

CYNERGY CAPITAL LTD

Consolidated financial statements for the period ended 31 December 2018

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Definitions

| | |
|----------------|--|
| The "Company" | Cynergy Capital Ltd |
| "Bank Company" | Cynergy Bank Limited |
| The "Group" | Cynergy Capital Ltd and its controlled entities |
| The "Bank" | Cynergy Bank Limited and its controlled entities |
| "BOC CY" | Bank of Cyprus Public Company Limited |
| "BOC UK" | Bank of Cyprus UK Limited |
| "FCA" | Financial Conduct Authority |
| "FSCS" | Financial Services Compensation Scheme |
| "IAS" | International Accounting Standards |
| "IASB" | International Accounting Standards Board |
| "IFRS" | International Financial Reporting Standards |
| "PRA" | Prudential Regulation Authority |

Corporate information

Directors – the Company

Pradip Dhamecha, OBE - *Executive Director - appointed 23 May 2018*

Balbinder Sohal - *Executive Director - appointed 17 May 2018*

Principal Banker

HSBC Bank plc

26 Broad St

Reading

Berkshire RG1 2BU

Independent auditor

Ernst & Young LLP

25 Churchill Place

London E14 5EY

Registered office

97 Park Lane Mayfair, London, United Kingdom, W1K 7TG

Registered in England and Wales under company number 11368222

Strategic Report

Business review

The Company was incorporated in the United Kingdom under the Companies Act 2006 on 17 May 2018 with its principal activity being that of a holding company.

On 23 November 2018, the Company completed the purchase of Bank of Cyprus UK Limited from Bank of Cyprus Public Company Limited following the receipt of regulatory approvals from the Prudential Regulation Authority and European Central Bank. The effective date of the sale was 30 September 2018. On 7 December 2018 "Bank of Cyprus UK Limited" rebranded to "Cynergy Bank Limited".

A strategic plan to 2022 for the Bank was approved December 2018 reinforcing the Group's desire to be a bank of choice for medium business owners with a diversified customer base and product set, whilst being a great place to work and to be a contributor to society.

Our 2019 focus, year 1 of the new 2022 Strategy, is to grow the customer franchise and lending book, and bring to market new products enhancing the current offering and meeting our clients' demands.

Key performance indicators

The Group key performance indicators at 31 December were as follows:

| | 2018 £'m |
|---|-------------|
| Comprehensive income after tax for the year | 15.0 |
| Loans and advances to customers | 1,668.9 |
| Equity attributable to shareholders | 91.5 |

Lending assets at £1.67bn are below the full year plan of £1.80bn. This reflects current market uncertainty. Pipeline remains strong and the Group is expected to achieve its 2019 plan of £2.36bn.

Principal risks and uncertainties

The Board has ultimate responsibility for ensuring that the Group's principal risks are identified and managed. It establishes the Group's risk appetite and oversees the effectiveness of risk management and internal controls through the Risk Committee and Audit Committee. The principal risks are as follows:

| Risk | Description | Mitigation |
|--|--|--|
| Capital risk | The risk of business failure or regulatory breach arising from inadequate capital | An annual capital adequacy assessment is prepared and approved by the Board. Capital adequacy is reviewed monthly on an actual and projected basis. Capital adequacy is also considered as part of the budget and business plan process. |
| Cyber risk | The risk of external or internal misuse of computer systems leading to financial loss or reputational damage | The Group has received ISO27001 certification for information security. Firewalls and anti-virus software are in place. Systems are monitored at all times and penetration testing is carried out periodically. |
| Operational risk, including systems risk | The risk of loss or reputational damage arising from human, process or system failure | An enterprise risk management system has been implemented to catalogue risks and controls, to document control risk self-assessments and to record operational risk incidents. Controls are in place to ensure that errors are prevented or detected. |
| Human Resources risk | The risk of having insufficient appropriately qualified staff to manage the business soundly | Recruitment is carried out through reputable agencies. Staff turnover is monitored and succession plans are in place for all critical positions. Staff appraisals identify training and development needs and plans are put in place to meet them. |
| Conduct risk | The loss or reputational damage arising from a failure of the Group or its staff to act ethically and treat customers fairly | A strengthened Compliance Unit carries out reviews of high risk areas to identify failures. A new product approval process ensures that new products are fair to customers and comply with regulations. |
| Data risk | The risk of loss or reputational damage arising from a failure to safeguard, control or process data appropriately | The information security policy and data retention policies set out standards for data integrity, safeguarding and retention. |
| Political and economic risk | The risk of changes in the political or economic environment which are detrimental to the Group | The Executive Committee reviews economic and risk indicators and a Central Planning Scenario is prepared quarterly with external assistance to update the Group's view of the economy. In relation to Brexit, a Working Party has identified the impacts and a contingency plan has been prepared. |
| Liquidity and funding risk | The risk of business failure arising from inadequate liquidity or funding | The Group has a liquidity risk appetite which is more conservative than regulatory requirements. Cash flow projections are prepared weekly to confirm adherence to the |

| | | |
|------------------------------|--|---|
| | | risk appetite. An annual liquidity adequacy assessment is prepared and approved by the Board. |
| Strategy implementation risk | The risk of failing to appropriately implement the bank's strategy | The Transformation Committee oversees the implementation of strategic initiatives. Performance against objectives and deadlines is monitored and reported to the Executive Committee. |
| Market risk | The risk of loss arising from unfavorable movements in market prices | The Board's risk appetite sets limits to the acceptable level of interest rate and foreign exchange risk. The Asset and Liability Committee monitors adherence to these limits. A new Asset and Liability Management system has been implemented to enhance the management of market risk. |
| Credit risk | The risk of financial loss arising from the failure of a borrower or other counterparty to meet its contractual financial obligations to the Group | The Board approved risk appetite sets limits on sector and individual concentration. Lending is guided by a conservative credit policy and is secured on property in the UK. Stress testing and exception monitoring identify potential credit weaknesses which are closely managed. |
| Financial crime risk | The risk of failure to comply with statutory obligations to prevent money laundering, terrorist financing, bribery or corruption | The Financial Crime unit develops the financial crime policy and exercises oversight on the customer due diligence which is carried out for new customers and periodically for existing customers. |
| Legal and regulatory risk | The risk of financial loss or reputational damage arising from the failure to comply with applicable laws or regulations | Horizon scanning identifies new regulations and legal requirements. Where these affect the Group a gap analysis identifies the actions which are required. For significant new requirements, such as those introduced by the General Data Protection Regulation (GDPR), a project team manages implementation projects. |

Outlook for 2019 including Brexit

The Group strategy is predicated on a benign to marginally positive outlook for the UK market over the next four years, whilst recognising that there is a global and local uncertainty in Brexit, heightening downside risks.

We expect competition to be intense but rational, recognising that the UK is a large and diverse market where small market share equates to large business outcomes. Challenger banks will continue to play an increasingly disruptive role.

The property outlook assumes moderate growth in house prices underpinned by a lack of supply. Commercial real estate capital values are likely to see mild growth over the strategy period.

Regulatory changes will continue to impact the operations, costs and overall behaviours within the banking industry.

We are closely monitoring the ongoing Brexit process and are planning for different scenarios, especially in consideration of funding of which a proportion is European held deposits.

We have noted that our customers are delaying investment decisions until they have more certainty on the outcome of Brexit, and wish to provide them with ongoing support through these times.

If the muted market and low interest rate environment were to continue into an economic downturn, it would affect the Group's ability to deliver significant income growth.

By order of the Board



Balbinder Sohal
Director

Directors' report

The Directors present their report and the audited consolidated financial statements for the period ended 31 December 2018.

Cynergy Capital Ltd (registered number: 11368222) was incorporated in the United Kingdom under the Companies Act 2006 on 17 May 2018 with its year end being 31 December.

Subsidiaries

Cynergy Capital Ltd is the immediate owner of 100% of the shares of Cynergy Bank Limited. Cynergy Bank Limited is the immediate owner of 100% of the shares of a UK company, Bank of Cyprus Financial Services Limited (BOCFS), a previously appointed representative of Legal & General Partnership Services Limited. Until 30 September 2017 BOCFS sold insurance and protection products of Legal & General. BOCFS ceased to trade on 30 September 2017.

Principal activity

The principal activity of the Company is that of a financial holding company. The principal activity of the Group, through its direct subsidiary, Cynergy Bank Limited is business and personal banking.

Financial results

The results of the Group for the period ended 31 December 2018 are set out in the income statement on page 10. The Directors endorse the information and views set out in the Chairman's statement and Chief Executive Officer's review and strategic report in the Bank Company financial statements.

The Directors are satisfied that the capital and liquidity positions of the Group more than meet regulatory requirements and are adequate for the foreseeable future.

Going concern

The following factors were taken into consideration when preparing the Going Concern statement: the change in ownership, the conduct programme, capital, and the projected operating performance of the Group. The Directors are satisfied that the Group is able to meet its working capital liabilities through the normal cyclical nature of receipts and payments.

A statement of responsibilities of the Directors in relation to the financial statements is shown on page 7.

Capital

The current regulatory capital is shown in note 33 of the financial statements.

Liquidity

The Group manages liquidity with an internal methodology which fully meets the regulatory Liquidity Coverage Ratio (LCR) measure. During 2018 the Group fully met all its regulatory liquidity requirements including the LCR and Net Stable Funding Ratio (NSFR).

Dividends

The Directors do not recommend payment of a dividend for 2018 and do not expect to pay dividends in the near future.

Future developments

A new strategic plan to 2022 was approved by the Group in December 2018. 2019 will demonstrate ongoing investment in the organisation across processes, people and systems to provide strength in depth, and resilience to any headwinds, and finally further growth in lending across the three key lending pillars, delivering on the diversification and growth strategy.

Events after the reporting period

Subsequent to the year end, the Directors identified that the Group was required to issue additional capital instruments in order to comply with the Prudential Regulation Authority's (PRA's) Rulebook for consolidated groups. The Directors informed the PRA as soon as they became aware and subsequently, on 6 September 2019, the Company reclassified £89m of preference shares owned by related parties to ordinary share capital. On 27 September 2019 and 19th November 2019 the Company issued £46m and £7m, respectively, of Ordinary share capital instruments to those same related parties. The Directors expect the PRA to permit classification of these ordinary shares as Core Equity Tier 1 capital instruments shortly.

The effect of this transaction was an increase in eligible capital to:

| | |
|--|---|
| Unaudited | |
| At 31 December 2018 | £76.3m |
| 11 February 2019: Shares issued | £15.0m (Preference shares of £15m) |
| 6 September 2019: Reclassification | - (reclassification of £89m preference shares to ordinary shares) |
| 27 September 2019: Shares issued | £46.0m |
| 19 November 2019: Shares issued | <u>£ 7.0m</u> |
| CET 1 eligible Ordinary Shares | £144.3m |
| Less regulatory deductions | (£5.8m) |
| Total CET1 eligible Capital | £138.5m |
| Total AT1 Capital | £0.0m |
| Eligible T2 Capital - issued by Cynergy Bank | £28.1m |
| Eligible Capital | £166.6m |

Financial instruments

The Group, where appropriate, uses interest rate swaps to hedge against interest rate risk and foreign exchange contracts to hedge against foreign exchange rate risk. Details of financial instruments are provided in notes 16 and 29 of the financial statements.

Human resources

The Group had 234 permanent employees at 31 December 2018.

Board of Directors

Full details of the Board of Directors, including appointments and resignations during the period are shown on page 2.

Directors and their interests

According to the register of directors' shareholdings, none of the directors holding office at the end of the financial year had any interest in the share capital or debentures of the Company or related corporations, except as follows:

| | | <i>Holdings registered in name of director</i> | <i>Holdings in which a director is deemed to have an interest*</i> |
|-----------------|--------------------------------------|--|--|
| | Class of shares – The Company | At 31 December 2018 | At 31 December 2018 |
| Pradip Dhamecha | Ordinary A shares of £0.01 each | 46,000,100 | |
| Pradip Dhamecha | Preferred ordinary shares of £1 each | 14,800,000 | |
| Pradip Dhamecha | Ordinary B shares of £0.01 each | | 46,000,100 |
| Pradip Dhamecha | Preferred ordinary shares of £1 each | | 14,800,000 |
| Balbinder Sohal | Ordinary B shares of £0.01 each | | 46,000,100 |
| Balbinder Sohal | Preferred ordinary shares of £1 each | | 14,800,000 |

Pradip Dhamecha and Balbinder Sohal are directors in the Company.

* Shares held in Cynergy Capital Ltd, registered in the name of a legal entity in which the directors have an interest.

No other Director had any beneficial interest in the share capital of the Company at any time during the period.

Disclosure of information to the auditors

So far as each person who was a Director at the date of this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow Directors and the Group's auditor, each Director has taken all the steps that they are obliged to take as a Director in order to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors

It is the intention of the Group to appoint PricewaterhouseCoopers LLP as auditors during 2019. Until then Ernst & Young LLP continue as auditors of the Group. The Group consists of private limited companies and under the Companies Act 2006 are not required to appoint auditors annually.

Charitable donations

During the period under review the Group made charitable donations totalling £5,001.

Political donations

During the period under review the Group did not make any political donations.

Third party indemnity provisions for the benefit of Directors

The Group has taken out Directors' and officers' liability insurance.

By Order of the Board



Balbinder Sohal
Director

Directors' responsibilities in respect of the financial statements

The Directors are responsible for preparing the strategic report, the Directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) and applicable law. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing these financial statements the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8 'Accounting Policies, Changes in Accounting Estimates and Errors' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements;

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CYNERGY CAPITAL LTD

Opinion

We have audited the financial statements of Cynergy Capital Ltd ('the parent company') and its subsidiaries (the 'group') for the period ended 31 December 2018 which comprise the Income Statement and Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Consolidated Statement of Cash Flows and the related notes 1 to 34, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In our opinion:

- the financial statements give a true and fair view of the group's and of the parent company's affairs as at 31 December 2018 and of the group's and parent company's profit and loss respectively for the period then ended;
- the financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial period for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



*Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
17th December 2019*

Notes:

1. The maintenance and integrity of the Cynergy Capital Ltd web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income statement and statement of comprehensive income

For the period ended 31 December 2018

| | | Consolidated | Company |
|---|--------------|---------------------|----------------|
| | | 2018 | 2018 |
| | <i>Notes</i> | £000 | £000 |
| Interest income calculated using the effective interest method | 5 | 18,142 | - |
| Other interest and similar income | 5 | 471 | - |
| Interest expense calculated using the effective interest method | 6 | (5,619) | - |
| Other interest and similar income | | (514) | - |
| Net interest income | | 12,480 | - |
| Fee and commission income | 7 | 571 | - |
| Management fee income | | - | 33 |
| Finance income | | - | 1 |
| Foreign exchange gains | 8 | 65 | - |
| Fair value gain on hedging instruments | 9 | 261 | - |
| Gain on bargain purchase | 34 | 17,482 | - |
| Total operating income | | 30,859 | 34 |
| Staff costs | 10 | (6,711) | - |
| Depreciation, amortisation and impairment | 11 | (2,296) | - |
| Other operating expenses | 12 | (5,963) | (65) |
| Total operating income before conduct and legal provision | | 15,889 | (31) |
| Profit before credit loss expense on financial assets | | 15,889 | (31) |
| Credit loss on financial assets | 13 | (772) | - |
| Profit before tax | | 15,117 | (31) |
| Income tax (expense) / credit | 14 | (164) | 3 |
| Profit after tax | | 14,953 | (28) |
| Total comprehensive profit for the period attributable to the equity holders | | 14,953 | (28) |

The notes on pages 14 to 46 form an integral part of these financial statements.

Statement of financial position

As at 31 December 2018

| | | <i>Consolidated</i> | <i>Company</i> |
|--------------------------------------|--------------|---------------------|----------------|
| | | 2018 | 2018 |
| | <i>Notes</i> | £000 | £000 |
| Assets | | | |
| Cash and balances with central banks | 15 | 196,454 | - |
| Placements with banks | 15 | 56,399 | 861 |
| Loans and advances to customers | 17 | 1,668,923 | - |
| Other assets | 18 | 18,245 | 419 |
| Investment in subsidiary | 30 | - | 127,848 |
| Intangible assets | 19 | 1,010 | - |
| Property and equipment | 20 | 15,652 | - |
| Total assets | | 1,956,683 | 129,128 |
| Liabilities | | | |
| Customer deposits | 21 | 1,762,654 | - |
| Bank deposits | 22 | 240 | - |
| Provision for customer redress | 23 | 12,221 | - |
| Other liabilities | 24 | 60,553 | 52,618 |
| Subordinated loan | 25 | 29,524 | - |
| Total liabilities | | 1,865,192 | 52,618 |
| Equity | | | |
| Share capital | 26 | 76,348 | 76,348 |
| Share premium | | 190 | 190 |
| Accumulated profits / (losses) | | 14,953 | (28) |
| Total equity | | 91,491 | 76,510 |
| Total liabilities and equity | | 1,956,683 | 129,128 |

The notes on pages 14 to 46 form an integral part of these financial statements.

These financial statements were approved by the board of directors on 17th DEC and were signed on its behalf by:



Balbinder Sohal
Director

Statement of changes in equity**For the period ended 31 December 2018****Consolidated**

| | <i>Share capital</i> | <i>Share premium</i> | <i>Accumulated profits/(losses)</i> | <i>Total</i> |
|---------------------------------|----------------------|----------------------|---|---------------|
| | <i>£000</i> | <i>£000</i> | <i>£000</i> | <i>£000</i> |
| At 17 May | - | - | - | - |
| Share Capital issued | 76,348 | 190 | - | 76,538 |
| Profit for the period after tax | - | - | 14,953 | 14,953 |
| 31 December | 76,348 | 190 | 14,953 | 91,491 |

Company

| | <i>Share capital</i> | <i>Share premium</i> | <i>Accumulated profits/(losses)</i> | <i>Total</i> |
|---------------------------------|----------------------|----------------------|---|---------------|
| | <i>£000</i> | <i>£000</i> | <i>£000</i> | <i>£000</i> |
| At 17 May | - | - | - | - |
| Share Capital issued | 76,348 | 190 | - | 76,538 |
| Profit for the period after tax | - | - | (28) | (28) |
| 31 December | 76,348 | 190 | (28) | 76,510 |

The notes on pages 14 to 46 form an integral part of these financial statements.

Consolidated statement of cash flows

For the period ended 31 December 2018

| | <i>Consolidated</i> | <i>Company</i> |
|--|---------------------|------------------|
| | 2018 | 2018 |
| | £000 | £000 |
| Operating activities | | |
| Profit / (loss) before tax | 15,117 | (31) |
| Adjustments for: | | |
| Provisions for credit loss expense | 772 | - |
| Depreciation of property and equipment | 239 | - |
| Amortisation of intangible assets | 354 | - |
| Impairment of fixed assets | 1,703 | - |
| Gain on bargain purchase | (17,482) | - |
| Interest on subordinated loan | 705 | - |
| Amortisation of issuance costs relating to subordinated loan | 13 | - |
| Tax paid | - | - |
| Changes in operating assets | | |
| Increase in loans and advances to customers | (39,786) | - |
| Decrease / (increase) in other assets | 28,108 | (416) |
| Changes in operating liabilities | - | - |
| Decrease in customer deposits | (4,786) | - |
| Increase in bank deposits | 240 | - |
| Increase in other liabilities and provision for customer redress | 10,249 | 52,618 |
| Net cash flow (used in) / from operating activities | (4,554) | 52,171 |
| Investing activities | | |
| Purchase of property and equipment | (958) | - |
| Purchase of intangible assets | (1,035) | - |
| Acquisition of a subsidiary, net of cash acquired | 182,862 | (127,848) |
| Net cash flow used in investing activities | 180,869 | (127,848) |
| Financing activities | | |
| Proceeds from issuance of new share capital | 76,538 | 76,538 |
| Net cash flow from financing activities | 76,538 | 76,538 |
| Net increase in cash and cash equivalents for the year | 252,853 | 861 |
| Cash and cash equivalents (see note 15) | | |
| 17 May | - | - |
| Net increase in cash and cash equivalents for the year | 252,853 | 861 |
| 31 December | 252,853 | 861 |
| Operational cash flows from interest | 2018 | 2018 |
| | £000 | £000 |
| Interest paid | 5,391 | - |
| Interest received | 17,672 | 1 |

Refer to notes 15 and 24 for disclosures of cash and cash equivalents and changes in liabilities arising from financing activities respectively. The notes on pages 14 to 46 form an integral part of these financial statements.

Notes to the financial statements

1 Corporate information

Cynergy Capital Ltd (registered number: 11368222), incorporated in England and Wales on 17 May 2018, is a private company limited by shares with its registered office at 97 Park Lane Mayfair, London, United Kingdom, W1K 7TG. The Company year end is 31 December. The first accounts are made up from 17 May 2018 to 31 December 2018. Cynergy Capital Ltd (the Company) together with its subsidiaries (the Group) provides business and personal banking services in the UK and is incorporated in the United Kingdom under the Companies Act 2006. Cynergy Bank Limited (the Bank Company) is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA.

On 23 November 2018, the Company completed the purchase of Bank of Cyprus UK Limited from Bank of Cyprus Public Company Limited following the receipt of regulatory approvals from the Prudential Regulation Authority and European Central Bank. The effective date of the sale was 30 September 2018. On 7 December 2018 "Bank of Cyprus UK Limited" rebranded to "Cynergy Bank Limited", whose principal place of business is England and Wales and whose registered office is 27-31 Charlotte Street, London, W1T 1RP. Cynergy Capital Ltd owns 100% of the ordinary shares of Cynergy Bank Limited.

2 Basis of preparation and consolidation

2.1 Basis of preparation

The consolidated and Company financial statements have been prepared on a historical cost basis, except for land and buildings classified as property and derivative financial instruments that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at cost, are adjusted to record changes in fair value attributable to the risks that are being hedged.

Statement of compliance

The consolidated and Company financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU and the requirements of the Companies Act 2006.

Presentation of financial statements

The financial statements are presented in sterling, which is the Group's functional and presentational currency. All values are rounded to the nearest thousand, except where otherwise indicated.

The Group presents its balance sheet broadly in order of decreasing liquidity. An analysis regarding expected recovery or settlement of financial assets and liabilities within twelve months after the balance sheet date and more than twelve months after the balance sheet date is presented in note 29.

Financial assets and financial liabilities are offset, and the net amount reported in the balance sheet, only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis and to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by an accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

Foreign currency translation

Transactions in foreign currencies are recorded using the functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated at the reporting currency rate of exchange ruling at the balance sheet date. All differences are taken to 'Foreign exchange gains' in the income statement.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in Other Comprehensive Income (OCI) or profit or loss are also recognised in OCI or profit or loss, respectively).

2.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 31 December 2018. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee
- The ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement(s) with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of OCI are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognised in profit or loss. Any investment retained is recognised at fair value.

3. Summary of significant accounting policies

3.1 New accounting standards and interpretations issued by the IASB but not yet adopted by the EU

The standards and interpretations that are issued, but not yet adopted, up to the date of issuance of the Group's financial statements which are relevant to its operations are disclosed below. The Group intends to adopt these standards when they become effective.

Except where otherwise stated, the Group does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the financial statements:

IFRS 16 - Leases: Effective for annual periods beginning on or after 1 January 2019. The scope of IFRS 16 includes leases of all assets, with certain exceptions. A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. IFRS 16 requires lessees to account for all leases under a single on-balance sheet model in a similar way to finance leases under IAS 17. The standard also requires lessees and lessors to make more extensive disclosures than under IAS 17. The impact of adopting this standard is immaterial.

IAS 12 – Income Taxes (IASB annual improvement 2015-2017 cycle): The amendments clarify that all income tax consequences of dividends (i.e. a distribution of profits) should be recognised where it originally recognised those passed transactions or events which generated distributable profits, regardless of how tax arises. Amendments are effective for annual periods beginning on or after 1 January 2019.

IAS 23 – Borrowing Costs (IASB annual improvement 2015-2017 cycle): The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings. Amendments are effective for annual periods beginning on or after 1 January 2019.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatments: Effective for annual periods beginning on or after 1 January 2019. In June 2017, the IASB issued IFRIC Interpretation 23 Uncertainty over Income Tax Treatments which clarifies application of the recognition and measurement requirements in IAS 12 Income Taxes when there is uncertainty over income tax treatments. Management is currently evaluating the impact of adopting the interpretation on its financial statements.

IFRS 9 (prepayment features): On 12 October 2017, the IASB published 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)' to address the concerns about how IFRS 9 'Financial Instruments' classifies particular pre-payable financial assets. In addition, the IASB clarified an aspect of the accounting for financial liabilities following a modification. The amendments are to be applied retrospectively for fiscal years beginning on or after 1 January 2019.

IAS 28 (long-term interests): On 12 October 2017, the IASB published 'Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)' to clarify that an entity applies IFRS 9 'Financial Instruments' to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendments are to be applied retrospectively for fiscal years beginning on or after 1 January 2019.

IAS 19 (plan amendments): On 7 February 2018, the IASB published 'Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)' to harmonise accounting practices and to provide more relevant information for decision-making. An entity applies the amendments to plan amendments, curtailments or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1 January 2019.

3.2 Segmental information

The Group operates in the United Kingdom in one principal activity, namely business and personal banking.

3.3 Revenue recognition

Revenue is recognised when it is probable that economic benefits will flow to the Group and the revenue can be reliably measured.

Interest income

Under IFRS 9, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost and financial instruments designated at FVPL. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

Fee and commission income integral to the effective interest rate

Fees that the Group considers to be an integral part of the corresponding financial instruments include: loan origination fees, loan commitment fees for loans that are likely to be drawn down and other credit related fees. The recognition of these fees (together with any incremental costs) form an integral part of the corresponding financial instruments and are recognised as interest income through an adjustment to the EIR.

Banking fees and commissions

Revenue from banking fees and commissions are measured based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. The Group recognises revenue when it transfers control over a product or service to a customer.

The nature, timing of satisfaction of performance obligations and significant payment terms of products and services are set out in the below table:

| Nature of good or service | Timing of Recognition | Timing of billing & payment | Geographical region |
|--|---------------------------------|--|----------------------------|
| Service fees for current accounts | Monthly | Quarterly | UK |
| Service fees for Debit / Credit cards | At point of delivery | At point of delivery | UK |
| Services fees for handling payments | At point of delivery | At point of delivery | UK |
| Service fees for credit Administration | At point of delivery | At point of delivery | UK |
| Early repayment charges | At point of delivery | At point of delivery | UK |
| Ad hoc fees | Monthly or at point of delivery | At point of delivery or periodic | UK |

3.4 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. When the effect of the time value of money is material, the Group determines the level of provision by discounting the expected cash flows at a pre-tax rate reflecting the current rates specific to the liability. The expense relating to any provision is presented in the income statement net of any reimbursement in other operating expenses. Detailed disclosures are provided in Note 23.

3.5 Retirement benefits

The Group operates a defined contribution pension plan in the UK. The cost of providing retirement pensions is charged to the profit and loss account at the amount of the defined contributions payable for each year. Differences between contributions payable and those actually paid are shown as accruals or prepayments.

3.6 Taxation

Taxation on income is provided in accordance with fiscal regulations and is recognised as an expense in the period in which the income arises. Deferred tax is provided using the liability method.

Deferred tax liabilities are recognised for all taxable temporary differences between the tax basis of assets and liabilities and their carrying amounts at the balance sheet date which will give rise to taxable amounts in future periods.

Deferred tax assets are recognised for all deductible temporary differences and carry-forward of unutilised tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carry-forward of unutilised tax losses can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to utilise all or part of the deductible temporary differences or tax losses.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Current tax and deferred tax relating to items recognised directly in equity are also recognised in equity and not in the statement of comprehensive income.

3.7 Financial instruments – initial recognition

Date of recognition

Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, are initially recognised on the trade date, i.e. the date that the Group becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Loans and advances to customers are recognised when funds are transferred to customers' accounts. The Group recognises balances due to customers when funds are transferred to the Group.

Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount. Trade receivables are measured at the transaction price. When the fair value of financial instruments at initial recognition differs from the transaction price, the Group accounts for the Day 1 profit or loss, as described below.

Day 1 profit or loss

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Bank recognises the difference between the transaction price and fair value in 'Total operating income'. In those cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss when the inputs become observable, or when the instrument is derecognised.

Measurement categories of financial assets and liabilities

From 1 January 2018, the Group classifies all of its financial assets based on the business model for managing the assets and the assets' contractual terms, measured at either:

- **Amortised Cost:** Assets that are held for the collection of contractual cash flows, where those cash flows represent solely payments of principal and interest ('SPPI') and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by an expected credit loss allowance recognised and measured as described in 3.9. Interest income from these financial assets is included in 'Interest income' using the effective interest method.
- **Fair value through other comprehensive income (FVOCI):** Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent SPPI, and that are not designated at FVPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on instruments' amortised cost which are recognised in the profit or loss. When a financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.
- **Fair value through profit or loss (FVPL):** Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of the hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Total operating income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net Investment Income'. Interest income from these financial assets is included in 'Other interest and similar income'.

The Group classifies and measures its derivative and trading portfolio at FVPL. The Group may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading and derivative instruments or the fair value designation is applied.

3.8 Financial assets and liabilities

Cash and balances with central banks, Placements with banks, Placements with/by related entities, Loans and advances to customers, Customer deposits and Subordinated loan at amortised cost

From 1 January 2018, the Group only measures Cash and balances with central banks, Placements with banks, Placements with / by related entities, Loans and advances to customers, Customer deposits and Subordinated loan at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding

The details of these conditions are outlined below.

i) Business model assessment

The Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the Group's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated;
- The expected frequency, value and timing of sales are also important aspects of the Group's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Group's original expectations, the Group does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

ii) The SPPI test

As a second step of its classification process the Group assesses the contractual terms of financial assets to identify whether they meet the SPPI test. 'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium / discount). The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Group applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set. In contrast, contractual terms that introduce a more than '*de minimis*' exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases the financial asset is required to be measured at FVPL.

Derivatives recorded at fair value through profit or loss

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variables, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

The Group enters into derivative transactions with various counterparties. These include interest rate swaps, futures, credit default swaps, cross-currency swaps, forward foreign exchange contracts and options on interest rates, foreign currencies and equities. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Fully collateralised derivatives that are settled net in cash on a regular basis are only recognised to the extent of the overnight outstanding balance. The notional amount and fair value of such derivatives are disclosed separately in Note 16. Changes in the fair value of derivatives are included in 'Total operating income' unless hedge accounting is applied. Hedge accounting disclosures are provided in Notes 9 and 16.

Embedded derivatives

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variables, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

From 1 January 2018, with the introduction of IFRS 9, the Group accounts in this way for derivatives embedded in financial liabilities and non-financial host contracts. Financial assets are classified based on the business model and SPPI assessments. Embedded derivatives are not separated from financial assets.

Financial assets or financial liabilities held for trading

The Group classifies financial assets or financial liabilities as held for trading when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets and liabilities are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognised in 'Total operating income'. Interest and dividend income or expense is recorded in 'Total operating income' according to the terms of the contract, or when the right to payment has been established.

Included in this classification are debt securities, equities, short positions and customer loans that have been acquired principally for the purpose of selling or repurchasing in the near term.

Debt instruments at FVOCI

The Group measures debt instruments at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. The ECL calculation for Debt instruments at FVOCI is explained in Note 3.11. Where the Group holds more than one investment in the same security, they are deemed to be disposed of on a first-in first-out basis. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

Equity instruments at FVOCI (Policy applicable from 1 January 2018)

Upon initial recognition, the Group occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

Debt issued and other borrowed funds

After initial measurement, debt issued and other borrowed funds are subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issued funds, and costs that are an integral part of the EIR. A compound financial instrument which contains both a liability and an equity component is separated at the issue date.

When establishing the accounting treatment for financial instruments with equity conversion rights, write-down and call options, the Group first establishes whether the instrument is a compound instrument and classifies such instrument's components separately as financial liabilities, financial assets, or equity instruments in accordance with IAS 32. Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercising the option may appear to have become economically advantageous to some holders. When allocating the initial carrying amount of a compound financial instrument to the equity and liability components, the equity component is assigned as the residual amount after deducting from the entire fair value of the instrument the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument, other than the equity component (such as an equity conversion option), is included in the liability component. Once the Group has determined the split between equity and liability, it further evaluates whether the liability component has embedded derivatives that must be separately accounted for.

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

Financial assets and financial liabilities in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management only designates an instrument at FVPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis;

Or

- The liabilities are part of a group of financial liabilities, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy;

Or

- The liabilities contain one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited.

Financial assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Group's own credit risk. Such changes in fair value are recorded in the Own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, taking into account any discount/ premium and qualifying transaction costs being an integral part of the instrument. Interest earned on assets mandatorily required to be measured at FVPL is recorded using contractual interest rates. Dividend income from equity instruments measured at FVPL is recorded in profit or loss as other operating income when the right to the payment has been established.

Financial guarantees, letters of credit and undrawn loan commitments

The Group issues financial guarantees, letters of credit and loan commitments. Financial guarantees are initially recognised in the financial statements (within Provisions) at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and an ECL provision as set out in Note 27. The premium received is recognised in the income statement in Net fees and commission income on a straight line basis over the life of the guarantee.

Undrawn loan commitments and letters of credit are commitments under which, over the duration of the commitment, the Group is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of the ECL requirements. The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position. The nominal values of these instruments together with the corresponding ECLs are disclosed in Note 27. The Group occasionally issues loan commitments at below market interest rates drawdown. Such commitments are subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

3.9 De-recognition of financial assets and liabilities

Under IFRS 9, the Group will recalculate the gross carrying amount of the financial asset (or the amortised cost of the financial liability) by discounting the modified contractual cash flows at the original effective interest rate and recognise any resulting adjustment as a modification gain or loss in profit or loss.

3.10 Impairment of financial assets

The impairment of financial assets under IFRS 9 requires a 12 month (Stage 1) ECL calculation where financial assets have not experienced a significant increase in credit risk since origination; and a lifetime ECL calculation where it has been demonstrated that there has been a significant increase in credit risk (Stage 2 and 3). The lifetime ECL calculation is further refined into separate stages depending on whether the financial asset is credit-impaired or not. The area of IFRS 9's impairment criteria where the greatest judgment is required relates to when financial assets display a significant deterioration in credit quality since initial recognition and subsequently move from a 12 month ECL calculation (Stage 1) to a non-credit-impaired lifetime ECL calculation (Stage 2).

i) Overview of the ECL principles

The Group records the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, including loan commitments in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12m ECL) as outlined in Note 29. The Group's policies for determining if there has been a significant increase in credit risk are set out in Note 29.

The 12m ECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Based on the above process, the Group groups its loans into Stage 1, Stage 2 and Stage 3 as described below:

- **Stage 1:** When loans are first recognised, the Group recognises an allowance based on 12m ECLs. Stage 1 loans also include loans where the credit risk has improved and the loan has been reclassified from Stage 2.
- **Stage 2:** When a loan has shown a significant increase in credit risk since origination, the Group records an allowance for the LTECLs. Stage 2 loans also include loans where the credit risk has improved and the loan has been reclassified from Stage 3.
- **Stage 3:** Loans are considered credit-impaired. The Group records an allowance for the LTECLs.

For financial assets for which the Group has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) de-recognition of the financial asset.

ii) The Calculation of ECLs

The Group calculates ECLs based on three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

- **Probability of Default (PD):** The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period if the facility has not been previously derecognised and is still in the portfolio.
- **Exposure at Default (EAD):** The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in Note 29.
- **Loss Given Default (LGD):** The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD. The LGD is further explained in Note 29.

When estimating the ECLs, the Group considers three scenarios: good, average and bad ('downside 1'). Each of these is associated with different PDs, EADs and LGDs, as set out in Note 29. When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset. The maximum period for which the credit losses are determined is the contractual life of a financial instrument.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

The mechanics of the ECL method are summarised below:

- **Stage 1:** The 12m ECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Group calculates the 12m ECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the three scenarios, as explained above.
- **Stage 2:** When a loan has shown a significant increase in credit risk since origination, the Group records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.
- **Stage 3:** For loans considered credit-impaired, the Group recognises the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.
- **Loan commitments:** When estimating LTECLs for loan commitments, the Group estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the three scenarios. The expected cash shortfalls are discounted at the expected EIR on the loan.
- **Overdrafts:** The Group does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Group's expectations of the customer behaviour, its likelihood of default and the Group's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Group's expectations, the period over which the Group calculates ECLs for these products, is five years for corporate and seven years for retail products. The interest rate used to discount the ECLs for overdrafts is based on the average EIR that is expected to be charged over the life of the instrument.

iii) Forward looking information

In its ECL models, the Group relies on a broad range of forward looking information as economic inputs, such as:

- GDP growth;
- Unemployment rates;
- Central Bank base rates;
- House price indices.

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are material.

3.11 Collateral valuation

To mitigate its credit risks on financial assets, the Group seeks to use collateral where possible. The collateral comes in various forms, such as real estate, cash, securities, letters of credit / guarantees, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. Collateral, unless repossessed, is not recorded on the Group's statement of financial position. However, the fair value of collateral affects the calculation of ECLs. It is generally assessed, at a minimum, at inception and re-assessed on a quarterly basis.

To the extent possible, the Group uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on professional valuations.

3.12 Write-offs

Financial assets are written off either partially or in their entirety only when the Group has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

3.13 Forborne and modified loans

The Group sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or otherwise enforcing collection of collateral. The Group considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Group would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants or significant concerns raised by the Credit Risk Department. Forbearance may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Group's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur. De-recognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

When the loan has been renegotiated or modified but not derecognised, the Group also reassesses whether there has been a significant increase in credit risk, as set out in Note 29. The Group also considers whether the assets should be classified as Stage 3. Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In

order for the loan to be reclassified out of the forbore category, the customer has to meet all of the following criteria:

- All of its facilities have to be considered performing;
- The probation period of two years has passed from the date the forbore contract was considered performing;
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period;
- The customer does not have any contract that is more than 30 days past due

Funding for Lending Scheme ("FLS")

The Group is a participant in the FLS which enables it to borrow highly liquid UK Treasury Bills in exchange for eligible collateral. The Treasury Bills issued are for an original maturity of nine months and if delivered back prior to their maturity date can be exchanged for further nine month Bills. Costs of borrowing are charged directly to the Income Statement. The Treasury Bills are not recorded on the Group's balance sheet as ownership remains with the Bank of England. The risk and rewards of the collateral provided remains with the Group and continues to be recognised in the Group's Financial Statements.

3.14 Cash and cash equivalents

Cash and cash equivalents for the purposes of the statement of cash flows consist of cash, non-obligatory balances with central banks, placements with banks and other securities that are readily convertible into known amounts of cash or are repayable within three months of the date of their acquisition. Placements by related entities which are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purposes of the Statement of cash flows.

3.15 Property and equipment

Property is originally measured at cost and subsequently measured at fair value less accumulated depreciation. Valuations are carried out on a three-year cycle by independent qualified valuers on the basis of current market values. Management reassesses the carrying amount to ensure that it does not differ materially from the fair value at the end of each intervening reporting period. Revaluation increments are credited to the asset revaluation reserve, unless these reverse deficits on revaluations charged to the income statement in prior years. To the extent that they reverse previous revaluation gains, revaluation losses are charged against the asset revaluation reserve. This policy is applied to assets individually. Revaluation increases and decreases are not offset, even within a class of assets, unless they relate to the same asset.

Computer hardware and furniture and equipment are carried at cost, less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to acquisition.

Property and equipment carrying amounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of (i) the asset's fair value less costs to sell and (ii) the asset's value in use.

Depreciation of buildings and equipment is calculated on a straight line basis over the estimated useful life, as follows: buildings 30 years, computer equipment 5 years, furniture and fixtures 10 years. Asset residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. Gains or losses on the disposal of property and equipment, which are determined as the difference between the net sale proceeds and the carrying amount at the time of sale, are included in the income statement. Any realised amounts in the asset revaluation reserve are transferred directly to retained earnings on disposal of the underlying property.

3.16 Intangible assets

An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Group. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life, or the expected pattern of consumption of future economic benefits embodied in the asset, are accounted for by changing the amortisation period or methodology, as appropriate, which are then treated as changes in accounting estimates.

Intangible assets are reviewed for impairment when events relating to changes to circumstances indicate that the carrying value may not be recoverable. If the carrying amount exceeds the recoverable amount then the intangible assets are written down to their recoverable amount.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives, as follows:

- Computer software – 3 years
- Core application software – 10 years
- Core deposits systems – 5 years

3.17 Impairment of non-financial assets

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The Group operates one CGU, being the Bank Company.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs of disposal, recent market transactions are taken into account. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded companies or other available fair value indicators.

The Group bases its impairment calculation on detailed budgets and forecast calculations, which are prepared separately for each of the Group's CGUs to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. A long-term growth rate is calculated and applied to project future cash flows after the fifth year. Impairment losses of continuing operations are recognised in the statement of profit or loss in expense categories consistent with the function of the impaired asset, except for properties previously revalued with the revaluation taken to OCI. For such properties, the impairment is recognised in OCI up to the amount of any previous revaluation.

For assets excluding goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognised impairment losses no longer exist or have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

Intangible assets with indefinite useful lives are tested for impairment annually as at 31 January at the CGU level, as appropriate, and when circumstances indicate that the carrying value may be impaired.

4 Significant accounting judgments, estimates and assumptions

The preparation of the financial statements requires the Group's management to make judgments, estimates and assumptions that can have a material impact on the amounts recognised in the financial statements. The accounting policies that are critical to the Group's results and financial position in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgment including the use of estimates and assumptions are set out below.

Critical judgments and estimates

The preparation of financial information requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and management assumptions are reviewed on a regular basis and when new information becomes available. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in subsequent accounting periods.

The judgments and assumptions that are considered to be the most important in the portrayal of the Group's financial affairs are those related to the conduct risk and legal provision included in these accounts.

Provision for conduct risk, customer remediation and litigation

The Group operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result it is involved in various litigation, arbitration, conduct and regulatory investigations and proceedings, arising in the ordinary course of the Group's business.

When the Group can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Group records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the Group is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Group does not include detailed, case-specific disclosures in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the Group takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgment is required to conclude on these estimates.

The Group has established a provision for redress payable in respect of historic conduct issues. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. Details of the provision for customer redress are presented in Note 23 to the financial statements.

Impairment losses on financial assets

The measurement of impairment losses under IFRS 9 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Group's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies.

Elements of the ECL models that are considered accounting judgements and estimates include:

- The Group's internal credit grading model, which assigns PDs to the individual grades
- The Group's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models

The effective interest method

The Group's interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost and fair value through other comprehensive income. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The Group recognises interest income at a rate of return that represents the best estimate of a constant rate of return over the expected behavioural life of loans and deposits and recognises the effect of potentially different interest rates charged at various stages and other characteristics of the product life cycle (including prepayments and penalty interest and charges). This estimation, by nature, requires an element of judgment regarding the expected behaviour and life-cycle of the instruments, as well as expected changes to the Group's and the Central Bank base rate and other fee income / expense that are integral parts of the instrument.

Provisions and other contingent liabilities

The Group operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result it is involved in various litigation, arbitration, conduct and regulatory investigations and proceedings in the UK, arising in the ordinary course of the Group's business.

When the Group can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Group records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the Group is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Group does not include detailed, case-specific disclosures in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the Group takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgment is required to conclude on these estimates.

Taxation

The Group operates in the United Kingdom and is therefore subject to United Kingdom corporation tax. Estimates are required in determining the provision for taxes at the balance sheet date. The Group recognises tax liabilities for transactions whose tax treatment is uncertain. Where the final tax is different from the amounts initially recognised in the income statement, such differences will impact the income tax expense, the tax liabilities and deferred tax assets or liabilities of the period in which the final tax is agreed with the relevant tax authorities. In relation to current year tax there are no assumptions or estimates that significantly affect the tax provision.

Deferred tax assets are recognised by the Group in respect of tax losses to the extent that it is probable that future taxable profits will be available against which the losses can be utilised. Judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax-planning strategies. These variables have been established on the basis of significant management judgment and are subject to uncertainty.

Revaluation of land and buildings classified as property

The Group carries its land and buildings classified as property at fair value, with changes in fair value being recognized in the statement of other comprehensive income.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IFRS 9 Financial Instruments,

is measured at fair value with the changes in fair value recognised in the statement of profit or loss in accordance with IFRS 9. Other contingent consideration that is not within the scope of IFRS 9 is measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

5 Interest income **2018**
£000

Group

| | |
|---|---------------|
| Loans and advances to customers | 17,659 |
| Placements with banks and central banks | 411 |
| Placements with related entities | 72 |
| | 18,142 |
| Other interest and similar income | 471 |
| | 18,613 |

Interest income includes fee income forming an integral part of the corresponding financial instruments' yield through an adjustment to the instruments' EIR. This amounted to £970,262.

6 Interest expense **2018**
£000

Group

| | |
|----------------------------------|--------------|
| Customer deposits | 4,720 |
| Placements by related entities | 98 |
| Bank deposits | 96 |
| Subordinated loan (note 25) | 705 |
| | 5,619 |
| Derivative financial instruments | 514 |
| | 6,133 |

7 Fee and commission income

Group

Disaggregation:

| Nature of good or service | Timing of Recognition | Timing of billing & payment | Geographical region | |
|--|---------------------------------|----------------------------------|---------------------|------------|
| Service fees for current accounts | Monthly | Quarterly | UK | 212 |
| Service fees for Debit / Credit cards | At point of delivery | At point of delivery | UK | 113 |
| Services fees for handling payments | At point of delivery | At point of delivery | UK | 60 |
| Service fees for credit Administration | At point of delivery | At point of delivery | UK | 20 |
| Early repayment charges | At point of delivery | At point of delivery | UK | 166 |
| Ad hoc fees | Monthly or at point of delivery | At point of delivery or periodic | UK | - |
| | | | | 571 |

8 Foreign exchange gains

Foreign exchange gains arise from the re-translation of monetary assets in foreign currency at the balance sheet date, realised exchange gains from transactions in foreign currency which have been settled during the period and the revaluation of foreign exchange derivatives.

9 Net gain / (loss) on financial instrument transactions

Group

| | |
|---|------------|
| Net gain arising from fair value hedges (see note 16) | 261 |
|---|------------|

10 Staff costs

Group

| | |
|--|--------------|
| Salaries | 5,788 |
| Social security costs | 476 |
| Retirement benefit costs - defined contribution scheme | 447 |
| | 6,711 |

The number of staff employed (including two executive directors) by the Group as at 31 December 2018 was 234. The Directors of Cynergy Capital Ltd did not receive remuneration during the period to 31 December 2018.

11 Depreciation, amortisation and impairment

2018
£000

Group

| | |
|-----------------------------------|--------------|
| Depreciation | 239 |
| Amortisation of intangible assets | 354 |
| Impairment | 1,703 |
| | 2,296 |

12 Other operating expenses

Group

| | Group | Company |
|--|--------------|----------------|
| Information technology | 1,168 | - |
| Professional fees | 2,325 | 45 |
| Money transmission | 274 | - |
| Communication | 66 | - |
| Advertising | 147 | - |
| Premises | 324 | - |
| Printing and stationery | 75 | - |
| Other operating expenses – refer to analysis below | 1,584 | 20 |
| | 5,963 | 65 |

Professional fees include fees payable to the Group's auditor of £208,740 which are analysed below:

| | | |
|---|------------|-----------|
| Audit of the Group's financial statements | | 45 |
| Audit of the subsidiary's financial statements* | 164 | |
| | 164 | 45 |

* The audit fee quoted has been apportioned to the relevant period.

Other operating expenses are further analysed below:

| | | |
|--------------------------|--------------|-----------|
| Directors' fees | 62 | |
| Recruitment | 253 | |
| Training | 67 | |
| Travel and entertaining | 137 | |
| Strategic initiatives | 327 | |
| Rebranding | 680 | |
| Other insurances | 68 | |
| Miscellaneous | (13) | |
| Other operating expenses | 3 | 20 |
| | 1,584 | 20 |

13 Credit loss on financial assets

The table below shows the ECL charges on financial instruments for the year recorded in the income statement:

| <i>Group</i> | Stage 1 Individual £000 | Stage 1 Collective £000 | Stage 2 Individual £000 | 2018 Stage 2 Collective £000 | Stage 3 Collective £000 | POCI £000 | Total £000 |
|-----------------------------|-------------------------------|-------------------------------|-------------------------------|---------------------------------------|-------------------------------|--------------|---------------|
| Loans advances to customers | - | 221 | - | 23 | 528 | - | 772 |
| Total impairment loss | - | 221 | - | 23 | 528 | - | 772 |

14 Taxation

| | 2018 £000 Group | 2018 £000 Company |
|--------------------------------------|-----------------------|-------------------------|
| UK corporation tax | | |
| Charge for the year | 199 | - |
| Adjustments in respect of prior year | - | - |
| | 199 | - |
| Deferred tax | | |
| (Credit) / charge for the year | (35) | (3) |
| Tax charge for the year | 164 | (3) |

A reconciliation of the tax charge in the income statement for the year and the accounting profit multiplied by the standard rate of corporation tax in the United Kingdom of 19.00% is presented below:

| | | |
|--|------------|------------|
| Profit / (loss) before tax | 15,117 | (31) |
| Tax calculated at 19.00% | 2,872 | (6) |
| Tax effect of: | | |
| Income not chargeable to Corporation Tax | (2,764) | - |
| Expenses not deductible for tax purposes | - | 3 |
| Tax rate change | 56 | - |
| Tax charge for the year | 164 | (3) |

| | 2018 £000 Group | 2018 £000 Company |
|--|-----------------------|-------------------------|
| The net deferred asset (liability) arises from: | | |
| Difference between capital allowances and depreciation | 517 | 3 |
| Net deferred tax asset / (liability) | 517 | 3 |

The movement in the net deferred tax asset is set out below:

| | | |
|---|-----|---|
| 1 January | 482 | - |
| Deferred tax recognised in the income statement | 35 | 3 |
| 31 December | 517 | 3 |

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

| | | |
|--|------|---|
| Difference between capital allowances and depreciation | 102 | - |
| Other temporary differences | (11) | 3 |
| Change in tax rates | (56) | - |
| Deferred tax credit / (charge) for the year | 35 | 3 |

The corporation tax rate reduces to 17% effective from 1 April 2020 enacted in September 2016. Accordingly, the deferred tax asset is calculated at 17%.

15 Cash, balances with central banks and placements with banks

Group

| | |
|-----------------------------------|---------|
| Cash | 457 |
| Balances with the Bank of England | 195,997 |
| | 196,454 |
| Placements with banks | 56,399 |
| Cash and cash equivalents | 252,853 |

The ECLs relating to Cash, balances with central banks and placements with banks are negligible and round to zero.

Placements with banks earn interest (or in some cases are charged interest) based on the inter-bank rate for the relevant term and currency.

Balances with central banks include mandatory deposits of £2,682,295 which are not available for use in the Group's day-to-day business. These comprise cash ratio deposits which are non-interest bearing deposits placed with the Bank of England under the provisions of the Bank of England Act 1998.

16 Derivative financial instruments

The use of derivatives is an integral part of the Group's activities. Derivatives are used to manage the Group's own exposure to fluctuations in interest rates and exchange rates.

Forward exchange rate contracts are irrevocable agreements to buy or sell a specified quantity of foreign currency on a specified future date at an agreed rate.

Interest rate swaps are contractual agreements between two parties to exchange fixed rate and floating rate interest by means of periodic payments based upon a notional principal amount and the interest rates defined in the contract.

Interest rate caps and floors protect the holder from fluctuations of interest rates above or below a specified interest rate for a specified period of time.

The fair value of derivative financial instruments represents the cost of replacement of these contracts at the balance sheet date. The credit exposure arising from these transactions is managed as part of the Group's market risk management.

The fair value of the derivatives can be either positive (an asset) or negative (a liability) as a result of fluctuations in market interest rates or foreign exchange rates in accordance with the terms of the relevant contract. The aggregate net fair value of derivatives may fluctuate significantly over time.

The Group applies hedge accounting using derivatives when the required criteria for hedge accounting are met. For designated and qualifying fair value hedges the cumulative change in the fair value of a hedging derivative is recognised in the income statement in operating income. In addition, the cumulative change in the fair value of the hedged item attributable to the hedged risk is recognised in the income statement in operating income, and also recorded as part of the carrying value of the

hedged item in the statement of financial position. For designated and qualifying cash flow hedges, the effective portion of the cumulative gain or loss on the hedging instrument is initially recognised directly in OCI within equity (Cash flow hedge reserve). The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in Operating income in the Income statement.

The Group also uses derivatives to hedge the changes in interest rates or exchange rates which do not meet the criteria for hedge accounting. As a result, these derivatives are accounted for as trading derivatives and the gains or losses arising from revaluation are recognised in the income statement.

Gains or losses due to changes on fair value hedges and trading derivatives for the year are as follows:

| <u>Group</u> | 2018 |
|---|--------------|
| | £000 |
| Losses from change in fair value of trading derivatives | (22) |
| Gains from change in fair value of hedging instruments | (102) |
| Gains /(losses) from change in fair value of hedged items | 385 |
| | 261 |

The table below shows the fair values of derivative financial instruments recorded as assets or liabilities together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

| <u>Group</u> | 2018 | | |
|---------------------------------------|-------------------------------------|------------------------|-----------------------------|
| | Notional amount £000 | Fair value | |
| | | Assets £000 | Liabilities £000 |
| <u>Exchange rate contracts</u> | | | |
| By type | | | |
| Foreign exchange trading swaps | 48,735 | 105 | (252) |
| Foreign exchange spots | 207 | 1 | (1) |
| Total exchange rate contracts | 48,942 | 106 | (253) |
| By maturity | | | |
| Up to 1 year | 48,942 | 106 | (253) |
| Total exchange rate contracts | 48,942 | 106 | (253) |
| By counterparty | | | |
| Banks and building societies | 48,813 | 105 | (253) |
| Customers | 129 | 1 | - |
| Total exchange rate contracts | 48,942 | 106 | (253) |

| <u>Group</u> | 2018 | | |
|---------------------------------------|-------------------------------------|------------------------|-----------------------------|
| | Notional amount £000 | Fair value | |
| | | Assets £000 | Liabilities £000 |
| <u>Interest rate contracts</u> | | | |
| By type | | | |
| Interest rate swaps | 205,000 | 356 | - |
| Total interest rate contracts | 205,000 | 356 | - |
| By maturity | | | |
| Up to 1 year | 205,000 | 356 | - |
| Total interest rate contracts | 205,000 | 356 | - |
| By counterparty | | | |
| Banks and building societies | 205,000 | 356 | - |
| Total interest rate contracts | 205,000 | 356 | - |
| By hedging status | | | |
| Economic | 205,000 | 356 | - |
| Total interest rate contracts | 205,000 | 356 | - |

17 Loans and advances to customers

| | 2018 |
|---|------------------|
| <u>Group</u> | £000 |
| Loans | 1,660,652 |
| Overdrafts | 11,817 |
| | 1,672,469 |
| Less: Allowance for ECL/impairment losses | (3,546) |
| | 1,668,923 |

The tables below shows the credit quality and the maximum exposure to credit risk based on the Group's internal credit rating system and year-end stage classification. The amounts presented are gross of impairment allowances. Details of the Group's internal grading system are explained in Note 29.

Loans

| <u>Group</u> | 2018 | | | | | | |
|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------|------------------|
| | Stage 1 Individual | Stage 1 Collective | Stage 2 Individual | Stage 2 Collective | Stage 3 Collective | POCI | Total |
| Internal rating grade | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| Standard grade | - | 1,567,247 | - | 62,463 | - | - | 1,629,710 |
| Watch list medium risk | - | - | - | 10,820 | - | - | 10,820 |
| Watch list high risk | - | - | - | - | - | - | - |
| Individually impaired | - | - | - | - | 20,122 | - | 20,122 |
| Total | - | 1,567,247 | - | 73,283 | 20,122 | - | 1,660,652 |

Overdrafts

| <u>Group</u> | 2018 | | | | | | |
|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------|---------------|
| | Stage 1 Individual | Stage 1 Collective | Stage 2 Individual | Stage 2 Collective | Stage 3 Collective | POCI | Total |
| Internal rating grade | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| Standard grade | - | 9,738 | - | 1,792 | - | - | 11,530 |
| Watch list medium risk | - | - | - | 76 | - | - | 76 |
| Watch list high risk | - | - | - | - | - | - | - |
| Individually impaired | - | - | - | - | 211 | - | 211 |
| Total | - | 9,738 | - | 1,868 | 211 | - | 11,817 |

An analysis of changes in the gross carrying amount is as follows:

Loans

| <u>Group</u> | 2018 | | | | | | |
|-------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------|------------------|
| | Stage 1 Individual | Stage 1 Collective | Stage 2 Individual | Stage 2 Collective | Stage 3 Collective | POCI | Total |
| | £000 | £000 | £000 | £000 | £000 | £000 | £000 |
| 17 May | - | - | - | - | - | - | - |
| Acquisition of subsidiary | - | 1,490,017 | - | 94,606 | 23,070 | - | 1,607,693 |
| New assets originated | - | 149,936 | - | 1,266 | 2,232 | - | 153,434 |
| Assets derecognised or repaid | - | (59,785) | - | (29,113) | (11,164) | - | (100,062) |
| Transfers to Stage 1 | - | 15,105 | - | (14,892) | (213) | - | - |
| Transfers to Stage 2 | - | (27,349) | - | 28,637 | (1,287) | - | - |
| Transfers to Stage 3 | - | (676) | - | (7,221) | 7,897 | - | - |
| Modifications | - | - | - | - | - | - | - |
| Amounts written-off | - | - | - | - | (413) | - | (413) |
| Foreign exchange adjustments | - | - | - | - | - | - | - |
| Total | - | 1,567,247 | - | 73,283 | 20,122 | - | 1,660,652 |

OverdraftsGroup

| | Stage 1 | Stage 1 | Stage 2 | 2018 | Stage 3 | POCI | Total |
|-------------------------------|----------------|----------------|----------------|--------------|----------------|-------------|---------------|
| | Individual | Collective | Individual | Stage 2 | Collective | | |
| | £000 | £000 | £000 | Collective | £000 | £000 | £000 |
| 17 May | - | - | - | - | - | - | - |
| Acquisition of subsidiary | - | 16,111 | - | 1,535 | 330 | - | 17,977 |
| New assets originated | - | 498 | - | 3 | 1 | - | 502 |
| Assets derecognised or repaid | - | (5,875) | - | (661) | (122) | - | (6,657) |
| Transfers to Stage 1 | - | 78 | - | (78) | - | - | - |
| Transfers to Stage 2 | - | (1,074) | - | 1,074 | - | - | - |
| Transfers to Stage 3 | - | - | - | (6) | 6 | - | - |
| Modifications | - | - | - | - | - | - | - |
| Amounts written off | - | - | - | - | (5) | - | (5) |
| Foreign exchange adjustments | - | - | - | - | - | - | - |
| Total | - | 9,738 | - | 1,868 | 211 | - | 11,817 |

An analysis of changes in the ECL is as follows:

LoansGroup

| | Stage 1 | Stage 1 | Stage 2 | 2018 | Stage 3 | POCI | Total |
|-------------------------------|----------------|----------------|----------------|-------------|----------------|-------------|--------------|
| | Individual | Collective | Individual | Stage 2 | Collective | | |
| | £000 | £000 | £000 | Collective | £000 | £000 | £000 |
| 17 May | - | - | - | - | - | - | - |
| Acquisition of subsidiary | - | 1,200 | - | 315 | 1,525 | - | 3,040 |
| New assets originated | - | 505 | - | 2 | 187 | - | 694 |
| Assets derecognised or repaid | - | (157) | - | 494 | (473) | - | (136) |
| Transfers to Stage 1 | - | 10 | - | (10) | - | - | - |
| Transfers to Stage 2 | - | (102) | - | 103 | (1) | - | - |
| Transfers to Stage 3 | - | (38) | - | (569) | 607 | - | - |
| Modifications | - | - | - | - | - | - | - |
| Amounts written-off | - | - | - | - | (413) | - | (413) |
| Foreign exchange adjustments | - | - | - | - | - | - | - |
| Total | - | 1,418 | - | 335 | 1,432 | - | 3,185 |

OverdraftsGroup

| | Stage 1 | Stage 1 | Stage 2 | 2018 | Stage 3 | POCI | Total |
|-------------------------------|----------------|----------------|----------------|-------------|----------------|-------------|--------------|
| | Individual | Collective | Individual | Stage 2 | Collective | | |
| | £000 | £000 | £000 | Collective | £000 | £000 | £000 |
| 17 May | - | - | - | - | - | - | - |
| Acquisition of subsidiary | - | 21 | - | 13 | 117 | - | 151 |
| New assets originated | - | - | - | - | - | - | - |
| Assets derecognised or repaid | - | 7 | - | - | (7) | - | - |
| Transfers to Stage 1 | - | 1 | - | (1) | - | - | - |
| Transfers to Stage 2 | - | (4) | - | 4 | - | - | - |
| Transfers to Stage 3 | - | - | - | (2) | 2 | - | - |
| Modifications | - | - | - | - | - | - | - |
| Amounts written-off | - | - | - | - | (5) | - | (5) |
| Foreign exchange adjustments | - | - | - | - | - | - | - |
| Total | - | 25 | - | 14 | 107 | - | 146 |

18 Other assets

| <u>Group</u> | 2018 |
|--|---------------|
| | £000 |
| Debtors | 575 |
| Receivable from the Bank of Cyprus Public Company Limited towards redress payments (note 23) | 12,845 |
| Prepayments and accrued income | 1,249 |
| Receivables from payment service provider | 1,701 |
| Assets under construction | 895 |
| Derivatives | 461 |
| Deferred tax asset (note 14) | 517 |
| Other | 2 |
| | 18,245 |

Assets under construction include cost incurred in relation to new software. These assets are not complete and will be included in Intangible assets and amortised once ready and in use. The Group has assessed and concluded there is no indication of impairment.

19 Intangible assets

| <u>Group</u> | 2018 |
|---|-------------|
| | £000 |
| Computer software | |
| Cost at 17 May | - |
| Acquisition of subsidiary | 1,649 |
| Additions | 1,052 |
| Reclassifications | 168 |
| Cost at 31 December | 2,869 |
| Amortisation charge for the period | (348) |
| Disposals, write-offs and impairments | (1,343) |
| Reclassifications | (168) |
| Accumulated amortisation at 31 December | (1,859) |
| Net book value at 31 December | 1,010 |

20 Property and equipment

| | 2018 | | | | |
|---|--------------------------|---------------------------|---------------------------|----------------------------------|--------------|
| <u>Group</u> | Freehold property | Leasehold property | Computer equipment | Furniture & equipment | Total |
| | £000 | £000 | £000 | £000 | £000 |
| Cost or valuation at 17 May | - | - | - | - | - |
| Acquisition of subsidiary | 13,796 | 476 | 566 | 455 | 15,293 |
| Additions | - | - | 959 | 5 | 964 |
| Cost or valuation at 31 December | 13,796 | 476 | 1,525 | 460 | 16,257 |
| Depreciation charge for the year | (71) | (4) | (79) | (91) | (245) |
| Disposals, write-offs and impairments | - | - | - | (360) | (360) |
| Accumulated depreciation at 31 December | (71) | (4) | (79) | (451) | (605) |
| Net book value at 31 December | 13,725 | 472 | 1,446 | 9 | 15,652 |

Property includes land amounting to £6,513,000, of which £6,450,000 relates to freehold property and £63,000 relates to leasehold property. No depreciation is charged for land. The net book value of freehold property and leasehold property, on a cost less accumulated depreciation basis, as at 31 December 2018 would have amounted to £4,901,666 and £244,500 respectively.

21 Customer deposits

| <u>Group</u> | 2018 |
|--|------------------|
| | £000 |
| Customer deposits by category | |
| Demand | 856,862 |
| Notice | 113,497 |
| Term | 792,295 |
| | 1,762,654 |
| | 2018 |
| | £000 |
| Customer deposits by geographical area | |
| United Kingdom | 1,409,316 |
| Cyprus | 278,789 |
| Greece | 60,324 |
| Other countries | 14,225 |
| | 1,762,654 |

22 Bank deposits

| <u>Group</u> | 2018 |
|------------------------------------|-------------|
| | £000 |
| Bank deposits by category | |
| Demand | 240 |
| Bank deposits by geographical area | |
| United Kingdom | 240 |

23 Provision for customer redress

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will result in an outflow of resources (payment), and it can be reliably estimated.

The most significant of the provisions recognised as at 31 December 2018 is the conduct and legal risk provision for customer redress relating to historic conduct issues within the Bank Company (2008 to 2012). This provision is underwritten by BOC CY.

In October 2016, after a review of an issue which had been a source of complaints and litigation against the Bank Company, and following a clarification of the legal situation in an Appeal Court Decision in June 2016 (*Alexander vs West Bromwich Mortgage Company*), the Bank Company concluded that the manner in which it re-priced a group of loans breached an FCA conduct principle and the matter was notified to the FCA.

Remediation principles were agreed and in 2016 the Bank Company made an initial assessment of the level of provision that was considered appropriate to meet current and future expectations in relation to the customer remediation exercise. As a result, a provision for £14.9m was established for the year ended 31 December 2016. This was increased to £50.37m in 2017 funded by a £16m injection of equity from BOC CY, £2.9m self-funded by the Bank Company and the balance underwritten by BOC CY under the terms of a Financial Deed of Support.

Management has exercised judgement around the key assumptions that underpin the estimates. Key assumptions include customers' opt in rate, uphold rate, consulting and operational costs, Financial Ombudsman Service referrals, and expected level of consequential loss. The most significant of these assumptions is the combined response rate and opt-in rate. The sensitivity of the provision to this combined assumption is shown in the table below.

Sensitivity analysis based on customer opt-in rates

| Customer Opt-in Rate* | Total Provision £000 |
|-----------------------|-------------------------|
| 78% | 54,018 |
| 79% | 54,324 |
| 80% | 54,527 |
| 81% | 54,773 |
| 82% | 55,019 |
| 85% | 55,759 |

* Opt-in rate is calculated across all the population affected by the remediation programme and applies to 'Invitation to review' cohorts

Over the course of 2018, the Group has reassessed the level of provision that was considered appropriate and concluded that the total cost of the remediation programme had increased to £54.27m (2017: £50.37m), resulting in a charge of £3.9m (2017: £35.46m), incorporating the new estimate based on new information that became available.

The full charge of £3.9m is recognised in the accounts of BOC CY (2017:£31.46m), with Cynergy Bank recognising both the increase in conduct provision liability and corresponding receivable (see note 18).

This provision constitutes one of the Group's critical accounting estimates as disclosed in note 4 to the financial statements.

| | 2018 |
|--|----------------|
| | £000 |
| Provision for customer redress | |
| At 17 May | - |
| Acquisition of subsidiary | 14,455 |
| Arising during the year: | |
| Provided for by BOC CY under the Deed of Support (note 18) | 3,894 |
| Payments made during the year | (6,128) |
| At 31 December | 12,221 |

The Group's economic exposure to the impact of historic conduct related liabilities was mitigated by a Capped Indemnity of £67m from BOC CY. In accordance with the Deed of Financial Support (DoFS) executed on 23 November 2018 between Cynergy Bank and Bank of Cyprus Public Company Limited, liability in regards to UK regulatory matters remains an obligation for settlement by the Bank of Cyprus Public Company Limited.

24 Other liabilities

| | 2018 | 2018 |
|---|---------------|----------------|
| | £000 | £000 |
| | Group | Company |
| Trade creditors | 828 | - |
| Accruals | 6,597 | 390 |
| Accrued interest payable incl. subordinated debt | 2,531 | - |
| Financial Services Compensation Scheme levy (note 28) | - | - |
| Derivatives | 253 | - |
| PAYE and NI settlement | 614 | - |
| Items in the course of settlement | 427 | - |
| Corporation Tax payable | 706 | - |
| Tax deduction scheme for interest | 63 | - |
| Amounts owed to Bank of Cyprus Public Company Limited | 47,210 | 51,500 |
| Amounts owed to Cynergy Investments Ltd | 500 | 500 |
| Amounts owed to Dhamecha Foods Limited | 238 | 238 |
| Other | 586 | (10) |
| Total | 60,553 | 52,618 |

25 Subordinated loan

| | 2018 £000 |
|-----------------------------|----------------------|
| Unsecured subordinated loan | 29,524 |

With the prior consent of the Prudential Regulation Authority, the subordinated loan due to the previous parent was converted into share capital during May 2017 generating 30,000,000 new ordinary shares of £1 each.

In December 2017, the Bank Company issued a £30 million unsecured and subordinated Tier 2 capital loan (the loan), priced at par. Interest is payable semi-annually on the loan at a coupon of 8.00% per annum up to 21 December 2022 and then at the 5-year swap rate plus a margin of 6.99% per annum up to the loan maturity on 21 December 2027. Subject to meeting contractual notice conditions, the Bank Company has the option to redeem the loan on 21 December 2022. The loan is unlisted.

Changes in liabilities arising from financing activities

| 2018 | 17 May 2018 £000 | Acquisition of subsidiary £000 | Cash flows £000 | Conversion to equity £000 | Other £000 | 31 December 2018 £000 |
|-----------------------------|---------------------------------|---|--------------------------------|--|-----------------------|--|
| Unsecured subordinated loan | - | 29,511 | - | - | 13 | 29,524 |

26 Share capital

The Company

| | 31 December 2018 | |
|--|-------------------------|---------------|
| | Number of shares | £000 |
| Issued and fully paid: | | |
| Issued at incorporation on 17 May 2018: 1 Ordinary A Share at nominal value of £1 each | 1 | - |
| Issued on 8 October 2018: 4 Ordinary A Share at nominal value of £1 each | 4 | - |
| Subdivision on 23 November 2018: 5 ordinary A shares of £1 each into 500 ordinary A shares of 0.01p each | 495 | - |
| Reclassification on 23 November 2018: 200 ordinary A shares of 0.01p each into 200 ordinary B shares of 0.01p each | - | - |
| Issued on 23 November 2018: | | |
| 138m Ordinary A Shares at nominal value of 0.01p each | 137,999,500 | 1,380 |
| 92m Ordinary B Shares at nominal value of 0.01p each | 92,000,000 | 920 |
| 2.25m Ordinary C Shares at nominal value of 0.01p and a premium of 0.04p each | 2,250,000 | 23 |
| 2.5m Ordinary D Shares at nominal value of 0.01p and a premium of 0.04p each | 2,500,000 | 25 |
| 74m Preferred Ordinary Shares at nominal value of £1 each | 74,000,000 | 74,000 |
| | 308,750,000 | 76,348 |

Each Ordinary A, B, C and D shareholder shall have the right to vote. Each Preferred Ordinary shareholder shall not have the right to vote.

27 Contingent liabilities and commitments

27.1 Guaranteed and commitments

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

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

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

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

| | 2018 | 2017 |
|--|---------|---------|
| | £000 | £000 |
| Acceptances, guarantees and cashing facilities | 1,278 | 1,020 |
| Commitments to advance | 265,924 | 99,944 |
| Total | 267,202 | 100,964 |

The tables below show the credit quality and the maximum exposure to credit risk based on the Group's internal credit rating system and year-end stage classification. The amounts presented are gross of impairment allowances. Details of the Group's internal grading system are explained in Note 29.

**Acceptances,
guarantees and
cashing facilities**

| | 2018 | | | | | | |
|------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-----------------|--------------|---------------|
| Group | Stage 1 Individual £000 | Stage 1 Collective £000 | Stage 2 Individual £000 | Stage 2 Collective £000 | Stage 3 £000 | POCI £000 | Total £000 |
| Internal rating grade | | | | | | | |
| Standard grade | - | 1,149 | - | 129 | - | - | 1,278 |
| Watch list medium risk | - | - | - | - | - | - | - |
| Watch list high risk | - | - | - | - | - | - | - |
| Individually impaired | - | - | - | - | - | - | - |
| Total | - | 1,149 | - | 129 | - | - | 1,278 |

**Commitments to
advance**

| | 2018 | | | | | | |
|------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-----------------|--------------|---------------|
| Group | Stage 1 Individual £000 | Stage 1 Collective £000 | Stage 2 Individual £000 | Stage 2 Collective £000 | Stage 3 £000 | POCI £000 | Total £000 |
| Internal rating grade | | | | | | | |
| Standard grade | - | 265,924 | - | - | - | - | 265,924 |
| Watch list medium risk | - | - | - | - | - | - | - |
| Watch list high risk | - | - | - | - | - | - | - |
| Individually impaired | - | - | - | - | - | - | - |
| Total | - | 265,924 | - | - | - | - | 265,924 |

An analysis of changes in the gross carrying amount is as follows:

**Acceptances, guarantees and
cashing facilities**

| | 2018 | | | | | | |
|--|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-----------------|--------------|---------------|
| Group | Stage 1 Individual £000 | Stage 1 Collective £000 | Stage 2 Individual £000 | Stage 2 Collective £000 | Stage 3 £000 | POCI £000 | Total £000 |
| 17 May | - | - | - | - | - | - | - |
| Acquisition of subsidiary | - | 1,149 | - | 129 | - | - | 1,278 |
| New exposures | - | 4 | - | - | - | - | 4 |
| Exposure derecognised or matured / lapsed | - | (4) | - | - | - | - | (4) |
| Transfers to Stage 1 | - | - | - | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - | - | - | - |
| Modifications | - | - | - | - | - | - | - |
| Amounts written-off | - | - | - | - | - | - | - |
| Foreign exchange adjustments | - | - | - | - | - | - | - |
| Total | - | 1,149 | - | 129 | - | - | 1,278 |

Commitments to advance

| | 2018 | | | | | | |
|---------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-----------------|--------------|---------------|
| Group | Stage 1 Individual £000 | Stage 1 Collective £000 | Stage 2 Individual £000 | Stage 2 Collective £000 | Stage 3 £000 | POCI £000 | Total £000 |
| 17 May | - | - | - | - | - | - | - |
| Acquisition of subsidiary | - | 208,776 | - | - | - | - | 208,776 |
| New exposures | - | 59,238 | - | - | - | - | 59,238 |

| | | | | | | | |
|---|---|----------------|---|---|---|---|----------------|
| Exposure derecognised or matured/lapsed | - | (2,090) | - | - | - | - | (2,090) |
| Transfers to Stage 1 | - | - | - | - | - | - | - |
| Transfers to Stage 2 | - | - | - | - | - | - | - |
| Transfers to Stage 3 | - | - | - | - | - | - | - |
| Modifications | - | - | - | - | - | - | - |
| Amounts written-off | - | - | - | - | - | - | - |
| Foreign exchange adjustments | - | - | - | - | - | - | - |
| Total | - | 265,924 | - | - | - | - | 265,924 |

The ECLs relating to Acceptances, guarantees and cashing facilities and Commitments to advance here round to zero.

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

27.2 Conduct risk related matters

There continues to be significant uncertainty and thus judgement required in determining the quantum of conduct risk related liabilities with note 23 reflecting the Group's current position in relation to redress provisions in respect of the remediation programme. The final amount required to settle the Group's potential liability for this, including any consequential and / or reputational loss is materially uncertain.

Contingent liabilities include those matters where redress is likely to be paid and costs incurred but the amounts cannot currently be estimated. The Group will continue to reassess the adequacy of the provision in this respect and the assumptions underlying the calculation at each reporting date based upon experience and other relevant factors at that time.

Any contingent liabilities in excess of the amount already provided in the financial statements will be met by Bank of Cyprus Public Company Limited, subject to the terms of the Deed of Financial Support.

28 Financial Services Compensation Scheme levy

The FSCS has provided compensation to eligible depositors following the collapse of a number of deposit takers, such as Bradford & Bingley plc. The compensation paid out was funded by £20 billion of loans to the FSCS from the Bank of England and HM Treasury. Under the FSCS Levy rules, all deposit takers, including Cynergy Bank, will be required to pay a proportion of any irrecoverable principal amounts on the loans. Deposit takers are also obligated to share the interest costs of the loans and the management expenses of the FSCS. The proportion of the total levy charged to each bank is determined by the individual bank's market share of deposits protected through the FSCS.

During 2015, the FSCS levy was also charged to institutions for the third of three annual levies to cover capital repayments to the UK Government. The principal of these borrowings, which remains after the three annual levies have been paid, is expected to be repaid from the realisation of the assets of the defaulted institutions.

The ultimate cost of the FSCS Levy to the industry as a result of the 2008 collapses is dependent upon various uncertain factors, including: the value of potential recoveries of assets by the FSCS; changes in the interest rate on the loans; the level of protected deposits and the population of FSCS members at the time.

29 Risk management

Through its normal operations the Group is exposed to a number of risks, the most significant of which are liquidity risk, credit risk, operational risk and market risk. To manage these risks the Group has established clear risk policies, including limits, reporting lines and control procedures. Adherence to these policies and procedures is independently monitored by the Group's credit risk, market risk, operational risk, compliance and internal audit functions. The Group's risk management processes and internal controls are subject to regular review by the appropriate executive committees, including the Executive Committee, Asset & Liability Committee and the board Audit and Risk Committees and from 1st January 2019, the Executive Risk Committee.

Fair value of financial assets and liabilities

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments in IFRS 9. For the purposes of this note, carrying value refers to amounts reflected in the balance sheet.

31 December 2018

| | Notes | Carrying value £000 | Fair value £000 |
|--------------------------------------|----------------|------------------------|--------------------|
| Financial assets | | | |
| Cash and balances with central banks | (a, Level 1) | 196,454 | 196,454 |
| Placements with banks | (b, Level 1) | 56,399 | 56,399 |
| Placements with related entities | (b, Level 1) | - | - |
| Derivative financial assets | (e, see below) | 461 | 461 |
| Loans and advances to customers | (c, Level 3) | 1,668,923 | 1,684,723 |

| | | | |
|----------------------------------|----------------|-----------|-----------|
| Financial liabilities | | | |
| Bank deposits | (b, Level 1) | 240 | 240 |
| Placements by related entities | (b, Level 1) | - | - |
| Customer deposits | (d, Level 3) | 1,762,654 | 1,761,792 |
| Derivative financial liabilities | (e, see below) | 253 | 253 |
| Subordinated loan | (f, Level 2) | 29,524 | 29,524 |

The fair value estimates are based on the following methodologies and assumptions:

- The carrying amounts of these financial assets are largely due to the short term maturities of these instruments approximating fair value.
- The carrying value of placements with banks and amounts due to banks is considered to approximate fair value. Placements with banks are repayable on demand or within twelve months. Amounts due to banks and related entities are re-priced every three months at market rates. As a result, these carrying values approximate fair values.
- The carrying value of loans and advances to customers is net of allowance for impairment losses and unearned income. The estimated fair value of the advances is calculated by discounting the cash flows using prevailing market interest rates adjusted for risk premium of the Group.
- The carrying value of customer deposits is calculated by discounting the cash flows using prevailing market interest rates. The estimated fair value of deposits with no stated maturity, which include non-interest-bearing deposits, is the amount repayable on demand.
- The fair value of derivatives (including foreign exchange contracts and interest rate swaps) designated as being carried at fair value through profit or loss are based on quoted market prices and data or valuation techniques based on observable market data as appropriate to the nature and type of the underlying instrument.
- The subordinated loan is non-traded and the carrying value approximates fair value.

The following table shows an analysis of derivative financial instruments recorded at fair value by level of the fair value hierarchy:

| 31 December 2018 | Level 1 | Level 2 | Level 3 | Total fair value |
|----------------------------------|----------------|----------------|----------------|-------------------------|
| | £000 | £000 | £000 | £000 |
| Derivative financial assets | - | 461 | - | 461 |
| Derivative financial liabilities | - | (253) | - | (253) |

Level 1 inputs are those with quoted prices for similar instruments, level 2 inputs have directly observable market inputs other than level 1 inputs and level 3 inputs are not based on observable market data.

Liquidity risk

Liquidity risk is the risk of failure to realise assets or raise funds to meet current and future commitments. Liquidity risk is managed each day by the Group's Treasury department under the supervision of the Asset & Liability Committee. To manage liquidity risk the Group maintains a portfolio of high quality liquid and marketable assets sufficient to meet the liquidity requirements of the PRA and the Group's internal policies. Actual and projected cash flows of the Group are monitored on a continuing basis to ensure that the Group preserves a satisfactory liquidity position at all times.

Under CRD IV LCR became the Pillar I standard for liquidity in the UK on 1 October 2015, with a minimum standard of 80%, thereafter a 10% increase on 1 January 2017 and 2018, to reach 100% on 1 January 2018. The objective of the LCR is to ensure that banks have sufficient high quality liquid assets (HQLA) that can be converted easily into cash to meet their liquidity needs for a 30 calendar day liquidity stress scenario. Assets which are eligible for inclusion as HQLA include, balances held at the Central Bank and holdings of securities issued by central banks.

The Group's LCR as at 31 December 2018 was 727%, and is in excess of the current minimum requirement of 100% set by the PRA. The Group has continued to maintain a significant level of HQLA throughout the year. In October 2016 the Bank Company was admitted to the Bank of England's Funding for Lending Scheme (FLS), which provides an additional source of liquid assets.

Analysis of assets and liabilities by expected maturity

| 31 December 2018 | Carrying value | Demand | Up to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years |
|--------------------------------------|-----------------------|----------------|-----------------------|---------------------------|--------------------------|---------------------|
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Assets: | | | | | | |
| Cash and balances with central banks | 196,454 | 193,772 | - | 2,682 | - | - |
| Placements with banks | 56,399 | 56,399 | - | - | - | - |
| Loans and advances to customers | 1,668,923 | 21,161 | 58,578 | 78,897 | 1,079,880 | 430,407 |
| Property and equipment | 15,652 | - | - | - | - | 15,652 |
| Intangible assets | 1,010 | - | - | - | 1,010 | - |
| Other assets | 18,245 | 1,992 | - | 16,253 | - | - |
| Total assets | 1,956,683 | 273,324 | 58,578 | 97,832 | 1,080,890 | 446,059 |

Liabilities and equity:

| | | | | | | |
|------------------------------|-----------|---------|---------|---------|---------|--------|
| Bank deposits | 240 | 240 | - | - | - | - |
| Customer deposits | 1,762,654 | 856,859 | 227,676 | 530,532 | 147,587 | - |
| Other liabilities | 77,064 | - | - | 77,064 | - | - |
| Subordinated loan | 29,524 | - | - | - | 29,524 | - |
| Total liabilities | 1,869,482 | 857,099 | 227,676 | 607,596 | 177,111 | - |
| Total equity | 87,201 | - | - | - | - | 87,201 |
| Total liabilities and equity | 1,956,683 | 857,099 | 227,676 | 607,596 | 177,111 | 87,201 |
| Acceptances and guarantees | 1,278 | 1,278 | - | - | - | - |

The tables below have been drawn up based on the undiscounted contractual maturities of the financial liabilities including interest that will accrue to those liabilities except where the Group is entitled and intends to repay the liability before its maturity.

The following table details the Group's remaining contractual maturity for its non-derivative financial liabilities:

Non-derivative financial liabilities

| | 2018 | | | | |
|-------------------|---------------|-----------------------|---------------------------|--------------------------|---------------------|
| | <i>Demand</i> | <i>Up to 3 months</i> | <i>3 months to 1 year</i> | <i>1 year to 5 years</i> | <i>Over 5 years</i> |
| | <i>£000</i> | <i>£000</i> | <i>£000</i> | <i>£000</i> | <i>£000</i> |
| Bank deposits | 240 | - | - | - | - |
| Customer deposits | 857,313 | 227,406 | 534,819 | 151,521 | - |
| Subordinated loan | 2,472 | 600 | 1,800 | 37,134 | - |

Credit risk

Credit risk arises principally from lending activities, but also from other on and off balance sheet transactions where there is a risk that the counterparty may not meet its obligations to the Group. Credit risk occurs mainly in customer advances. To control credit risk, the Group establishes lending policies and exposure limits by various categories including counterparty, sector and country, which are reviewed on a continuing basis.

Credit policies are approved by the Board of directors on recommendation from the Executive Risk Committee, which has management oversight of credit risk. The Group maintains a dedicated credit risk function with responsibility for managing credit risk and monitoring management of advances by the Group's business units.

The Executive Risk Committee meets monthly and reviews reports on credit concentration, portfolio performance and provisions. The Credit and Advances Committee, a sub-committee of the Executive Risk Committee, approves credit facilities within its authority or makes recommendations to the Board of Directors for approval where on an exception basis facilities fall outside credit policy.

Definition of default and cure

The Group considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Group considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Group also considers a variety of instances that may indicate unlikelihood to pay. When such events occur, the Group carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default;
- The borrower requesting emergency funding from the Group;
- The borrower having past due liabilities to public creditors or employees;
- The borrower is deceased;
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral;
- A material decrease in the borrower's turnover or the loss of a major customer;
- A covenant breach not waived by the Group;
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application / protection.

It is the Group's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least eighteen consecutive months. The decision whether to classify an asset as Stage

2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition. The Group's criterion for 'cure' for ECL purposes is less stringent than the 24 months requirement for forbearance which is explained in note 3.14.

i) The Group's internal rating and PD estimation process

The Group's independent Credit Risk Department operates its internal rating systems. The Group runs separate systems for its key portfolios in which its customers are rated using internal grades. The systems incorporate both qualitative and quantitative information. PDs are assigned to the internal credit grades based on historical experience, where such experience is sufficient to establish a robust estimate of PD. Where there is insufficient historical experience PDs are estimated on the basis of information from a credit rating agency. PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward looking information and the IFRS 9 Stage classification of the exposure. This is repeated for each economic scenario as appropriate.

ii) Treasury, trading and interbank relationships

The Group's counterparties comprise financial services institutions and central banks. For these relationships, the Group's credit risk department analyses publicly available information such as financial information and other external data, e.g., the rating of Moody's or Standard and Poor.

iii) Corporate and small business lending

For corporate and small business lending, borrowers are assessed by relationship managers under the oversight of the Credit Risk unit of the Group. The credit risk assessment is based on a credit grading system that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the Group's performance.

The complexity and granularity of the grading techniques varies based on the exposure of the Group and the complexity and size of the customer.

iv) Consumer lending and retail mortgages

Consumer lending comprises unsecured personal loans and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income / salary levels based on records of current accounts, personal indebtedness and expected interest re-pricing;
- Retail mortgages: GDP growth, unemployment rates, changes in personal income / salary levels based on records of current accounts, personal indebtedness and expected interest re-pricing.

v) Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

For loans, EAD is modelled on the basis of the contractual amortisation profile of the loan but assuming that for the last 90 days before default no further repayments are made. No account is taken of early repayments made at the option of the borrower. For overdrafts, the EAD is taken as the full amount of the approved limit or, if higher, the overdrawn balance at the balance sheet date. Undrawn facilities which have been offered in the last three months before the balance sheet date are assumed to draw down in full, as are the undrawn portions of staged loans, such as property development loans.

vi) Loss given default

LGD values are assessed at least every three months by account managers and reviewed and approved by the Bank's specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The LGD rate for customer advances is based on the following principal inputs:

- The probability that the account will cure after default, in which case the loss will be nil. The estimate of the probability of cure is based on historical experience and is a function of LTV. For cases that are in Recoveries the probability of cure is taken to be nil;
- The LTV of the borrower at the time of default;
- The forced sale discount, which is determined on a probability distribution with a mean of 26% for residential properties and 33% for commercial properties;
- The cost of realisation, which is assumed to be 5%, based on the Group's experience of recoveries in the past;
- The discount rate applied to the realisation proceeds, which is the effective interest rate of the exposure;

- The time to sale, which is assumed to be 18 months from the date of default, based on the Group's experience and based on the Group's assessment of industry practice;
- Post write-off recoveries, which are assumed to be nil.

Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in collateral values including property prices for mortgages, payment status or other factors that are indicative of losses in the group. The Group estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2 and Stage 3 IFRS 9 segment of each asset class. These are repeated for each economic scenario as appropriate.

vii) Significant increase in credit risk

The Group continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12m ECL or LTECL, the Group assesses whether there has been a significant increase in credit risk since initial recognition. The Group considers an exposure to have significantly increased in credit risk when any of the following has occurred:

- The exposure is forborne;
- The exposure is placed on the Watch List;
- The exposure is graded D or E using the Group's internal grading methodology;
- The exposure has been downgraded from A to C using the Group's internal grading methodology.

In certain cases, the Group may also consider that events explained in note 3.11 are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due the credit risk is deemed to have increased significantly since initial recognition.

For borrowers with exposure of less than £100,000 there is no annual review, so the grade is not re-assessed unless there are symptoms of credit weakness, such as arrears. For these accounts (which account for 2% of total customer advances), a separate assessment of the evidence of a significant deterioration and an adjustment is made to the ECL estimate as a management overlay, if appropriate.

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

| | 2018 |
|---|------------------|
| | £000 |
| Business sector | |
| Property investment | 1,264,223 |
| Property development | 61,224 |
| Hotels, catering and leisure | 92,025 |
| Manufacturing | 9,213 |
| Retail and wholesale | 7,337 |
| Other business sectors | 49,079 |
| Personal sector | 189,368 |
| | 1,672,469 |
| Less: Allowance for ECL / impairment losses | (3,546) |
| Carrying amount | 1,668,923 |

The amount of loans and advances subject to forbearance is analysed below. Forbearance means the active agreement by the Group with the customer to vary the terms of a loan agreement, either temporarily or permanently, to assist a customer to overcome financial stress and repay a loan.

| 31 December 2018 | Total | Stage 1 | Stage 2 | Stage 3 |
|---|--------------|----------------|----------------|----------------|
| | £000 | £000 | £000 | £000 |
| Temporary conversions from repayment to interest only | 1,545 | 695 | 717 | 133 |
| Term extensions for capital repayment | 446 | 55 | 391 | - |
| Payment holidays | 401 | 378 | 23 | - |
| Amortisation profile change | 1,577 | 110 | 14 | 1,453 |
| Refinance | 580 | 580 | - | - |

| | | | | |
|--------|-------|-------|-------|-------|
| Others | 352 | 86 | 53 | 213 |
| Total | 4,901 | 1,904 | 1,198 | 1,799 |

Loans and advances which have been subject to forbearance continue to be classified as being subject to forbearance until the loan or advance is redeemed or upon completion of a minimum 24 months monitoring period subject to their ongoing performance.

Maximum exposure to credit risk and collateral and other credit enhancements

The table below shows the maximum exposure to credit risk and the tangible and measurable collateral held. It also shows the net exposure to credit risk, which is the exposure after taking into account the impairment loss and tangible and measurable collateral held. Where guarantees are held the collateral shown below includes any collateral supporting the guarantee. In normal circumstances the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on its balance sheet. It is the Group's policy to dispose of the repossessed assets in an orderly fashion. For financial assets recognised on the balance sheet, the gross exposure to credit risk is equal to the carrying amount.

| 31 December 2018 | Maximum exposure | Fair value of collateral held by the Group | | | Net exposure |
|--|------------------|--|-----------|----------------|--------------|
| | | Cash | Property | Net collateral | |
| | £000 | £000 | £000 | £000 | £000 |
| Assets: | | | | | |
| Cash and balances with central banks | 196,454 | - | - | - | 196,454 |
| Placements with banks | 56,399 | - | - | - | 56,399 |
| Placements with related entities | - | - | - | - | - |
| Loans and advances to customers | 1,668,923 | 2,298 | 2,970,150 | 1,654,891 | 14,032 |
| Other assets | 18,245 | 12,845 | - | 12,845 | 5,400 |
| On-balance sheet total | 1,940,021 | 15,143 | 2,970,150 | 1,667,736 | 272,285 |
| Contingent liabilities: | | | | | |
| Acceptances, guarantees and cashing facilities | 1,278 | 21 | 4,944 | 1,278 | - |
| Commitments to advance | 265,924 | 366 | 894,242 | 263,688 | 2,236 |
| Off-balance sheet total | 267,202 | 387 | 899,186 | 264,966 | 2,236 |
| Total credit risk exposure | 2,207,223 | 15,530 | 3,869,336 | 1,932,702 | 274,521 |

Operational risk

Operational risk is the risk of loss or reputational damage arising from inadequate systems, errors, poor management, internal control breaches, fraud and external events. Procedures and controls are in place to manage these risks throughout the Group and are supplemented by contingency planning to ensure business continuity, as well as the maintenance of insurance cover where appropriate.

Market risk

Market risk is the risk that changes in the level of interest rates, exchange rates and other financial indicators will have an adverse financial impact. The Group is exposed to interest rate risk as a result of mismatches in its balance sheet between the dates on which interest receivable on assets and interest payable on liabilities next reset to market rates or the dates on which the assets and liabilities mature. The Group aims to manage this risk through controlling such mismatches within limits set by reference to the maximum potential loss of earnings under given changes of interest rates. Interest rate risk arising from the mismatch between the Group's lending and deposit rates is actively managed. The majority of the advances and deposits are priced off market rates and margins are closely monitored and evaluated. In managing these mismatches the Group makes use of appropriate interest rate derivative contracts including interest rate swaps. The exposure to interest rate changes and sensitivity is regularly reported to and reviewed by the Asset & Liability Committee, which manages the overall exposure within an agreed limit.

A summary of the Group's interest rate gap position based on the contractual re-pricing date of assets and liabilities is as follows:

| 31 December 2018 | Carrying value | Non-interest bearing | Up to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years |
|---------------------------------|----------------|----------------------|----------------|--------------------|-------------------|--------------|
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Assets: | | | | | | |
| Cash and bank advances | 252,853 | 1,318 | 248,852 | 2,683 | - | - |
| Loans and advances to customers | 1,668,923 | - | 79,740 | 78,898 | 1,079,880 | 430,405 |
| Fixed assets | 16,662 | 16,662 | - | - | - | - |
| Other assets | 18,245 | - | - | 18,245 | - | - |
| Total assets | 1,956,683 | 17,980 | 328,592 | 99,826 | 1,079,880 | 430,405 |

| | | | | | | |
|-------------------|-----------|---------|---------|---------|---------|---|
| Liabilities: | | | | | | |
| Bank deposits | 240 | - | 240 | - | - | - |
| Customer deposits | 1,762,654 | 233,170 | 857,050 | 525,752 | 146,682 | - |
| Other liabilities | 77,064 | - | - | 77,064 | - | - |
| Subordinated loan | 29,524 | - | - | - | 29,524 | - |
| Total liabilities | 1,869,482 | 233,170 | 857,290 | 602,816 | 176,206 | - |

| | | | | | | |
|-------------------|--------|-----------|-----------|-----------|---------|---------|
| Interest rate gap | 87,201 | (215,190) | (528,698) | (502,990) | 903,674 | 430,405 |
|-------------------|--------|-----------|-----------|-----------|---------|---------|

The Group monitors its exposure to interest rate risk and during the 2018 period implemented an enhanced Interest Rate Risk management and monitoring process. The annualised impact of a potential 0.6% change, both increase and decrease, in the interest rates against the Group's interest bearing assets and liabilities is as follows:

| | |
|------------------|----------------|
| | 2018 |
| | £000 |
| Increase of 0.6% | 4,050 |
| Decrease of 0.6% | (4,093) |

The interest rate sensitivities set out above are based on the Group's internal monitoring at the end of the period. The figures represent the effect on net interest income for a year arising from a parallel rise or fall in all market interest rates.

The Group is exposed to foreign currency risk as a result of mismatches between assets and liabilities in foreign currencies arising from the Group's lending, deposit taking and currency dealing activities. The majority of currency dealings are carried out for the purpose of facilitating customer transactions. The Group's treasury department is responsible for managing currency risk within intra-day and overnight limits. The Group's currency net exposures remain low at the balance sheet date. The potential impact on profit after tax and on equity of a change in currency exchange rates is negligible at the reporting date.

Set-off

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

The table below shows potential effect of the amounts that could be offset under the Group's right of set-off but which are shown gross in the financial statements.

| | 2018 | | |
|---------------------------------|--|------------------------------------|-----------------------------|
| | Gross amounts presented in the balance sheet £000 | Offset amounts £000 | Net amounts £000 |
| Financial assets | | | |
| Placements with banks | 56,399 | - | 56,399 |
| Loans and advances to customers | 1,668,923 | 54,584 | 1,614,339 |
| Financial liabilities | | | |
| Bank deposits | 240 | - | 240 |
| Customer deposits | 1,762,654 | 54,584 | 1,708,070 |

Conduct risk

Conduct risk is defined as the risk that the Group's behaviour, offerings or interactions with unfair outcomes for its customer's results in fines, compensation, redress costs and reputational damage.

The Group manages conduct risk in a way that is consistent with its overall risk appetite and with its business strategy. Conduct risk involves treating customers fairly, in line with regulatory requirements arising from FCA rules and guidance.

Remediation principles were agreed and in 2016 the Bank Company made an initial assessment of the level of provision that was considered appropriate to meet current and future expectations in relation to the customer remediation exercise. As a

result, a provision for £14.9m was established for the year ended 31 December 2016. This was increased to £53.27m in 2017 and 2018. Details of the provision for customer redress are presented in note 23 to the financial statements.

30 Investment in subsidiary

On 23 November 2018, the Company completed the purchase of Bank of Cyprus UK Limited from Bank of Cyprus Public Company Limited following the receipt of regulatory approvals from the Prudential Regulation Authority and European Central Bank. The effective date of the sale was 30 September 2018. On 7 December 2018 "Bank of Cyprus UK Limited" rebranded to "Cynergy Bank Limited", whose principal place of business is England and Wales and whose registered office is 27-31 Charlotte Street, London, W1T 1RP. Cynergy Capital Ltd owns 100% of the ordinary shares of Cynergy Bank Limited. The investment in subsidiary is accounted for at cost.

Investment in subsidiary

| | |
|--|----------------|
| Purchase consideration at acquisition – 30 September 2018 - undiscounted | 103,000 |
| Purchase price adjustment | 3,676 |
| Acquisition costs | 1,172 |
| Acquisition of 20m ordinary shares at nominal value of £1 per share – 26 November 2018 | 20,000 |
| | 127,848 |

Bank of Cyprus Financial Services Limited (BOCFS), whose principal place of business is England and Wales and whose registered office is 27-31 Charlotte Street, London, W1T 1RP, is a wholly owned subsidiary of Cynergy Bank Limited (100% of the ordinary shares of BOCFS is held directly by the Cynergy Bank Limited). BOCFS was an appointed representative of Legal & General Partnership Services Limited. Until 30th September 2017 BOCFS sold insurance and protection products of Legal & General. BOCFS ceased to trade on 30 September 2018. The investment in subsidiary is accounted for at cost.

31 Capital management

The Group is supervised by the PRA, as a UK authorised bank, and is required to satisfy the liquidity and capital requirements of the PRA. It is required to demonstrate to the PRA that it can withstand liquidity and capital stresses.

The Group carries out a full annual review of the adequacy of its capital to support its current and future activities, including during periods of stress, using the standardised approach for credit risk. The review is documented in the Internal Capital Adequacy Assessment Process document, which is approved by the board of directors and submitted to the PRA. The PRA reviews the Internal Capital Adequacy Assessment Process document and issues Individual Capital Guidance (ICG) setting out the minimum capital requirements for the Group.

The Group manages its capital so as to ensure that it will have adequate capital resources to support its plans and to meet the regulatory requirements as set out in the ICG, including during periods of stress. For this purpose it maintains its own buffer in excess of the regulatory requirements. The preparation of annual plans, budgets and forecasts includes a projection of the capital position and capital requirements to ensure that capital resources will continue to be adequate.

Pillar 3 disclosures for the Bank are published on an annual basis concurrently with the Annual Report & Accounts in accordance with regulatory guidelines. Both the Pillar 3 document and the Annual Report & Accounts are published on the Bank's website www.cynergybank.co.uk.

32 Related party transactions

Key management personnel

Our key management personnel, and persons connected with them, are considered to be related parties for disclosure purposes. Key management personnel are identified as those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The Directors and members of the Executive Committee are considered to be the key management personnel for disclosure purposes.

Key management compensation

| | 2018 |
|---|--------------|
| <u>Group</u> | £000 |
| Short-term benefits | 718 |
| Termination benefits | 404 |
| Total compensation for key management personnel | 1,122 |

Key management compensation shown relates to post acquisition remuneration. The Directors of Cynergy Capital Ltd did not receive remuneration during the period to 31 December 2018.

We provide banking services to Directors and other key management personnel and persons connected to them. A connected person is a person or corporate entity connected to a director, such as a member of the director's family or a company controlled by the director. Loan transactions during the year and the balances outstanding at 31 December were as follows:

| <u>Group</u> | 2018 £000 |
|---|----------------------------|
| Loans and overdrafts: | |
| Loans and overdrafts outstanding at 17 May | - |
| Loans and overdrafts issued during the period | 6,800 |
| Loans and overdrafts repayments during the period | (366) |
| Loans and overdrafts outstanding at 31 December | 6,434 |
| Interest expense on Loans and overdrafts payable to the Group | 280 |

Deposit accounts and current account credit balances:

| | |
|-------------------------------------|------------|
| Deposits outstanding at 17 May | 340 |
| Net movements in the period | 86 |
| Deposits outstanding at 31 December | 426 |

There were four loans outstanding at 31 December 2018 totalling £6.4m. All loans are commercial mortgages secured on property and were provided on normal commercial terms.

Other transactions with related parties – the Company

| | 2018 |
|------------------------------------|-------------|
| Balance receivable from Subsidiary | 120 |
| Total | 120 |

Transactions with related parties

| | |
|---|-----------|
| Management fees received from Subsidiary paid to parent | 40 |
| Total | 40 |

Outstanding balances at the year-end are unsecured and interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. The ultimate parent of the Group is Cynergy Capital Ltd.

33 Events after the reporting period

Subsequent to the year end, the Directors identified that the Group was required to issue additional capital instruments in order to comply with the Prudential Regulation Authority's (PRA's) Rulebook for consolidated groups. The Directors informed the PRA as soon as they became aware and subsequently, on 6 September 2019, the Company reclassified £89m of preference shares owned by related parties to ordinary share capital. On 27 September 2019 and 19th November 2019 the Company issued £46m and £7m, respectively, of Ordinary share capital instruments to those same related parties. The Directors expect the PRA to permit classification of these ordinary shares as Core Equity Tier 1 capital instruments shortly.

The effect of this transaction was an increase in eligible capital to:

| | |
|--|---|
| Unaudited | |
| At 31 December 2018 | £76.3m |
| 11 February 2019: Shares issued | £15.0m (Preference shares of £15m |
| 6 September 2019: Reclassification | - (reclassification of £89m preference shares to ordinary shares) |
| 27 September 2019: Shares issued | £46.0m |
| 19 November 2019: Shares issued | <u>£ 7.0m</u> |
| CET 1 eligible Ordinary Shares | £144.3m |
| Less regulatory deductions | (£5.8m) |
| Total CET1 eligible Capital | £138.5m |
| Total AT1 Capital | £0.0m |
| Eligible T2 Capital - issued by Cynergy Bank | £28.1m |
| Eligible Capital | £166.6m |

34 Business Combinations

Acquisitions in 2018

Acquisition of Cynergy Bank Limited

On 23 November 2018, the Company completed the purchase of Bank of Cyprus UK Limited from Bank of Cyprus Public Company Limited following the receipt of regulatory approvals from the Prudential Regulation Authority and European Central Bank. The effective date of the purchase was 30 September 2018. On 7 December 2018 "Bank of Cyprus UK Limited" rebranded to "Cynergy Bank Limited". The reason for the acquisition is to unlock the significant opportunities for growth and to better address the needs of small businesses in the UK banking sector, including those of the Cypriot community.

Cynergy Bank Limited (the Bank Company) is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA.

The acquisition has been fair valued under IFRS3, with no material adjustments, save for the value of deferred consideration.

Assets acquired and liabilities assumed at fair value

| Assets | £000 |
|---|----------------|
| Cash and cash equivalents | 285,248 |
| Loans and advances to customers | 1,629,909 |
| Other assets | 46,318 |
| Intangible assets | 1,672 |
| Property and equipment | 15,293 |
| Liabilities | |
| Customer deposits | 1,767,440 |
| Provision for customer redress | 14,455 |
| Other liabilities | 47,166 |
| Subordinated loan | 29,511 |
| Total identifiable net assets at fair value | 119,869 |
| Gain on bargain purchase * | (17,482) |
| Purchase consideration transferred | 102,386 |
| <i>Purchase consideration (There are no contingent consideration arrangements)</i> | |
| Purchase price | 98,710 |
| Purchase price adjustment | 3,676 |
| | 102,386 |

No further intangible assets have been separately identified or recognised.

Deferred consideration of £25.75m is payable November 2019 and £25.75m payable November 2020.

If the acquisition would have been taken place on 17 May 2018 the consolidated revenue and profit would have been £30.0m and £10.7m respectively. The revenue and loss of the Bank Company since acquisition (1 October 2018 to 31 December 2018) have been £11.6m and £1.3m respectively.

* Bank of Cyprus Public Company Limited sold Bank of Cyprus UK Limited primarily to raise capital to support its recovery plans as the biggest lender in Cyprus. Bank of Cyprus was rescued by European authorities after the Cyprus debt crisis five years ago.