Additional Risk and Capital Management Disclosures

30 September 2015

Bank of Cyprus Group

1. Credit risk

The Central Bank of Cyprus (CBC) issued to credit institutions the Loan Impairment and Provisioning Directive of 2014 and 2015 (Directive), which provides guidance to banks for loan impairment policy and procedures for provisions. The purpose of this Directive is to ensure that credit institutions have in place adequate provisioning policies and procedures for the identification of credit losses and prudent application of IFRSs in the preparation of their financial statements.

The Directive requires certain disclosures in relation to the loan portfolio quality, provisioning policy and levels of provision. The disclosures required by the Directive, in addition to those presented in Notes 3 and 46 of the consolidated financial statements for the year ended 31 December 2014 and on Note 27 of the interim condensed consolidated financial statements for the nine months ended 30 September 2015 are set out in the following tables. The tables disclose non-performing exposures (NPEs) based on the definitions of the European Banking Authority (EBA) standards.

According to the EBA standards NPEs are considered as those that satisfy one of the following conditions:

(i) The debtor is assessed as unlikely to pay its credit obligations in full without the realisation of the collateral, regardless of the existence of any past due amount or of the number of days past due.
(ii) Defaulted or impaired exposures as per the approach provided in Regulation (EU) No 575/2013 Article 178.
(iii) Material exposures (defined below) which are more than 90 days past due.
(iv) Performing forborne exposures under probation for which additional forbearance measures are extended.
(v) Performing forborne exposures under probation that present more than 30 days past due within the probation period.

Exposures include all on and off balance sheet exposures, except those held for trading, and are categorised as such for their entire amount without taking into account the existence of collateral.

The following materiality criteria are applied:

- When the problematic exposures of a customer, that fulfil the NPEs criteria stated above, is greater than 20% of the gross carrying amount of all on balance sheet exposures of the customer, then total customer's exposure is classified as non-performing. Otherwise only the problematic exposure is classified as non-performing.

- Material arrear/excess is defined as follows:
  - Retail exposures:
    - Loans: Arrear amount is greater than €500 or number of instalments in arrear is greater than one.
    - Overdrafts: Excess amount is greater than €500 or greater than 10% of the approved limit.
  - Exposures other than retail: Total customer arrear/excess is greater than €1.000 or greater than 10% of total customer funded balances.

NPEs may cease to be considered as non-performing only when all of the following conditions are met:

(i) The extension of forbearance measures does not lead to the recognition of impairment or default.
(ii) One year has passed since the forbearance measures were extended.
(iii) Following the forbearance measures and according to the post-forbearance conditions there is no past due amount or concerns regarding the full repayment of the exposure.

1. **Credit risk** (continued)

The tables below present loans analysis based on EBA standards.

	Gross loans and advances to customers				**Provision for impairment and fair value adjustment on initial recognition**			
30 September 2015	**Group gross customer loans and advances[1]**	**Of which NPEs**	**Of which exposures with forbearance measures**		**Total provision for impairment and fair value adjustment on initial recognition**	**Of which NPEs**	**Of which exposures with forbearance measures**	
			Total exposures with forbearance measures	**Of which on non-performing exposures**			**Total exposures with forbearance measures**	**Of which on non-performing exposures**
	€000	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
General governments	**125.221**	7.545	5.372	5.372	**1.327**	1.327	1.327	1.327
Other financial corporations	**467.616**	279.374	187.490	145.524	**147.072**	133.156	58.698	57.795
Non-financial corporations	**13.875.394**	9.675.607	6.038.736	4.896.320	**3.575.540**	3.471.308	1.502.375	1.462.910
Of which: Small and medium sized enterprises[3]	**7.787.580**	5.466.794	2.755.960	2.281.129	**1.999.745**	1.946.051	611.077	595.941
Of which: Commercial real estate[2,3]	**11.207.490**	8.207.468	5.481.680	4.453.306	**2.643.428**	2.565.899	1.269.722	1.236.066
Non-financial corporations by sector								
Construction	**4.099.093**	3.554.346			**1.188.806**			
Wholesale and retail trade	**2.308.207**	1.325.450			**491.287**			
Accommodation and food service activities	**1.537.530**	989.835			**305.847**			
Real estate activities	**2.949.949**	1.761.773			**628.739**			
Manufacturing	**827.600**	513.711			**196.943**			
Other sectors	**2.153.015**	1.530.492			**763.918**			
Households	**8.394.325**	4.262.162	2.945.560	2.119.719	**1.158.895**	1.060.720	305.492	288.637
Of which: Residential mortgage loans[2,3]	**5.605.534**	2.881.252	2.184.101	1.609.711	**514.552**	447.812	165.945	155.318
Of which: Credit for consumption[3]	**1.117.763**	640.626	299.143	252.827	**310.501**	291.535	68.332	65.078
Total on-balance sheet	**22.862.556**	**14.224.688**	**9.177.158**	**7.166.935**	**4.882.834**	**4.666.511**	**1.867.892**	**1.810.669**

[1] Excluding loans and advances to central banks and credit institutions.
[2] The balances are not comparable with the respective lines of the 31 December 2014 table, as the basis of preparation has changed, following a clarification received from EBA Q&As in May 2015.
[3] The analysis shown in lines 'non financial corporations' and 'households' are non-additive across categories as certain customers could be in both categories.

1. **Credit risk** (continued)

31 December 2014	Gross loans and advances to customers				Provision for impairment and fair value adjustment on initial recognition			
	Group gross customer loans and advances[1]	Of which NPEs	Of which exposures with forbearance measures		Total provision for impairment and fair value adjustment on initial recognition	Of which NPEs	Of which exposures with forbearance measures	
			Total exposures with forbearance measures	Of which on non-performing exposures			Total exposures with forbearance measures	Of which on non-performing exposures
	€000	€000	€000	€000	€000	€000	€000	€000
General governments	**130.052**	17.896	5.788	5.394	**5.408**	4.102	2.310	2.244
Other financial corporations	**1.377.624**	1.054.461	568.797	535.887	**413.685**	400.633	211.585	211.303
Non-financial corporations	**13.564.570**	9.638.812	5.258.556	4.633.644	**3.345.574**	3.201.810	1.302.186	1.276.545
Of which: Small and medium sized enterprises[3]	**7.905.810**	5.218.681	2.354.251	2.021.543	**1.872.104**	1.774.187	542.122	532.449
Of which: Commercial real estate[2,3]	**5.559.541**	3.829.988	2.413.147	1.991.612	**1.068.189**	995.537	472.554	456.664
Non-financial corporations by sector								
Construction	**3.915.975**	3.420.501			**1.099.188**			
Wholesale and retail trade	**2.398.645**	1.432.267			**503.531**			
Accommodation and food service activities	**1.417.618**	1.051.113			**295.932**			
Real estate activities	**2.793.045**	1.818.300			**535.422**			
Manufacturing	**871.240**	541.328			**214.513**			
Other sectors	**2.168.047**	1.375.303			**696.988**			
Households	**8.699.866**	4.249.680	2.480.680	1.745.329	**1.289.292**	1.191.582	271.687	257.169
Of which: Residential mortgage loans[2,3]	**4.885.223**	2.260.731	1.619.643	1.146.121	**346.303**	313.663	114.654	106.877
Of which: Credit for consumption[3]	**1.351.911**	740.501	278.255	223.496	**426.934**	384.774	59.024	56.558
Total on-balance sheet	**23.772.112**	**14.960.849**	**8.313.821**	**6.920.254**	**5.053.959**	**4.798.127**	**1.787.768**	**1.747.261**

The comparatives above include loans and related provisions classified as a disposal group held for sale.

1 Excluding loans and advances to central banks and credit institutions.
2 The balances are not comparable with the respective lines of the 30 September 2015 table, as the basis of preparation has changed, following a clarification received from EBA Q&As in May 2015.
3 The analysis shown in lines 'non financial corporations' and 'households' are non-additive across categories as certain customers could be in both categories.

2. Capital management

The primary objective of the Group's capital management is to ensure compliance with the relevant regulatory capital requirements and to maintain strong credit ratings and healthy capital adequacy ratios in order to support its business and maximise shareholder value.

The capital adequacy regulations which govern the Group's operations are established by the CBC.

As from 1 January 2014, the new Capital Requirements Regulation (CRR) and amended Capital Requirements Directive IV (CRD IV) became effective, comprising the European regulatory package designed to transpose the new capital, liquidity and leverage standards of Basel III into the European Union's legal framework. CRR establishes the prudential requirements for capital, liquidity and leverage that entities need to abide by. It is immediately binding on all EU member states. CRD IV governs access to deposit-taking activities and internal governance arrangements including remuneration, board composition and transparency. Unlike the CRR, CRD IV needs to be transposed into national laws, and allows national regulators to impose additional capital buffer requirements. CRR introduced significant changes in the prudential regulatory regime applicable to banks including amended minimum capital adequacy 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.

The minimum CET1 ratio under the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV) was set by the Central Bank of Cyprus (CBC) at 8% on a transitional basis (Pillar I capital requirement). The Group is also subject to additional capital requirements for risks which are not covered by the Pillar I capital requirements (Pillar II add-ons). The CET1 Pillar II add-on capital requirement at 30 September 2015 stands at 5,2% (resulting in a total minimum CET1 of 13,2%) and it may be further reduced by future losses of up to €658 million, up to a CET1 ratio of 8%. However, the Group's Pillar II add-on capital requirements are a point in time assessment and therefore are subject to change over time (section 3).

The Group's overseas banking subsidiaries comply with the regulatory capital requirements of the local regulators in the countries in which they operate. The insurance subsidiaries of the Group comply with the requirements of the Superintendent of Insurance including the minimum solvency ratio.

2.1 Capital position

The capital position of the Group under CRD IV/CRR basis (after applying the transitional arrangements set by the CBC) is presented below.

	30 September 2015	31 December 2014
Regulatory capital	**€000**	€000
Transitional Common Equity Tier 1 (CET1)[4]	**3.230.648**	3.190.955
Transitional Additional Tier 1 capital (AT1)	**-**	-
Tier 2 capital (T2)	**22.839**	42.146
Transitional total regulatory capital	**3.253.487**	3.233.101
Risk weighted assets – credit risk[5]	**18.829.481**	20.624.507
Risk weighted assets – market risk	**7.313**	5.025
Risk weighted assets – operational risk	**1.879.925**	2.085.000
Total risk weighted assets	**20.716.719**	22.714.532
	%	%
Transitional Common Equity Tier 1 ratio	**15,6**	14,0
Transitional total capital ratio	**15,7**	14,2

[4] Includes independently verified profits for the nine-months to 30 September 2015. CET1 includes regulatory deductions, primarily deferred tax assets and intangible assets, amounting to €28.310 thousand and €68.468 thousand as at 30 September 2015 and 31 December 2014 respectively.

[5] Includes CVA (note 3.4).

2. Capital management (continued)

2.1 Capital position (continued)

The Group's capital position as at 30 September 2015 exceeds its Pillar I and Pillar II add-on capital requirements, providing a loss-absorbing buffer to the Group.

On 20 February 2015, the European Central Bank (ECB) notified the Group of its final decision with respect to the minimum required capital ratios to be complied with, on an ongoing basis. The required Pillar I CET1 ratio is 8% and the required Pillar II CET1 add-on capital requirement was set by the ECB at 6,4% as at 31 December 2013, reducing to the extent of losses recognised through the Income Statement after that date of up to €919 million (up to a CET1 ratio of 8%). Therefore the CET1 Pillar II add-on capital requirement is dynamic and is subject to change according to the performance of the Group.

Taking into account the losses recognised in the Income Statement of the Group for year 2014 of €261 million, the CET1 Pillar II add-on capital requirement at 30 September 2015 is calculated at 5,2% and it may be further reduced by future losses of up to €658 million (of the total of €919 million), up to a CET1 ratio of 8%.

During the first nine months of 2015, the Group's CET1 ratio was positively affected by the profits of the period, the decrease of risk weighted assets (section 3.1) and the disposal of the Russian operations but was negatively affected by the phasing-in of transitional adjustments (mainly deferred tax) as from 1 January 2015.

3. Internal Capital Adequacy Assessment Process (ICAAP), Pillar II and supervisory review process

According to the resolution measures taken during 2013, the Group was required to prepare a restructuring plan for the period 2013 to 2017 aiming to ensure its viability and the reduction of its dependence on central bank funding. The CBC has assessed the Group's restructuring plan to ensure it is based on a robust and coherent strategy and is supported by a set of prudent financial projections. The restructuring plan was approved by the CBC on 26 November 2013. Based on the above, the CBC did not require the Group to submit an ICAAP report in 2014.

In early February 2015, the ECB requested the preparation and submission of both an ICAAP and Internal Liquidity Adequacy Assessment Process (ILAAP) report, as at 31 December 2014, to the Joint Supervisory Team (JST) by mid May 2015. The Group fully complied with this requirement by submitting these reports which have been approved by the Board of Directors.

The European Central Bank (ECB), as part of its supervisory role under Council Regulation (EU) No 1024/2013, has been conducting the Supervisory Review and Evaluation Process (SREP) and onsite inspections on the Group. SREP is a holistic assessment of, amongst other things: the Group'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 ECB to form an up-to-date supervisory view of the Group's risks and viability and to form the basis for supervisory measures and dialogue with the Group. An onsite inspection on credit quality was performed by the ECB with a reference date of 31 December 2014, and its scope included the review and assessment of the Group's non-performing and restructured but performing exposures.

The onsite inspection and related draft recommendation letter state that, on the basis of a modified set of assumptions there is, in the ECB's view, a provision-related adjustment of around €300 million for the judgemental (i.e. specifically assessed) portfolio and around €700 million for the statistical (i.e. collectively assessed) portfolio, mostly relating to the recovery value of real estate collateral. The Group is contesting certain of the assumptions used and is engaged in a supervisory dialogue with the ECB. The Group has in any case already, in the normal application of its provisioning methodology, substantially recognised the provisions for the judgmental portfolio reviewed by the ECB and part (around €100 million) of the provisions for the reviewed statistical portfolio in its consolidated financial results for the nine months ended 30 September 2015. The Group considers that the ECB calculated adjustments do not indicate that the Group is not in compliance with IFRS. In any case, the Group will continue monitoring and re-assessing its provisioning assumptions, estimates and methodology in the context of the prevailing market conditions and other relevant developments, always in the context and guidance provided by the IFRS.

3. Internal Capital Adequacy Assessment Process (ICAAP), Pillar II and supervisory review process (continued)

If the impact of the provision-related adjustment calculated by the ECB and which, in the view of the Group, has not been recognised to date amounting to around €600 million was to be considered, there would be a decrease of 2,4% on CET1 ratio (pre-tax).

The Group estimates that the ECB's current SREP dialogue and onsite inspection process and related considerations will be concluded by the end of 2015. As part of this process, the Group will, in due course, be submitting a multi-year capital plan to the ECB for its review to demonstrate that the level of capital held by the Group is sufficient.

The revised Pillar II CET1 capital requirement was preliminarily determined by the ECB to be 3,75%, resulting in a total minimum CET1 of 11,75%. Taking into account the Group's CET1 ratio of 15,6% as at 30 September 2015 and the expectations for the outcome of the SREP process, even after adjusting for potential additional capital requirements as a result of the credit risk inspection, the Group expects to be compliant with both its Pillar I and revised Pillar II add-on capital requirements and therefore does not expect to be required to raise any capital.