external market conditions (the banking industry and competition in Cyprus).

The objectives of these documents are (i) to promote and maintain sound lending standards and a sound credit risk management framework, (ii) monitor and control credit risk, (iii) assist and guide the Bank's employees on the performance of their duties in a uniform way across the Bank, (iv) clarify the credit risk profile of the Bank, (v) assist the Bank in achieving its goals, (vi) assist the Bank to comply with laws and regulations with regards to lending, (vii) identify the Bank's target customers, (viii) identify and administer problematic credit facilities.

2.4.5 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 reports;

<u>Collaterals:</u> In an effort to mitigate credit risk, the Bank requires collaterals against exposures. The Bank accepts as collateral, items, such as (a) cash pledged, deposited with 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.

<u>Credit Granting:</u> 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, sending out renewal notices 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.

Due to the importance of ensuring that the customer's internal grading accurately reflects the quality of individual credits, the responsibility for assigning or confirming such grading rests with the Risk Management Unit and the Internal Audit Department.

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.

This system is expected to enhance the Bank's credit risk assessment process for corporate customers given the benefits provided which are outlined below:

- It offers tools to facilitate financial statements analysis and enhance credit risk decision making for existing or new customers.
- It is a powerful uniform framework to collect, analyze and store credit data for standardized decision making.
- It collects analyses and stores historical and projected financial statements as well as non-financial assessment data for the bank's clients.
- It provides transparency and ease of use by bringing data, business rules and analysis together offering visibility into the underlying components.
- Through the use of multiple scoring scenarios, Risk Analyst can accommodate dynamic factors and weightings, for example, varying sector attributes, the availability and quality of the financials, account behavior of the obligor, its owners/directors and company-group relationships, etc.
- It reduces data entry errors and helps avoid costly mistakes.
- Examines clients' cash flows and ratios and make comparisons with peers of a foreign jurisdiction (North America).
- It is a framework within which the bank can determine defaults estimates, obligor, and facility ratings and loss severity estimates.

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 and problems (>90 dpd). The attempts from the Bank for restructuring settlement or coverage of the irregularity by the customer may have not yet resulted in the desired outcome but no legal measures have been taken yet even if the customer is flagged as NPL
"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.

During 2013 the Bank proceeded in a number of negotiations with customers concerning the restructuring of their facilities. Due to the adverse economic conditions prevailing in the Cyprus economy, a number of borrowers were or became apparent that they would be unable to repay their facilities in accordance with the original terms of the agreement with the Bank. The Bank, in collaboration with its customers, proceeded to amend the original terms by offering more favorable terms to its borrowers such as the extension of grace period (with or without payment of interest), differing the payment of one or more loan instalments, reducing the amount of each instalment while extending the duration of the loan so that customers could facilitate the repayment of their obligations, and also giving the repayment option of bullet payment of their obligations in justifiable cases. At the same time, through the restructuring of loans, the Bank through its negotiation with the customers managed to improve the quality of collaterals (tangible and intangible) according to the abilities of each customer and as a result to limit its loses.

Provision Policy

The Bank's provision policy was revised at the end of year 2013 in order to comply with the CBC Directive for impairment of loans and advances, which was finally issued in February 2014. It is in line with the spirit of the requirement of IAS 39, which states that an assessment shall be made at the end of the reporting period in order to identify whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Bank's policy for specific and collective provisions

The Bank reviews the collectability of its loans and advances to customers and assesses whether a provision for impairment should be recorded in 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.

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 subject to a materiality threshold 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 in accordance with the relevant Directives of the CBC
- Exposures that are Performing but Restructured in accordance with the relevant Directives of the CBC

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.

Assumption regarding the realizable value of real estate collateral

A model is used to predict the realizable value of the collateralized properties at the time of disposal using as a benchmark the latest independent valuation in hand. Some other considerations taken into account for assessing the realizable value of the collateral include projections of the Cyprus economy and Management best estimates.

The realizable value is determined as the lower of the expected value at the point of sale given the above assumptions and the property's mortgaged value. The time of disposal is assessed on a case by case basis, bearing in mind the particular characteristics of each case, the customer's classification, customer intentions and market expectations.

Collective provision

All exposures which are assessed on an individual basis but for which no impairment is recognized 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.

2.4.6 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, large exposures and Director Facilities etc.

2.4.7 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 NPLs causing additional specific and collective provision
- Decrease in expected interest rates margin by 0,25%
- Further average decrease of Investment Properties values
- Operational risk capital needs

2.5 Operational Risk

2.5.1 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 man 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: The Bank is currently facing legal proceedings from certain customers at Evagoras Pallikarides branch regarding the branch manager, which was discovered by the Bank in June 2010. The Bank has formed a Committee which negotiates with the customers and their lawyers, where applicable, in order to settle the cases out of court. The Bank has recovered part of the amount through its BBB insurance policy. In addition the Bank has granted a loan to the above employee and his brothers, after obtaining tangible collateral with the aim to use part of the funds from the loan to repay part of the aggrieved customer claims.

Additionally the Bank is facing infringement proceedings before the CPC (Commission for the Protection of Competition) after a complaint lodged by FBME Card Services Limited ("FBME") on 4 January 2010 against JCC and the majority of commercial banks in Cyprus. The infringement that is being investigated by the CPC against the Bank, is that JCC Payment Systems ("JCC"), together with USB entered into a vertical agreement for the determination of Local Interchange Fees in violation of section 3(1)(a) of the Protection of Competition Laws of 2008 to 2014 and of section 101 of the Treaty on the Functioning of the European Union. CPC has indicated in its Statement of Objections that the bilateral agreement entered into with JCC (including the one entered into by the Bank) prima facie has an object and/or result in the restriction of competition in the market for the issuance of credit cards and in effect operate as de facto exclusivity resulting in the exclusion of FBME from the market for acquiring payment cards in the Republic of Cyprus.

A preliminary assessment has been given by the Bank's external legal advisors to the effect that prima facie they are of the impression that the facts and legal grounds of the alleged infringements are not unfounded, nor readily dismissed, nevertheless they cannot formulate an opinion and assign percentages as to the likelihood of the imposition of fines or other measures.

2.5.2 Materiality

The risk is considered to be of Low to Medium materiality for the Bank, given that operational risk is present in all of the Bank's activities.

2.5.3 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 / procedures issued to staff.

2.5.4 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 the new online software system, named STORM, in May 2012, all data losses as well as near miss events are collected by all Branches/Departments of the Bank.

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”.

Control Risk Self Assessment Exercise: The Bank has implemented a new procedure concerning the Control Risk Self Assessment (CRSA) exercise to be completed by all Branches/Departments of the Bank by 15th of November of each year. The purpose of the exercise, is the identification of all operational risks, their assessment by the Managers of the Branches/Departments according to the probability of occurrence and their impact on profitability, the identification of controls in place, the identification of the Key Risk Indicators (KRIs) concerning each risk described, as well as proposed action plans to be taken by the Management.

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.

The Bank has issued a policy and procedural circular regarding outsourcing to 3rd parties in line with the CBC’s directives.

2.5.5 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);
- 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);
- Formalizes contingency plan actions into Standard Operating Procedures (SOP);
- 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;
- Creates a framework which can be continuously reviewed and updated, with post event analysis incorporated into best practice.

2.5.6 Reporting

The Operational Risk Unit reports frequently any data losses to the Risk Manager.

2.5.7 Capital Requirements

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

2.5.8 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.

2.6 Market Risk

2.6.1 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.

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.

2.6.2. 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.

2.6.3. 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.

2.6.4. 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.

2.6.5. 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.

Any deviations from the above limits are reported to the Chief Executive Officer and to the Manager of Risk and Legal Services Department, whilst an 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 Risk Manager.

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 sell or hold 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 (for further details kindly refer to Appendix II). Specifically:

- All investments purchased (as at the date of purchase) should be considered as liquid (as per the CBC's guidelines). Furthermore, investments in corporate bonds should be limited to financial institutions only (including investment banks/companies) unless approved by a higher authority following a recommendation from ALCO;

- All investments should meet the IFRS criteria for classification under 'Held to Maturity' unless otherwise specified by the ALCO;
- The maximum amount to be invested in Sovereign Bonds and Cyprus Government Treasury Bills should not exceed 50% of the total deposits of USB Bank;
- The maximum amount to be invested in Sovereign Bonds and Treasury Bills to each Government, in their local currency (provided that the government is in G10 or Australia, Switzerland and any EU country and has a minimum rating of A3) should not exceed 10% of the total assets of USB Bank;
- The maximum amount to be invested in Sovereign Bonds and Treasury Bills to each Government in foreign currency should not exceed 10% of the total assets of USB Bank (for governments with a minimum rating of Aa3) and 5% of the Bank's capital base (for governments with rating A1 – A3);
- The maximum amount invested (in senior debt) in Cypriot Banks and the Parent Bank issues (provided that they are classified to investment grade) should not exceed 10% of the Bank's capital base;
- The maximum amount invested (in senior debt) in each counterparty provided they have a minimum rating of A3 (face value of the investment), should not exceed 25% of the Bank's capital base;
- Investments in financial institutions' capital securities or in subordinated debt should be approved by the Risk Management Committee.

With regards to the monitoring of price risk, the Treasury Department forwards on a weekly 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 minimize market risk arising from equities, the Bank's Management has decided not to hold any significant positions in equities. The bank however, based on a decision taken by the ALCO, may invest in local and foreign equities an amount up to 5% of the Bank's capital base (with a maximum limit of 0,5% per issuer).

However it is noted that according to a recent Board decision, the Bank may purchase pledged quoted shares (in the CSE) of problematic customers. In such cases, to mitigate any equity market risk, the Risk Manager is notified prior to the purchase of the shares by the Recovery Manager so that any violations in limits are identified and avoided.

Monitoring of such equity investments, whether performed directly by the Bank or through the purchase of pledged shares, is performed through a report, prepared by the Treasury Department quarterly, on the holdings of local and foreign equities of the Bank.

2.6.6. 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.

2.6.7. Capital Requirements

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

2.6.8 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.

2.7 Liquidity Risk

2.7.1 Definition

Liquidity risk is defined as the risk that the Bank, although solvent, either does not have sufficient available financial resources to meet its obligations as they fall due (as a result of a sudden run down of customer deposits) or financial resources can only be secured at excessive cost.

2.7.2 Materiality

Liquidity risk is considered to be in the range 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 during the period ended 30/6/2014.

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 deposits while the respective percentage for foreign currencies is 70%. The Bank's liquidity ratio (available liquid assets to total liabilities) presented the following picture in year 2013 and 2012 respectively:

	2013	**2012**
	%	**%**
As at 31 December	25,94	17,80
Average Ratio	19,28	16,74
Maximum Ratio	25,94	24,49
Minimum Ratio	12,24	7,06

Following the downgrade of the Cyprus economy to non-investment grade status (in June 2012) the Cyprus Government Bonds became non-eligible for the purpose of ECB borrowing and non-liquid for the purpose of the liquidity ratio. The impact of the above is estimated at approximately 7% decrease in the ratio. This impact was reversed once the Troika Financial Assistance was agreed with the Cyprus Government and CGB became eligible again (June 2013).

2.7.3 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.

2.7.4 Policies and Procedures

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

2.7.5 Mitigation and Measurement

The Bank uses financial assets to manage liquidity risk on the basis of the Directives issued by the Central Bank of Cyprus. In an effort to minimize liquidity risk arising from possible outflows of deposits and simultaneously adhere to CBC requirements, the Bank has established the following limits:

- The liquidity ratio 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 should always be less than 10% for the 0 - 7 days maturities band;
- The protective liquidity ratio of the Bank should always be less than 25% for the 8-30 days maturities band.

Furthermore, as customer deposits are the Bank's main source of funding, daily monitoring of deposits is carried out. In addition, deposit interest rates are adjusted accordingly, based on market forces, in order to avoid deposit outflows.

In case any liquidity problems / breach of limits arise, these are immediately escalated to the ALCO, who is responsible for deciding the appropriate mitigants, which may include amongst others, funding from the European Central Bank, BLC and possible other inter-bank borrowing.

The Bank can mitigate and manage appropriately liquidity risk as this is evidenced by the fact that (i) USB Bank has the full support of both BLC and Fransabank and (ii) the Bank can obtain liquidity if needed from ECB (amounting to €73 million as at 31/12/2013)

2.7.6 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.

2.7.7 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 31/12/2013 were €62.022 thousand as shown below:

	€000
Original Own Funds (Tier 1)	
Share Capital	56.584
Share Premium	24.667
Special Reserves	20.000
Reserves	(52.114)
Intangible Assets	(628)
Core Tier 1	**48.509**
Subordinated Loan Stock	974
Total Tier 1	**49.483**
Additional Own Funds (Tier 2)	
Property Revaluation Reserve	3.330
Subordinated Loan Capital	9.209
Total Tier 2	**12.539**
Total Own Funds	**62.022**

3.1 Original Own Funds

Share Capital

The share capital of the Bank at 31 December 2013 amounted to €56.584.278 divided into 99.270.663 shares of nominal value of €0,57 each, while the share premium reserve remained at same levels of prior year and amounts to €24.666.732 at 31 December 2013.

In December 2013 the Parent company, BLC Bank SAL, made an irrevocable commitment to fully cover any required increase of capital of the Bank, in an effort for the Bank to comply in a timely manner with the regulatory requirements and maintain an adequate capital base by blocking €20 million in an escrow account demonstrating its continuous support to the Bank. As a result the Bank's equity is increased by €20 million through the Special Reserve account.

In a meeting held on the 24th February 2014 the Board of Directors of the Bank decided to proceed to an increase of the issued share capital of the Bank by €20 million (the "Issue") to strengthen the capital base. The proposed Issue concerns the issue and allotment of 66.666.667 new ordinary shares at an issue price of €0,30 per new share.

In order to facilitate the issue and allotment of new ordinary shares in view of the prevailing current financial conditions and the fact that pursuant to the Cyprus Companies Law Cap. 113 (as amended), new shares cannot be issued and allotted at a price lower than the current nominal value of €0,57 which is higher than the current net asset value per share, the Board of Directors of the Bank convened an Extraordinary General Meeting on the 27th March 2014 and approved a resolution for the reduction of the nominal value of the ordinary shares of the Bank from €0,57 to €0,10 per share. The reduction of the nominal value of the Bank's shares was approved in order to facilitate and provide greater flexibility to the Bank, for the issuance of 66.666.667 new ordinary shares. The total amount from the reduction of the nominal value of the issued ordinary shares amounting to €46.657.212 will be utilized for the reduction of the Bank's accumulated losses.

Subordinated Loan Stock

Capital Securities

The subordinated loan stock consists of capital securities which were offered to professional investors and to a specific number of non-professional investors in Cyprus. The Capital Securities rank as Tier 1 capital and have no maturity date, however, they may be redeemed in whole at the option of the Bank subject to the prior consent of the Central Bank of Cyprus, at their nominal amount together with any outstanding interest payments, five years after their issue date or on any interest payment date thereafter, and provided that they will be replaced with capital of equivalent or senior ranking unless the Central Bank of Cyprus concludes that the Bank's capital is at a satisfactory level.

The Capital Securities bear floating interest rate, which is revised at the beginning of each period interest is charged and will be valid for that specific period. Interest rate is equal to the base rate of the Bank at the beginning of each period interest is charged plus 1,60% annually. Interest is payable every six (6) months, on 30 June and 31 December. According to the terms of issue, if the Bank does not proceed with the repurchase of Capital Securities within ten years from their issuance date (ie up to 30 November 2015), then from 1 December 2015, the Capital Securities will bear floating interest rate that will be revised at the beginning of each period in which interest will be charged and will be equal to the base rate ruling at the beginning of each period interest is charged plus 2,25% annually.

3.2 Additional Own Funds

Subordinated Loan Capital

Non-convertible bonds

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

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

Convertible bonds

On 14 June 2010, the Bank issued €1.209.060 convertible bonds maturing on 30 June 2020. The convertible debentures are direct, unsecured and subordinated obligations of the Bank and carry a fixed rate of 7,25% per annum on the nominal value for the period from the date of issue until 30 June 2015. From 1 July 2015 until their maturity the convertible bonds will carry fixed interest rate 8,75% on the nominal value. Except the first interest period commencing on (included) 26 May 2010 and matures on 30 June 2010 (not included), each interest period will be 6 months.

The convertible bonds may, at the option of the holder, be converted into ordinary shares of the Bank in 2014 between 15-30 March and 15-30 September.

The conversion price is set at the average closing price of the share of the Bank on the CSE for a period of 30 days prior to the beginning of each conversion period. For the conversion periods of 2014, the conversion prices is as described above, less 15% while the conversion price cannot be reduced below the nominal value of the shares.

The Bank has a right of early redemption of convertible bonds in whole, but not part of a cash at par plus accrued interest of the current interest period on 30 June 2015 or any interest payment date, after approval from the Central Bank of Cyprus

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. Also, Basel II suggests 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 collateral.

The following table shows 8% of the risk-weighted exposure amounts as at 31/12/2013 for each of the exposure classes specified in paragraph 23 of Unit A of the Directive.

Exposure class	**€000**
Central governments or central banks	0
Administrative bodies and non-commercial undertakings	3
Institutions	1.349
Corporates	11.968
Retail	2.762
Secured by real estate property	2.176
Past due items	13.638
Other items	2.850
Total	**34.746**

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 2013, will also be reported on the next three quarterly returns upon preparation of the COREP (31 March 2014, 30 June 2014 and 30 September 2014) i.e will be the same figure as at 31st December 2013.

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

Gross Income (€000)			**Average**	**Capital Requirement (Average * 15%)**
2011	**2012**	**2013**		
19.654	22.063	24.261	21.993	**3.299**

4.4 Capital Adequacy Ratio

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. The minimum capital ratios effective as at 31st December 2013 are shown in note 2.2 of this report.

The Bank as at 31 December 2013 fully complies with all the regulatory limits.

The table below presents the position of the Bank's regulatory capital, in accordance with the principles of Basel II, at 31 December 2013:

	2013	**2012**
	€ '000	**€ '000**
Regulatory Capital		
Core Tier 1	48.509	43.068
Original own funds	49.483	44.042
Additional own funds	12.539	12.539
Total own funds	**62.022**	**56.581**
Risk weighted assets – credit risk	434.308	415.547
Risk weighted assets – operational risk	41.236	35.761
Risk weighted assets – market risk	-	351
Total Risk weighted assets	**475.544**	**451.659**
Core Tier 1 ratio	10,2%	9,5%
Tier 1 ratio	10,4%	9,8%
Tier 2 ratio	2,6%	2,8%
Total capital ratio	**13%**	**12,5%**

Recent Developments

Based on the Memorandum of Understanding between the Cyprus government and Troika dated 6 November 2013, as from 31 December 2013, the Central Bank of Cyprus increased the minimum Core Tier 1 capital ratio from 8% to 9% and the minimum requirements for Tier 1 and total capital ratios have been abolished.

However, the Central Bank of Cyprus may also impose additional capital requirements for risks not recognized by Pillar 1 (Pillar 2 add-ons).

At 31 December 2013, the Bank fully meets the minimum capital requirements. Specifically, the Core Tier 1 ratio was 10,2% (December 2012: 9,5%), Tier 1 ratio 10,4% (December 2012: 9,8%) and the Total Capital ratio 13,04% (December 2012: 12,5%).

5. Counterparty Credit Risk

As at 31 December 2013, 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

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.

Loan Impairment

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 order to make such assessment, the Bank takes into consideration the customer's payment record, his 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 methodology and assumptions used for estimating the provision are reviewed regularly to minimise any differences between estimated and realised losses from doubtful loans. In addition to the provisions on an individual basis, the Bank also makes provision for impairment of loans on a collective basis. The loss percentage is determined after taking into consideration estimates, historical data and past experience of the performance of the loan portfolio of the Bank.

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

Equity investments classified as available for sale 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.

6.1 Total Amounts of Original Exposures

The table below presents the total amount of original exposures with the off-balance sheet amounts being presented 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 31/12/2013**	**Average Exposure Amount for 2013**
	€000	**€000**
Central Governments or central banks	121.636	171.059
Administrative bodies and non-commercial undertakings	342	343
Institutions	80.469	73.906
Corporates	186.350	209.810
Retail	73.734	85.652
Secured by real estate property	68.508	80.477
Past due items	224.687	174.100
Other Items	43.284	42.393
Total	**799.010**	**837.740**

6.2 Distribution of the Exposures by Industry or Counterparty Types

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

	Retail Customers	**Corporate Customers**	**Financial Institutions**	**Governments and Local Authorities**	**Other**	**Total**
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Trade and manufacturing	25.365	94.924	-	-	-	**120.289**
Tourism	13.082	37.511	-	-	-	**50.593**
Financial services	-	-	80.469	-	-	**80.469**
Governments and Local Authorities	-	-	-	121.636	-	**121.636**
Property and construction	15.079	123.329	-	-	-	**138.408**
Personal and professional	119.490	95.839	-	-	-	**215.329**
Other sectors	4.962	24.040	-	-	43.284	**72.286**
Total	**177.978**	**375.643**	**80.469**	**121.636**	**43.284**	**799.010**

6.3 Geographic Distribution of the Exposures

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

	Retail Customers	Corporate Customers	Financial Institutions	Governments and Local Authorities	Other	Total
	€000	**€000**	**€000**	**€000**	**€000**	**€000**
Cyprus	172.616	368.320	64	121.636	43.284	**705.920**
Greece	570	404	62	-	-	**1.036**
Other EU countries	1.760	-	17.123	-	-	**18.883**
Non-EU countries	3.032	6.919	63.220	-	-	**73.171**
Total	**177.978**	**375.643**	**80.469**	**121.636**	**43.284**	**799.010**

6.4 Residual Contractual Maturity Breakdown of all the Exposures

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

Credit exposure by residual contractual maturity as at 31 December 2013					
	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	60.345	31.508	29.783	-	**121.636**
Administrative bodies and non-commercial undertakings	-	-	-	342	**342**
Institutions	80.326	89	54	-	**80.469**
Corporates	101.064	18.316	32.536	34.434	**186.350**
Retail	36.333	11.685	10.027	15.689	**73.734**
Secured by real estate property	10.073	2.862	14.329	41.243	**68.507**
Past due items	120.245	26.497	39.237	38.709	**224.688**
Other items	27.866	15.273	-	145	**43.284**
Total	**436.252**	**106.230**	**125.966**	**130.562**	**799.010**

6.5 Impaired Exposures and Past Due Exposures

The table below provides an analysis of impaired exposures, past due exposures, value adjustments and provisions, and charges for value adjustments and provisions during the year 2013.

Impaired and past due loans and advances as at 31 December 2013				
	Neither past due nor impaired	**Past due but not impaired**	**Impaired**	**Total**
	€000	**€000**	**€000**	**€000**
Total	**234.461**	**27.634**	**235.243**	**497.338**

Provisions for impairment of loans and advances	
	€000
1 January 2013	**57.100**
Collections/reversals	**(1.620)**
Charge for the year	**21.284**
Net charge for the year	**19.664**
Restriction of interest on impaired loans	**9.922**
Write-offs	**(992)**
Total	**28.594**
31 December 2013	**85.694**

Approximately 99% of the loans provided relate to local resident customers.

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 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.

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

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

In the case of financial institutions the credit quality step is determined according to the rating of the country under whose supervision they operate.

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

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

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

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

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

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

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

7.4 Exposure Before and After Credit Risk Mitigation

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

	Total Exposures before	Total exposure after
	€000	€000
Credit quality bands		
0%	121.636	121.636
20%	79.585	79.541
100%	759	758
150%	125	125

8. Exposure in Equities not included in the Trading Book

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

During 2013 the Bank disposed of its shareholding in companies which were listed in the Cyprus Stock Exchange, thus at 31 December 2013 the Bank has no equity exposures not included in the trading book.

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

9.1 Impact on Net Interest Income

Information in relation to interest rate risk can be found in Section 2.5. The table below indicates the effect on the Bank's net interest income and profit before tax, over a one-year period, from a reasonable 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	421.364	35.011	456	37.510	**494.341**
-0,25% for US Dollars, -0,5% for all other currencies	(436.284)	(17.506)	(456)	(37.510)	**(491.756)**

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	674.384	3.127	(566)	(73)	**676.872**
-0,25% for US Dollars, -0,5% for all other currencies	(674.384)	(1.564)	566	73	**(675.309)**

10. Remuneration policy and practices

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 Cyprus Stock Exchange Corporate Governance Code as well as the High-level Guidelines for Remuneration Policies issued by the Central Bank of Cyprus.

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 2013 was as follows:

Current composition	Since	
Chairman: George Galatariotis	21/03/2011	Non Executive, Independent
Members:		
Philippos Philis	21/10/2010	Non Executive, Independent
Maurice Sehnaoui	21/03/2011	Non Executive, Non Independent

All the members of the Remuneration Committee have sufficient knowledge and experience in remuneration policy. During the year 2013, the Committee has met once.

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).

Fees and emoluments of Directors and key management personnel

Directors emoluments	**2013** **€**	2012 €
Member Fees		
Non executives	**155.628**	155.872
Executives	**-**	-
Total Member fees	**155.628**	155.872
Executive directors' emoluments:		
Salaries and other short-term benefits	**248.407**	250.987
Employer contributions	**23.328**	18.268
Retirement benefit plan costs	**33.484**	33.484
Total executive director's emoluments	**305.219**	302.649
Total Board of Directors' emoluments	**460.847**	458.521
Key management personnel emoluments		
Salaries and other short term benefits	**907.154**	804.895
Employer's contributions	**89.660**	75.918
Retirement benefit plan costs	**115.315**	97.900
Total key management personnel emoluments	**1.112.129**	978.713
Total emoluments	**1.572.976**	1.437.235

Due to a change in the Bank's organizational structure, the salaries and other short term benefits for key management personnel as stated above, include the emoluments for 10 managers of the Bank for year 2013 (2012: 8).

Remuneration of Executive Members of the Board

The salaries and other short-term benefits of the Executive Members of the Board totalling €248K (2012: €251K) concern €128K (2012: €128K) for Mr. Andreas Theodorides and €120K (2012: €123K) 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.

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 2013.

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. The remuneration of the Non-Executive Directors has last time been revised at the Extraordinary General Meeting of the Bank's shareholders at 21 January 2009, taking into account the above and also the respective remuneration of Directors in other comparable organisations.

Also, as per the Bank's Articles of Association, the members of the Board of Directors can claim the travelling expenses incurred for attendance in meetings.

The approval of the remuneration of the Non-Executive Directors is subject to the approval of the shareholders at the annual General Meeting of the Bank.

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.

Variable Remuneration scheme

The Bank has no variable remuneration scheme in place for any of its Directors or its employees.

Appendix 1 – Glossary of Terms

CBC	Central Bank of Cyprus
IRRBB	Interest Rate Risk Banking Book
IT	Information Technology
BoD	Board of Directors
ALCO	Assets and Liabilities Committee
RMU	Risk Management Unit
RMC	Risk Management Committee
MIS	Management Information System
IAU	Internal Audit Unit
NPL	Non-Performing Loan

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